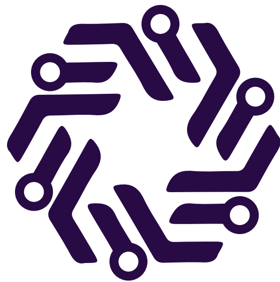


Capital requirements

A series of guides addressing the subject of capital requirements for UK authorised Electronic Money Institutions ("EMI") and Payment Institutions ("PI").

Guidance is provided for firms and is not intended as legal advice.

Guide 2: Capital requirements for Payment Institutions

Background

UK authorised PI firms must adhere to the regulatory requirements defined in the Payment Service Regulations 2017 ("PSR") as well as associated guidance from the UK's Financial Conduct Authority ("FCA").

The PSR require applicant firms that are seeking authorisation as a PI to hold, immediately before the time of authorization, an amount of initial capital that is defined in Schedule 3 Part 1 of the PSR. The amount of initial capital depends on the payment services that will be provided, and are: €20,000, €50,000 or €125,000.

Once authorized, the initial capital represents an ongoing minimum requirement that must be maintained. An authorised PI must calculate the required amount of initial capital using one of three prescribed methods as defined in the PSR. The choice of method would typically be set at authorisation, although it may be subsequently changed with agreement from the FCA.

Initial capital requirement

The Initial Capital requirement depends on the payment services that are provided, i.e. the regulatory permissions that the firm holds. The initial capital requirements are defined in Schedule 3 Part 1 of the PSR and the payment service permissions that can be held are defined in Schedule 1 Part 1 of the PSR.

The initial capital requirements are:

- **€20,000** for the services specified in paragraph 1(f) of Schedule 1, i.e. money remittance
- **€50,000** for the services specified in paragraph 1(g) of Schedule 1, i.e. payment initiation services; and
- **€125,000** for the services specified in paragraph 1(a) to (e) of Schedule 1.

Initial capital represents the minimum amount of capital that a PI must continue to hold in order to maintain its authorisation – the initial capital requirement must never be breached.

Own Funds requirement

The Own Funds requirement for a PI is calculated using one of three methods, as agreed with the FCA (at authorisation or by subsequent agreement). In summary these methods are:

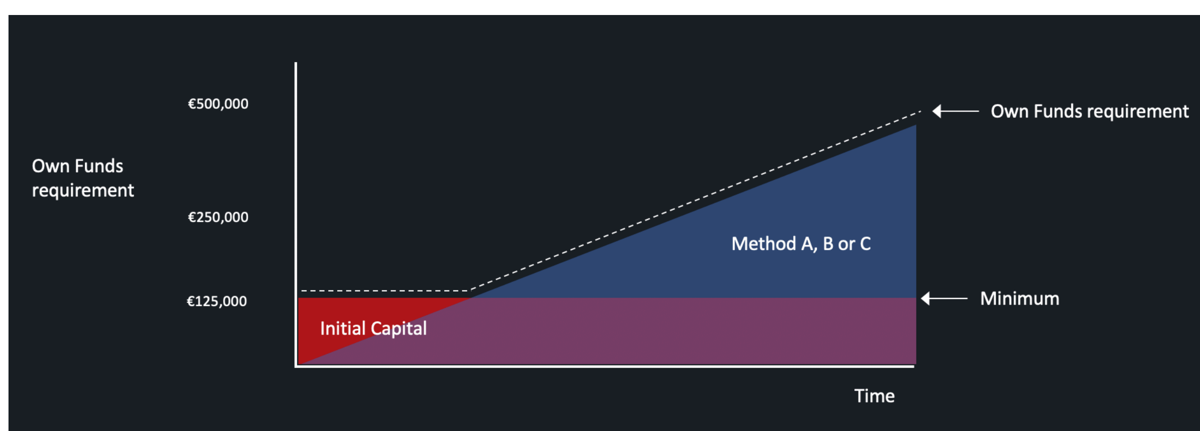
- **Method A** – Fixed overhead basis. Fixed overheads are defined as *"expenses that do not vary as a result of output volume or sales revenue".* The method uses 10% of the fixed overheads for the previous financial year.

- **Method B** – Payment volume basis. Payment volume is defined as *"the value of payment transactions processed during the previous financial year"*. The calculation involves calculating the average monthly payment volume for previous financial year and applying different percentages to the defined 'tiers'.

- **Method C** – Income basis. The calculation uses the firm's income over the previous financial year, defined as interest income - interest expended + commissions and fees received + other income related to the provision of payment services, and applying different percentages to the defined 'tiers'.

Example Own Funds requirement

The diagram below shows how the Initial Capital represents a minimum amount of capital which is surpassed, at a certain level of activity, by the requirement calculated under one of the prescribed Methods.



The red level represents the Initial Capital (e.g. €125,000 for a PI involved in 'Acquiring' activities) which is the minimum capital requirement. The blue level represents the capital requirement calculated under the firms chosen Method A, B or C. The minimum Initial Capital requirement must be held until it is exceeded by the calculation under the relevant Method. The dotted line therefore represents the firm's Own Funds requirement (i.e. the ongoing capital requirement that must be met by the PI).

Which Method should be used to calculate the Own Funds requirement?

PI firms are able to select which of the three prescribed Methods A, B, or C to use. The selection would typically be made as part of the application for authorisation and would be subject to approval by the FCA (as part of their assessment of the application).

Applicants for authorisation would describe (and evidence) their preferred choice in their application. Applicant firms would present calculations under all three Methods and describe the reasoning for the selection, i.e. why the preferred method is the most appropriate for the firm to use compared to the others.

The calculated Own Funds requirements under the three methods may vary significantly – applications for authorisation would need to evidence why the firm considers a particular Method to be the most appropriate (and not just because the Method provides the lowest capital requirement).

Authorised firms may also change the Method used by notification to, and agreement from, the FCA.

Method A calculation

The Method A calculation is based on 'Fixed Overheads' which include *"expenses that do not vary as a result of output volume or sales revenue"*. The FCA provide examples in their 'Approach Document' guidance, including: rent, insurance, office expenses and could also include salaries, taxes and pension costs. Only expenses that are related to payment services should be considered when calculating the Fixed Overheads.

The requirement is 10% of the Fixed Overhead for the previous financial year.

If there has been a material change in the business, e.g. acquisitions or disposals, the FCA may adjust the 10% requirement.

Hybrid businesses, i.e. those that provide both payment services and unregulated services, should only consider expenses that are related to the provision of the regulated payment services (and not the unregulated activities). This complicates the calculation and points to keeping unregulated service provision outside a regulated firm (one of many reasons).

Method B calculation

Method B is based on the average monthly 'Payment Volume', which is defined as "*the total amount of the firm's payment transactions executed in the previous financial year divided by the number of months in that year*". Calculations need to be made in Euro.

A number of steps are involved in the calculation:

Step 1 – Calculate the average monthly Payment Volume = Total Payment Volume for previous financial year divided by the number of months.

Step 2 – Apply the following percentages to the average monthly Payment Volume:

- 4% of the first €5m
- 2.5% of the next €5m
- 1% of the next €90m
- 0.5% of the next €150m
- 0.25% of the remaining average monthly Payment Volume.

Step 3 – Sum the above amounts and multiply by the required 'Scaling Factor' below, depending on the type of payment services that the firm provides:

- Money remittance = 0.5
- Other payment services = 1.0

The result is the Own Funds requirement calculated under Method B.

Method C calculation

Method C is based on the firm's income over the previous financial year. Income is defined as interest income - interest expended + commissions and fees received + other income related to the provision of payment services. Calculations need to be made in Euro.

A number of steps are involved in the calculation:

Step 1 – Calculate the total income for the previous financial year.

Step 2 – Apply the following percentages to the total income:

- 10% of income up to €2.5m
- 8% of the next €2.5m
- 6% of the next €20m
- 3% of the next €25m
- 1.5% of income above €50m.

Step 3 – Sum the above and multiply by the 'Scaling Factor' below depending on the type of payment service being provided:

- Money remittance = 0.5
- Other payment services = 1.0

The result is the Own Funds requirement calculated under Method C.

FCA adjustments to Own Funds requirement

The FCA may direct a firm to hold capital 20% higher, or permit it to hold capital 20% lower, than the amount required in accordance with the Own Funds requirement calculation made using the prescribed method. This is not, however, a common occurrence although is often considered during the assessment of applications in order to highlight where the forecast capital held is too close to the forecast Own Funds requirement (i.e. where there is little headroom to cover unforeseen or increased losses).

If the FCA were to require an adjustment it would be based on the FCA's evaluation of the firm's risk and internal control management. If the FCA consider these to be weak they might require an increase in the capital requirement. As such it is prudent to add 20% to the calculations in order to demonstrate that there is sufficient capital headroom for unexpected circumstances.