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Briefing Doc

CP24/20: Safeguarding



FCA Consultation Paper CP24/20: Safeguarding – Detailed Briefing Document

1. Executive Summary

This briefing document reviews the key themes and proposals outlined in the Financial Conduct Authority (FCA) Consultation Paper CP24/20 "Safeguarding". The paper proposes significant changes to the safeguarding regime for payment and e-money institutions in the UK, aiming to enhance consumer protection and market integrity.

2. Background

The existing safeguarding regime, under the Payment Services Regulations (PSRs) and Electronic Money Regulations (EMRs), has faced challenges, particularly highlighted by the Ipagoo judgment. This judgment revealed uncertainties regarding the legal status of safeguarded funds during insolvency, leading to delays and increased costs in returning funds to consumers.

3. Key Themes

Strengthening Consumer Protection: The proposed changes aim to provide greater certainty and protection for consumers' funds in case of firm insolvency.

Enhancing Market Integrity: The proposals aim to reduce operational risks and contagion effects within the payments sector.

Clarifying Legal Framework: The paper proposes establishing a statutory trust over safeguarded funds, providing a clearer legal basis for their treatment in insolvency.

4. Most Important Ideas and Facts

4.1. Statutory Trust

The paper proposes introducing a statutory trust over all relevant funds (funds received for payment services and e-money issuance), assets, insurance policies, and guarantees used for safeguarding.

This trust aims to ringfence client funds from claims of other creditors in case of firm insolvency.

The paper argues that a statutory trust provides "an established legal framework for IPs [Insolvency Practitioners] to rely on." (Chapter 7, paragraph 69)

4.2. Designated Safeguarding Accounts (DSAs)

The FCA expresses concerns about inadequate segregation of client funds in non-designated safeguarding accounts (NDSAs) currently permitted under the PSRs/EMRs. (Chapter 7, paragraph 30).

To address this, the paper proposes mandating the use of DSAs held with authorised credit institutions for all relevant funds.

This measure seeks to "improve market integrity by reducing the risk of operational disruption and contagion risk." (Chapter 2, paragraph 2.19)

4.3. Operational Dependency on EMIs

The paper highlights concerns about the reliance of some payment institutions on Electronic Money Institutions (EMIs) for providing NDSAs.

The failure of an EMI providing NDSAs could disrupt operations and potentially lead to the failure of multiple payment firms. (Chapter 7, paragraph 39)

4.4. Investing Client Funds

The FCA acknowledges the existing option for firms to safeguard by investing in secure liquid assets (SLAs).

However, under the proposed statutory trust, firms investing in SLAs would need to obtain necessary permissions to manage investments on behalf of their clients. (Chapter 6, paragraph 6.26)

4.5. Cost-Benefit Analysis

The FCA estimates that the proposed changes will result in significant benefits for consumers through faster return of funds and reduced shortfalls during insolvency.

The estimated net present value (NPV) of the benefits over the next 10 years is £16.0 million.

However, the proposals also come with costs for firms, particularly regarding switching to DSAs (£11.5 million) and annual audit requirements (£5.6 million). (Annex 2).

5. Conclusion

The FCA's proposed changes to the safeguarding regime represent a substantial overhaul aimed at strengthening consumer protection and market integrity. While the benefits for consumers are significant, firms will need to carefully assess the operational and financial implications of these changes.

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