



payments and crypto network

Compliance Arrangements

A series of guides addressing operational compliance issues for UK authorised Electronic Money Institutions (“EMI”) and Payment Institutions (“PI”).

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

Guide 1: Overview of key regulatory requirements

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 and associated guidance from the UK’s Financial Conduct Authority (“FCA”).

In addition, following the UK’s exit from the EU, the FCA continue to expect the firms that they regulate to comply with, to the extent that they remain relevant, guidelines published by the European Banking Authority (“EBA Guidelines”).

In order to ensure compliance with regulatory requirements, an EMI or PI will need to maintain a number of compliance related policies and procedures which address certain regulatory requirements – these will need to be documented, e.g. in a Compliance Manual. The Compliance Manual would operate, alongside other supporting documents, as part of a firms’ compliance framework.

This guide provides an overview of the main regulatory requirements (in no particular order) applicable to UK authorised EMI and PI businesses in accordance with the EMR and PSR. Note that financial crime controls will be addressed in separate guidance.

Governance arrangements

An authorized EMI or PI must maintain “*robust governance arrangements*” which should include the following:

- **Board of Directors:** The board of directors (“Board”) is responsible for the overall governance and strategic direction of the firm.



- **Senior Management:** The senior management team is responsible for the day-to-day operations and management of the firm and is accountable to the Board.
- **Risk Management:** The firm must have in place robust enterprise-wide risk management systems and controls, which include procedures for identifying, assessing, mitigating and reporting risks that are relevant to the business.
- **Compliance arrangements:** The firm must have in place a compliance function that is responsible for ensuring that the business complies with all relevant laws and regulations, including guidance published by the FCA and EBA.
- **Internal Audit:** Firms will need to consider how they will operate an internal audit function, that is independent from the rest of the organization, which is responsible for evaluating the effectiveness of the internal controls, risk management systems and governance arrangements.

The governance arrangements in an EMI / PI should ensure sound, effective and compliant business operations, protect the interests of customers and will need to be developed considering the specific context of the business.

For further guidance on governance arrangements see - ***Governance Arrangements: Guide 1 - Overview of governance arrangements.***

Internal controls

An EMI / PI must maintain “adequate internal control mechanisms” which are “comprehensive and proportionate to the nature, scale and complexity” of the regulated services being provided.

FCA Guidance states:

“Internal controls are the systems, procedures and policies used to safeguard the business from fraud and error, and to ensure accurate financial information. They should include sound administrative and accounting procedures”.

The internal controls should be designed to ensure that the firm:

- Is able to provide to the FCA financial reports that reflect a “true and fair” view of its financial position; and
- Allows the firm to comply with the requirements of the PSR and EMR in relation to its customers.

Regulatory compliance requirements arising from the EMR, PSR and associated FCA and EBA guidance, cover (to some extent) the internal control environment that an EMI / PI would be expected to maintain, for example, risk management and governance arrangements. Firms should agree internal control policies, and supporting procedures, and include them within the scope of their compliance framework. This will involve documenting the approach in the Compliance Manual, see guidance - ***Compliance Arrangements Guide 2: Developing a Compliance Manual.***

EMD / PSD Individuals

Individuals that are responsible for the provision of the e-money services or payment services will be classified as EMD or PSD Individuals (within an EMI these individuals are referred to as 'EMD Individuals' and within a PI they are 'PSD Individuals'). To be considered as being responsible for the provision of e-money or payment services, individuals will need to be performing a role such as:

- **Directors** – all company directors, whether executive or non-executive directors, would meet the definition of EMD / PSD Individuals. These would be legal directors of the company rather than just having 'director' in their job title.
- **Senior managers** – roles that are relevant to the provision of regulated services would be those within areas such as finance, regulatory compliance, financial crime, IT systems (that support the services), legal and customer services. Sales and business development roles are unlikely to be within scope.

All individuals that will perform EMD / PSD Individual roles should submit the necessary 'EMD Individual Form' or 'PSD Individual Form' to the FCA in order to be approved to perform the role, i.e. be assessed as 'Fit and Proper'.

The FCA's assessment of an individual's fitness and propriety comprises two parts:

- Honesty, integrity and reputation; and
- Competence, capability and experience.

Information submitted in the forms will be used by the FCA to perform their assessment. It is important therefore to be open and honest and make full disclosure of any issues that are covered by the form, or which the individual otherwise believes should be disclosed.

Forms would be submitted to the FCA either (i) as part of an application for authorisation, or (ii) for firms already authorised, prior to the individual performing the role. See guidance - ***Compliance Arrangements Guide 6: EMD / PSD Individuals***.

Capital requirements

The capital requirements for an EMI / PI should be viewed in two parts:

- **Initial capital requirement** – this is the level of capital that must be held in order to become authorised and, once authorised, represents an ongoing minimum level of capital that must continue to be held. This minimum capital must never be breached.
- **Ongoing capital requirement** – the ongoing capital requirement is calculated in accordance with a number of pre-defined 'Methods', the particular Method that is used depends on whether the firm is an EMI or PI and would be agreed with the FCA at the point of authorisation.

Capital requirements in the EMR and PSR are defined in Euro.

The required amount of initial capital is:

- For an EMI, **€350,000**.

- For a PI, the amount is dependent on the activities: **€125,000** for acquiring (and most other payment service permissions), **€50,000** for payment initiation services **€20,000** for money remittance.

Note: if an EMI provides unrelated payment services in addition to e-money services there are no additional initial capital requirements.

The ongoing capital requirement for a PI is calculated using one of three the Methods A, B or C. An EMI will need to use Method D in relation to its e-money services and, if it provides unrelated payment services, also one of the three Methods A, B or C in relation to those unrelated payment services. The FCA will approve the use of a particular Method as part of the firm's conditions of authorisation.

Further information is provided in the guidance – ***Capital Requirements Guide 1: Overview of capital requirements.***

Outsourcing arrangements

Firms may outsource functions that are required to deliver their regulated services, either in whole or in part, to service providers (who may be within or outside the firms' group of companies). The use of outsourcing arrangements is common place and well understood by the FCA, however, for a firm to outsource key business functions it will need to ensure that certain conditions are met. Firms will need to ensure that the outsourcing arrangements:

- do not impair the quality of internal control or the FCA's ability to monitor the firm
- do not result in the delegation of responsibility for complying with regulatory requirements
- the relationship and obligations of the firm towards its customers is not substantially altered
- that compliance with conditions of authorisation are not altered; and
- no authorisation conditions require removal or variation.

Outsourcing arrangements will need to be controlled through:

- Clearly defined services and service levels
- Contractual arrangements governing the outsourcing relationship; and
- Oversight of the outsourced functions.

Further guidance on outsourcing is available:

- ***Compliance arrangements Guide 4: Outsourcing arrangements***
- ***Compliance Arrangements Guide 5: Outsourcing Policy***

Qualifying Holdings and Close Links

The FCA will need to approve the Qualifying Holdings in an EMI / PI as part of the conditions of authorisation. The FCA's approval relates to whether the Qualifying Holding is 'Fit and Proper' and requires the submission of relevant forms to the FCA (in a similar way to the approval of EMD / PSD Individuals, as described above).

Qualifying Holdings, also referred to as “Controllers”, are defined as an individual or firm that does one of the following:

- holds 10% or more of the shares in the EMI / PI (including through a parent); or
- is able to exercise significant influence over the management of the EMI / PI through their holding in the firm or a parent; or
- is entitled to control or exercise control of 10% or more of the voting power in the firm (including through a parent); or
- is able to exercise significant influence over the management of the firm through their voting power in it or a parent.

Close Links do not require approval by the FCA, in the same way that a Qualifying Holding does, although the FCA must be notified of Close Links as part of an application for authorisation and, once authorised, through submission of reporting information. Close Links are defined as:

- a parent undertaking of the firm
- a subsidiary undertaking of the firm
- a parent undertaking of a subsidiary undertaking of the firm
- a subsidiary undertaking of a parent undertaking of the firm;
- an entity or individual that owns or controls 20% or more of the voting rights or capital of the firm; or
- the firm owns or controls 20% or more of the voting rights or capital in an entity.

Additional guidance is available – ***Compliance arrangements Guide 7: Qualifying Holdings and Close Links***.

Safeguarding

Safeguarding requirements are designed to protect customers, where their funds are held by an EMI / PI, by ensuring that those funds are either placed in a separate bank account (from the firm’s own funds), or are covered by an appropriate insurance policy or comparable guarantee. On the insolvency of a firm, the claims of e-money holders or payment service users are paid from the asset pool formed from these funds in priority to all other creditors.

The requirement to safeguard applies to “Relevant Funds”, as defined in both the PSR and EMR. Relevant Funds are:

- the funds that have been received in exchange for e-money that has been issued.
- the funds received from, or for the benefit of, a payment service user for the execution of a payment transaction (including sums received from a payment service provider for the execution of a payment transaction on behalf of a payment service user).

Firms will need to operate controls over the safeguarding arrangements, including reconciliations between the records of the users’ entitlement to Relevant Funds and the records of the amounts safeguarded.

Further guidance is available – ***Safeguarding arrangements Guide 1: Overview of safeguarding requirements***.

Notifications and Reporting

An authorised EMI / PI will need to make notifications of certain events to the FCA and the FCA also require certain reports to be submitted in accordance with a defined reporting frequency.

Notifiable events include where there is, or is likely to be, a significant change in circumstances of the firm which are relevant to the conditions of authorisation. Details of the change should be notified to the FCA without undue delay, or, in the case of a substantial change in circumstance which has not yet taken place, details of the likely change a reasonable period before it takes place. FCA guidance should be consulted for details of specific notifiable events and timelines. It is common for firms to maintain a schedule of notifiable events for reference purposes.

Firms are required to make reports to the FCA in accordance with a defined reporting timeline. Reports include annual reporting of activity, submission of audited financial statements, reporting of Close Links and Qualifying Holdings. It is advisable for firms to also maintain a reporting calendar for reference purposes.

Reporting and notification obligations would typically be the responsibility of the Compliance Manager (or similar compliance role).