Electronic Money Association
Crescent House
5 The Crescent
Surbiton, Surrey
KT6 4BN
United Kingdom
Telephone: +44 (0) 20 8399 2066
www.e-ma.org

Andrew Bailey
Governor
Bank of England
Threadneedle St,
London EC2R 8AH

4 September 2023

Dear Mr Bailey,

Re: EMA request to Bank of England to (1) allow EMIs to safeguard customer funds at the Bank of England, and to (2) upgrade the Settlement Account functionality to allow access to overnight reserves

The EMA is the UK and EU trade body representing electronic money issuers and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide, providing online payments, card-based products, electronic vouchers, and mobile payment instruments. Most members operate in the UK and across the EU, most frequently on a cross-border basis. A list of current EMA members is provided at the end of this document.

Whilst non-bank payment service providers (PSPs) are able to directly participate in the UK interbank payment systems, they remain at a significant competitive disadvantage when compared with banks as regards such access. Largely, this is due to inability to hold customer funds in an account at the Bank of England, other than for settlement purposes. In this letter, we set out why, in our view, it is important to enable non-bank PSPs to effectively safeguard customer funds with the Bank of England, and the suggested options for doing so, for your consideration.

The case for safeguarding at the Bank of England

Non-bank PSPs, i.e. Electronic Money Institutions (EMIs) and Payment Institutions (PIs), have to safeguard customer funds by one of the permitted methods prescribed in the relevant regulations.[1] By large, EMIs and PIs use the segregation method, whereby funds are held in a segregated bank account with a credit institution. There are significant benefits to be gained by the payment services industry by allowing non-bank PSPs to safeguard funds with the Bank of England, considering the following reasons.

(1) De-risking/de-banking. Opening and maintaining safeguarding accounts with banks by non-bank PSPs remains a significant challenge. The number of banks with an appetite for offering safeguarding accounts is limited; the risk that a particular bank might decide to withdraw their banking services from a particular non-bank PSP or an entire section of the market (the so-called de-risking) is ongoing. Even with established relationships, banks are reluctant to hold significant amounts of safeguarded funds, increasing the risk of de-banking, thus penalising non-bank PSPs as their business grows. Where access to safeguarding accounts is withdrawn or disrupted, this can leave millions of non-bank PSPs' customers unable to access their funds or use their services.
(2) Systemic risk. The unavoidable reliance on banks for safeguarding customer funds poses systemic risks, including concentration risks in the event of bank failure This issue has become particularly acute in the context of the recent failure of Silicon Valley Bank.
(3) Level-playing field, innovation and competition. Gaining further independence from the banking sector will foster growth, innovation and competition in the sector. Enabling access to the Bank of England on terms similar to those available to banks, including as regards earning interest on funds held with the Bank, would create a level-playing field across the industry and further the ability to compete with the banking sector.

Providing non-bank PSPs with a viable option to safeguard customer funds with the Bank of England would go towards addressing all of these challenges.

Bank of England's position

In 2019 the Bank of England consulted on opening up access to its balance sheet. In its response (Box K: Access to Balance Sheet Review), it recognised the competition and risk reduction benefits of allowing EMIs to safeguard at the Bank.

It also recognised the risk associated with a potential disorderly failure of a non-bank payments firm, and set out a number of conditions to be in place in order for the risk to be mitigated and for the Bank to be comfortable with directly holding customer funds:

(1) Customer funds to not only be 1-for-1 backed at all times, but for appropriate buffers and/or capital requirements to be in place to absorb unexpected losses.
(2) Protections for customers to be in place to guarantee that all funds are returned promptly to customers in the event of a firm's failure.
(3) Formal wind-down plans should be maintained to reduce the risk of disorderly failure.

[1] The safeguarding requirements are set out in the Electronic Money Regulations 2011 for EMIs and in Payment Services Regulations 2017 for PIs

We note that the regulatory expectations on non-bank PSPs have increased, thus addressing most of not all of the areas of concern highlighted above.

In relation to condition (1) individual firms may indeed be able to provide such a capital buffer as long as the buffers address specific risks associated with the EMI's business model, instead of containing oversimplified ratios. Prudential risk management and assessment of capital adequacy has since been addressed in the FCA's guidance in 2020 (Coronavirus Guidance) and now updated Payment Services and Electronic Money Approach Document (Approach Document). Further guidance on assessment of adequacy of financial resources has also been set out in the FCA's Finalised Guidance FG 20/1 of June 2020.

With regards to condition (2), the Payment and Electronic Money Institution Insolvency Regulations 2021 came into force in July 2021, and now improve the process and experience of customers in the event of the insolvency of an EMI or a PI. The Bank of England has also taken steps to amend the rules to make Financial Services Compensation Scheme (FSCS) depositor protection available to eligible customers of an EMI/PI in respect of their relevant proportion of safeguarded funds should the credit institution holding the safeguarded deposits fail.

Finally, condition (3) is now addressed as the FCA issued guidance in July 2020 (now incorporated into the Approach Document – see 3.73 to 3.76) clarifying their expectation that all EMIs and PIs should maintain wind-down plans which should include clear triggers to commence an orderly, solvent winding down of the business in certain circumstances.

The way forward

We invite the Bank to revisit the conclusions of the 2019 consultation and take steps towards either of the following:

(1) Settlement Account: Allowing non-bank PSPs to upgrade the status of the Settlement Account to have overnight reserves access, and allowing the Account to hold two pots: one for settlement of funds between financial institutions (as it is currently designed), and a new second pot of funds within the Settlement Account in which non-bank PSPs can safeguard customer funds, or

(2) Create a new account type: The Bank of England could create a new Safeguarding Account that non-bank PSPs could have access to, allowing PSPs to hold funds with the Bank beyond those needed for pure settlement purposes. This account should be interest bearing, so that PSPs are not put at a competitive disadvantage relative to the banks receiving interest on their deposits with the Bank, and would remove the systemic risk currently associated with non-bank PSPs having to safeguard funds with credit institutions.

I would be grateful for your consideration of our comments and proposals.

Yours sincerely,

Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

Appendix I: Background

There are currently two types of accounts that financial institutions ("FIs") may hold with the Bank of England:

1. **Settlement Account**: This allows FIs to settle transactions between other financial institutions via the UK's Deferred Net Settlement payment systems, such as FPS and Bacs. Until now, non-bank PSPs are restricted from accessing overnight reserves, a functionality currently available only to credit institutions, which allows them to:

    a. borrow funds directly from the Bank of England at the Bank's base interest rate.

    b. hold funds to earn interest at the Bank of England's base interest rate.

    c. access Continuous Linked Settlement (CLS) Group's bank-to-bank FX system, which allows firms to process multi-currency settlements.

2. **Collateral Account**: This is where money is held as collateral in order to settle transactions when there are not enough funds in the Settlement Account. It is used as a guarantee to ensure that all payments can be settled.

Members of the EMA, as of September 2023

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Airbnb Inc
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American Express
ArcaPay UAB
Banked
Bitstamp
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Blackhawk Network EMEA Limited
Boku Inc
Booking Holdings Financial Services International Limited
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CashFlows
Checkout Ltd
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Citadel Commerce UK Ltd
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Etsy Ireland UC
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Square
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