payments and crypto network

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 3: Capital requirements for Electronic Money Institutions

Background

UK authorised EMI and PI businesses must adhere to the regulatory requirements defined in the Electronic Money Regulations 2011 ("EMR") and the Payment Service Regulations 2017 ("PSR") as well as associated guidance from the UK's Financial Conduct Authority ("FCA").

The EMR and PSR require firms to maintain a certain level of capital as a condition of the firm's authorisation as well as on an ongoing basis in order to remain authorised. The initial and ongoing capital requirements differ depending on whether the firm is an EMI or a PI.

The EMR require applicant firms that are seeking authorisation as an EMI to hold, immediately before the time of authorization, an amount of initial capital of at least €350,000. Initial capital requirements must be demonstrated as part of the application for authorisation. Once authorized, the initial capital represents an ongoing minimum requirement that must be maintained.

Initial capital requirement

The Initial Capital requirement for an EMI, as defined in the EMR Part 1 of Schedule 2, is €350,000. The EMR specify the amount in Euro so firms should take account of potential EUR / GBP exchange rate fluctuations. Once authorised, the Initial Capital amount represents an ongoing minimum that must be maintained in order to remain authorised as an EMI. This is illustrated in the example diagram below.

Own Funds requirement

The Own Funds requirement for an EMI is calculated using Method D, with the Initial Capital as the minimum requirement. Method D applies in relation to the issuance of e-money and the provision of related payment services. Related and unrelated payment services are explained further below and effect both capital and safeguarding requirements.

Method D calculation

The Method D calculation is based on 2% of the **average e-money outstanding** with the initial capital requirement of €350,000 as the minimum Own Funds requirement.

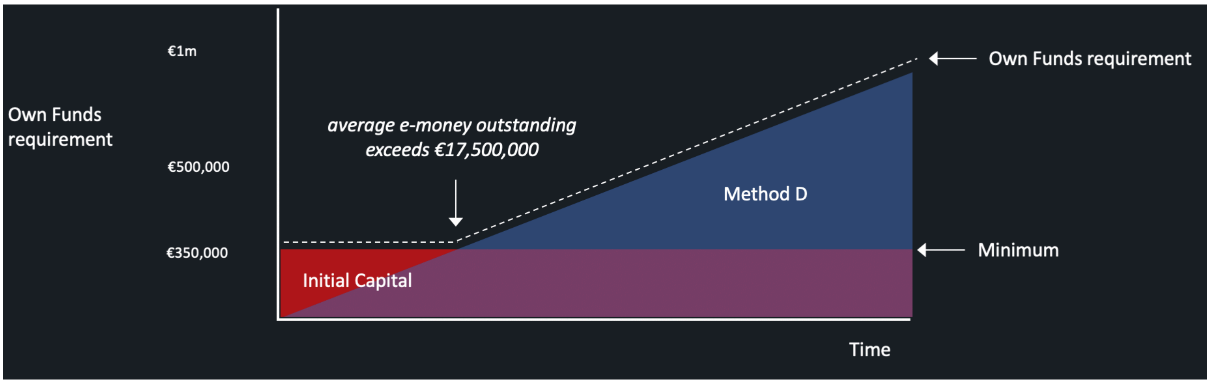
E-money is issued in exchange for funds received from the e-money holder. Customer funds received are safeguarded by the EMI and, in exchange, an equivalent amount of e-money is issued and a liability (payable to the customer) recorded by the EMI. The “e-money outstanding” is the financial liability that has been recorded in relation to the total e-money in issue.

Average e-money outstanding is calculated over the preceding six months, calculated on the first day of the month and applied throughout that calendar month. EMI firms should maintain a method of calculating this amount, and the Method D capital requirement, on an ongoing basis as part of their financial / accounting controls.

Projected e-money balances can be used where there are no historic figures, which would be the case in an application for authorisation.

Example Own Funds requirement

The diagram below shows how the Initial Capital represents the minimum amount of capital that must be held and which is surpassed, at a certain level of e-money activity, i.e. average e-money outstanding, by the requirement calculated under Method D.



The red level represents the Initial Capital requirement of €350,000, which remains as the minimum Own Funds requirement throughout the period of authorisation.

The blue area represents the capital requirement as calculated under Method D. The minimum €350,000 must be held until the Method D calculation exceeds the minimum – this will happen when the average e-money outstanding exceeds €17,500,000 (since 2% of this amount equals €350,000).

The dotted line therefore represents the firm’s Own Funds requirement, i.e. the ongoing capital requirement.

The additional capital required for unrelated payment services is not shown in the diagram but would form part of the blue area, i.e. the additional amount calculated using one of Methods A, B or C would be added to the Method D calculation.

Related and unrelated payment services

An EMI can provide both related and unrelated payment services. ‘Related’ payment services are those that are related to the e-money service, for example, e-money is used to fund a remittance payment. Unrelated payment services are separate and distinct from the e-money service (they would be provided outside the e-money model).

The distinction may not always be obvious, however, firms will need to clearly understand whether their payment services (if there are any) are related or unrelated in order to meet the capital requirements (as well as the separate safeguarding requirements that apply to unrelated payment services, see guidance ***Safeguarding Arrangements: Guide 1 - Overview of safeguarding arrangements***.

The following points are relevant:

- No additional Initial Capital is required (i.e. €350,000 still applies and remains the same) if unrelated payment services are provided.

- Related payment services do not require any additional capital (Own Funds) - use Method D for both e-money and related payment service activities.

- Unrelated payment services do require additional capital (Own Funds) – the additional capital required for unrelated payment services should be calculated using one of Methods A, B or C (as agreed with the FCA). See guidance: ***Capital Requirements Guide 2 - Capital requirements PI***. The amount calculated under Methods A, B or C would then be added to the Method D calculation to provide the total Own Funds requirement.

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. However, this has not been a common occurrence in practice. Consideration of 20% ‘headroom’ is however quite common during the assessment of an application for authorisation (although not enforced as a requirement).

If the FCA were to require an adjustment it would be based on the FCA’s evaluation of the firm’s management of risk and the effectiveness of its internal control environment. If the FCA consider these to be weak they might require an increase in the Own Funds requirement.