



payments and crypto network

Safeguarding arrangements

A series of guides addressing the subject of safeguarding customer funds 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: Reconciliation 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 associated guidance from the UK’s Financial Conduct Authority (“FCA”).

The EMR require an EMI to “*safeguard funds that have been received in exchange for electronic money that has been issued*”. The PSR require a PI to safeguard “*sums received from, or for the benefit of, a payment service user for the execution of a payment transaction*” and “*sums received from a payment service provider for the execution of a payment transaction on behalf of a payment service user*”.

Firms are required to ensure that appropriate organisational arrangements are in place to protect the safeguarded funds which are sufficient to minimise “*the risk of the loss or diminution of relevant funds or assets through fraud, misuse, negligence or poor administration*”. A key internal control to achieve this objective is the performance of reconciliations.

What should be reconciled?

The reconciliation process will need to consider internal records of user entitlements (i.e. e-money in issue and / or payment transactions waiting to be processed) and both internal and external records of the Relevant Funds held.

The objective of the reconciliation process should be to identify discrepancies between the user entitlements, as recorded on the firms’ payment or e-money system, when compared to the records of Relevant Funds held.

Once identified, discrepancies will need to be investigated and immediately rectified (at least by the end of the day on which the reconciliation was performed).

The reconciliation process will need to suit the firm but would typically involve, reconciling:

- **Internal records of user entitlements**, i.e. the record of e-money in issue or payment transactions to be processed, as recorded on the firms' systems
- **Internal records of the Relevant Funds** held as recorded in the cashbook in the firms' accounting system. Relevant Funds are the user funds that have been received by the firm in relation to the issuance of e-money or the provision of payment services; and
- **External records of the Relevant Funds** held per bank information, i.e. information from the bank that provides the safeguarding bank account (e.g. the bank statement).

The reconciliation of internal cashbook records to external bank records (i.e. points two and three above) is a 'traditional' bank reconciliation that would be performed as part of month end or year end accounts preparation. The firm's accounting or finance function should therefore be very familiar with this process. The addition of a third-stage to the reconciliation process, i.e. the reconciliation to the internal records of user entitlements, is an additional step which should be reasonably easy to incorporate into the reconciliation process (and may be capable of automation to some extent).

An explanation of the reconciliation process should be prepared that is sufficiently clear to provide third parties with an understanding of the process. The reconciliation process must be signed off by the Board and records should be retained.

How often should be reconciliation be performed?

Firms must perform reconciliations *"as regularly as is necessary and as soon as reasonably practicable after the date to which the reconciliation relates"*.

In determining the reconciliation frequency, firms will need to consider the risks to which the business is exposed, including the nature, volume and complexity of the business, and where and with whom the Relevant Funds and assets are held.

The frequency of reconciliations will also need to reflect the risk of discrepancies between the amount of Relevant Funds held and the liabilities due to users. The frequency of reconciliations should be increased where there is a greater risk of discrepancies, noting that reconciliations should be carried out not less than once during each business day.

Examples of arrangements where the risk of discrepancies increases include: where Relevant Funds are invested in secure, liquid assets; where Relevant Funds are held in a currency other than the currency of the payment transaction / issued e-money (i.e. FX differences); where net amounts are settled into the safeguarding bank account, and where there are complex charging and fee structures.

The reconciliation process will need to be able to identify discrepancies arising through these different flows, transactions and safeguarding methods and ensure that they are flagged for resolution.

Rectifying discrepancies identified through the reconciliations

Where discrepancies are identified through the performance of reconciliations, firms should endeavor to identify the underlying reason(s) for the discrepancies so that corrective action can be taken.

Certain discrepancies will arise as a result of timing differences and will essentially 'self-correct'. A common example of a timing difference is where e-money is issued upon confirmation of a successful card transaction authorisation prior to an EMI receiving settlement funds from the card scheme - settlement of funds usually takes place several days after the transactions are confirmed.

Discrepancies that are not related to timing differences will need to be corrected, as soon as possible, by paying into the safeguarding bank account any shortfall or withdrawing any excess. Firms should make these corrections by the end of the business day, i.e. the same business day as the reconciliation is performed.

Where a discrepancy cannot be immediately resolved, firms should assume that the records which show a greater amount of Relevant Funds (or assets) is the correct balance.

Records to be maintained

It is important that records are retained to evidence the operation of the safeguarding arrangements. Records should include policy and procedural documents, that are maintained in relation to safeguarding. Records of the reconciliations performed, discrepancies identified and the actions taken to resolve them should also be retained to evidence the operation of the safeguarding processes.

Records should include a clear description of the reconciliation process and an explanation describing why it is considered adequate for use by the firm. The reconciliation process should be signed off by the Board, and this approval should be recorded in the minutes of the relevant Board meeting.

The record keeping arrangements relating to the safeguarding processes would form part of the wider record-keeping arrangements applied to the compliance operations as a whole.

Notifications to the FCA

Firms should notify the FCA in writing, and without delay, if in any material respect they have not complied with, or are unable to comply with, the safeguarding requirements in the EMR and PSR.

The FCA cite examples of where notifications are required, including: failure to keep up to date records of Relevant Funds, inability to resolve reconciliation discrepancies, a decision by a credit institution to close a safeguarding account, or failure to carry out reconciliation as frequently as appropriate.