

**EXPLANATORY MEMORANDUM TO**  
**THE PAYMENT AND ELECTRONIC MONEY INSTITUTION INSOLVENCY**  
**REGULATIONS 2021**

**2021 No. [XXXX]**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

**2. Purpose of the instrument**

- 2.1 This instrument creates a new special administration regime for payment and electronic money institutions. It applies with modifications Part 24 of the Financial Services and Markets Act 2000 (which makes provision for insolvency) to those institutions except in respect of special administration. It also makes an amendment to the Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018 (BRRD Exit SI) and to the Bank Recovery and Resolution (Amendment) (EU Exit) Regulations 2020 (BRRD2 SI) to correct a minor defect in the BRRD2 SI.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Joint Committee on Statutory Instruments*

Why preamble refers to section 259(1) Banking Act 2009

- 3.1 The preamble of the instrument refers to the authority to make the instrument as being, in part, section 259(1) of the Banking Act 2009. Section 259(1) is relied on, for instance, to make regulation 12(10) (which makes different provision for small institutions and follows, and relates to, provision made under sections 233 and 234 as extended by S.I. 2020/175) and to make Schedule 4 (which makes provision which is consequential to provisions made under sections 233 and 234 of that Act as extended by S.I.2020/175). The Treasury considers that it may rely on, and cite, section 259(1) even though it was not expressly extended for the purpose of making provision about payment and electronic money institution insolvency (cf sections 233 and 234 which were expressly extended by S.I. 2020/175). This is because the opening words of section 259(1) refer to “A statutory instrument under this Act” and the Treasury considers that provisions of the instrument are made under the Act - that is, sections 233 and s34 of the Act - albeit that those provisions are made under the Act as extended by S.I.2020/175.

Why title does not comprehend correction of defect in regulation 49

- 3.2 Regulation 49 corrects a minor defect contained in the BRRD2 SI. The defect related to the UK’s withdrawal from the EU and bank recovery and resolution. The Treasury considered whether this ought to be reflected in the title but concluded it should not. The defect is very minor. A title reflecting a broader subject matter would dilute the

specific reference to the subject matter of regulations 1 to 48 and Schedules 1 to 5 or lengthen the title.

*Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)*

3.3 The territorial application of this instrument varies between provisions.

#### **4. Extent and Territorial Application**

4.1 The territorial extent of this instrument is to England and Wales and Scotland, subject as follows:

- Regulations 48 and 49 extend to England and Wales, Scotland and Northern Ireland.
- A modification made by Schedule 3 has the same extent as the provision modified.
- An amendment made by Schedule 4 has the same extent as the provision amended.

4.2 The territorial application of the instrument varies between provisions.

#### **5. European Convention on Human Rights**

5.1 The Economic Secretary to the Treasury, John Glen, has made the following statement regarding Human Rights:

“In my view the provisions of the Payment and Electronic Money Institution Insolvency Regulations 2021 are compatible with the Convention rights.”

#### **6. Legislative Context**

6.1 The Payment Services and Electronic Money (Amendment) Regulations 2020 (SI 2020/1275) extended the enabling powers in sections 233 and 234 of the Banking Act 2009 to include electronic money institutions and payment institutions.

6.2 The Payment Services and Electronic Money (Amendment) Regulations 2020 SI further implemented obligations in Directive 2015/2366/EU.

*Payment and Electronic Money Institution Special Administration Rules*

6.3 Insolvency rules, made under section 411 of the Insolvency Act 1986 as applied and modified by regulation 37 of the instrument, will be made in due course in England and Wales, setting out the procedural rules which the administrator has to follow in order to comply with the instrument. The English and Welsh rules will be put before the Insolvency Rules Committee, as required by the Insolvency Act 1986.

6.4 We regard insolvency rules in Scotland as a matter shared by the Scottish Ministers and a Minister of the Crown under Articles 2 and 5 of The Scotland Act 1998 (Insolvency Functions) Order 2018. Insolvency rules will therefore be made for Scotland on the condition that we receive the agreement of the Scottish Government.

*BRRD Exit SI Amendment*

6.5 This instrument also makes an amendment under powers conferred by section 8(1) of, and paragraph 21 of Schedule 7 to, the European Union Withdrawal Act 2018, relying on the implied power to amend under section 14 of the Interpretation Act 1978. It

makes an amendment to the BRRD Exit SI and a consequential amendment to the Bank Recovery and Resolution (Amendment) (EU Exit) Regulations 2020.

- 6.6 HM Treasury considers that it would be disproportionate to apply the free issue procedure to reissuing this legislation to those that have purchased it prior to amendments, due to only making minor amendments. HM Treasury has complied with the requirement stated in paragraph 4.7.6 of the Statutory Instrument Practice to consult with the SI registrar on this.

## **7. Policy background**

### *What is being done and why?*

#### Problem under consideration

- 7.1 Payments in the UK have seen rapid change over recent years with people increasingly using card, mobile and electronic wallets to make transactions. These changes offer opportunities for UK businesses and consumers, with many making payments faster, cheaper and more securely. However, and as will always be the case with a rapidly changing technological landscape, they also present new challenges and risks.
- 7.2 The payment and electronic money institutions providing these services have diverse business models that range from small money remittance firms to non-bank current account providers targeting SMEs, the under-banked, and the digital generation. Consumers and businesses are increasingly using payment and electronic money institutions as their transactional banking provider to, among other things, access their salaries and savings as well as make payments.
- 7.3 However, there is evidence that the existing insolvency process for payment and electronic money institutions is suboptimal with regards to consumers. Recent administration cases involving payment and electronic money institutions have taken years to resolve in some cases, with customers left without access to their money for prolonged periods and receiving reduced monies after the cost of distribution.

#### Rationale for intervention

- 7.4 This legislation will provide for a new special administration regime for payment and electronic money institutions (“pSAR”). The pSAR will give insolvency practitioners administering the insolvencies of payment or electronic money institutions an expanded toolkit. This will allow the insolvency practitioner to keep an insolvent institution operational with the aim of ensuring continuity for consumers and prioritising the return of their funds.
- 7.5 The existing Special Administration Regime for Investment Banks (“IBSAR”) has been utilised as a model for this new regime, with appropriate amendments to reflect the operational and regulatory differences between the sectors. The IBSAR has been successful in returning client assets more quickly and at reduced cost, and similar outcomes are anticipated for consumers of institutions in the payment and electronic money sectors.
- 7.6 The legislation will also extend the full suite of Financial Services and Markets Act 2000 (“FSMA”) Part 24 provisions to all payment and electronic money institutions entering the standard insolvency process. This will provide the Financial Conduct Authority (FCA) with specific powers to participate and protect consumers in the

event of an insolvency of a payment or electronic money institution as it does for other FCA supervised firms.

#### Scope

- 7.7 An institution will be within the scope of the pSAR if it satisfies the following conditions:
- a) is incorporated in, or formed under the law of any part of, England, Wales or Scotland (with the exception of limited liability partnerships or partnerships formed under the law of Scotland); and
  - b) is defined as a payment or electronic money institution under the Payment Services Regulations 2017 (“PSRs”) or Electronic Money Regulations 2011 (“EMRs”).
- 7.8 The instrument will not extend the pSAR to institutions established in Northern Ireland or partnerships or limited liability partnerships (LLPs) established in Scotland due to differences in insolvency law between the jurisdictions. HM Treasury will extend the pSAR to these other institutions in the future.
- 7.9 The application of FSMA Part 24 provisions to payment and electronic money institution insolvency extends to England and Wales, Scotland and Northern Ireland.

#### Special administration objectives

- 7.10 The pSAR will create three special administration objectives which administrators will have a duty to follow:
- Objective 1 is to ensure the return of relevant funds as soon as is reasonably practicable;
  - Objective 2 is to ensure timely engagement with payment system operators, the Payment Systems Regulator and the Bank of England, HM Treasury and the FCA; and
  - Objective 3 is to either rescue the institution as a going concern, or wind it up in the best interests of the creditors.
- 7.11 The administrator has the flexibility to prioritise these objectives as appropriate in order to achieve the best result overall for customers and creditors.
- 7.12 The pSAR aims to provide administrators with clarity and direction to resolve the institution, without needing to approach the Court on a frequent basis.
- 7.13 Here follows a detailed explanation of the most important tools the regime grants. It does not provide any additional information on the scope, extent or objectives of the legislation outlined above and is provided for those who wish to more fully understand the tools the legislation provides for.

#### FCA’s power of direction

- 7.14 The instrument will provide the FCA, after consulting with HM Treasury and the Bank of England, with the power to direct the administrator to prioritise certain objectives over others, if it is necessary to:
- maintain the stability of the financial systems of the UK;

- maintain public confidence in the stability of the UK financial markets, payment systems and payment services and electronic money sectors of the UK;
- secure an appropriate degree of protection for users or holders.

7.15 This direction from the FCA will give administrators clearer authority to undertake certain actions which otherwise they may be reluctant to undertake due to concerns over their personal liability for their actions.

*Treatment of asset pools*

7.16 An asset pool is any relevant funds or assets that are segregated, placed into an account or received in an account in accordance with the EMRs or PSRs, or any proceeds of an insurance policy or guarantee held in an account in accordance with the EMRs or PSRs. In the case of electronic money institutions, relevant funds are funds that have been received in exchange for electronic money that has been issued. For payment institutions and electronic money institutions that undertake payment services unrelated to electronic money issuance, relevant funds include:

- 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.

7.17 The pSAR stipulates that the administrator must carry out a reconciliation immediately after appointment using the method adopted by the institution when it last carried out a reconciliation (regardless of whether or not that method met the requirements of the EMRs or PSRs). Reconciliation involves assessing whether the total amount of relevant funds which an institution is required to safeguard is in agreement with the total amount of relevant funds which are being safeguarded. The aim of this process is to identify any shortfall or excess in the asset pool and to settle that shortfall or excess. However, this requirement does not apply where the administrator cannot identify any occasion on which the institution carried out a reconciliation or where the institution is also an investment bank.

7.18 The pSAR sets out the steps which the administrator must take to constitute the asset pool. This includes the requirement that the administrator takes reasonable steps to include any relevant funds identifiable in any other account held by the firm and transfer those funds into an appropriate relevant funds account. The administrator must additionally monitor any funds, liquid assets or insurance policies or guarantees held within an asset pool. The purpose of the monitoring is to preserve the asset pool on an ongoing basis so that the special administrator is able to identify any movements and risks of loss or diminution of the pool.

7.19 Relevant funds received by an institution while it is in special administration must be held in a separate relevant funds account to the relevant funds held when the institution entered special administration. These funds received post-administration must be promptly returned to the user or holder, less any costs incurred by the administrator in returning them.

7.20 The pSAR also requires that as soon as is reasonably practicable after appointment, the administrator must, in respect of the asset pool, determine the following:

- the identity of every user or holder on behalf of whom the institution was required to safeguard relevant funds; and
  - for each such person, the amount of relevant funds which it was required to safeguard.
- 7.21 There is currently a lack of clarity in insolvency law over how shortfalls in an asset pool should be allocated to clients. This uncertainty can delay the return of relevant funds and increase the costs of administration. The pSAR provides that the administrator must ensure that any shortfall in an asset pool is borne pro rata by all users or holders for whom the institution holds relevant funds within the asset pool. The inclusion of this provision aims to return relevant funds quicker, thereby resulting in a less costly administration for creditors and consumers.
- 7.22 The pSAR codifies the treatment of asset pools to ensure that the special administrator has sufficient certainty on the actions to take when pursuing Objective 1 and has a reduced need to go to the Court for directions.

Bar dates for claims to relevant funds

- 7.23 It is challenging for an administrator to start returning relevant funds until they have complete information on all claims to those funds. The pSAR gives an administrator the option of setting a “bar date” (a deadline by which claims need to be submitted) if they think it is necessary to expedite the return of relevant funds. Without this, there could be a severe delay before the administrator can start paying out claims. The bar date mechanism enables the administrator to make distributions based on relevant fund claims received by a given date. The administrator can set bar dates in which interim distributions can be made and a ‘hard’ bar date (a final deadline) for the submission of final relevant funds claims.
- 7.24 The hard bar date enables an administrator to more efficiently transfer unclaimed assets (or the proceeds of their disposal) to the failed firm’s general estate and close the client estate. Any rights that are not satisfied before residual assets are transferred may be pursued as unsecured claims against the general estate. The administrator cannot set a hard bar date without the approval of the Court given on application by the administrator.
- 7.25 The bar date must be set out in a notice and a reasonable time must be given after the notice has been published for affected clients to be able to calculate and submit relevant funds claims before the bar date. The administrator must not set a hard bar date without the approval of the Court given on application by the administrator. The Court may approve the setting of the hard bar date only if:
- it is satisfied that the administrator has taken all reasonable measures to identify and contact persons who may be entitled to the return of relevant funds; and
  - it considers that if a hard bar date is set there is no reasonable prospect that the administrator will receive claims for the return of relevant funds after that date.
- 7.26 A late claimant is not allowed to challenge the distribution of the administrator as long as it is conducted in good faith. This is to give certainty to clients who receive back their assets that they will not be challenged at a later date by a third party for the return of those assets.

- 7.27 To reduce the possibility of there being a late claimant, further safeguards will be set out in the Payment and Electronic Money Institution Special Administration Rules.

Continuity of service arrangements

- 7.28 The Government is seeking to ensure that suppliers of services which are key to the effective administration of payment and electronic money institutions, and to the meeting of the special administration objectives, cannot withdraw their services until the administrator has had time to make suitable alternative arrangements. The pSAR adapts the provisions of section 233 of the Insolvency Act 1986 to require continuity of supply of IT and other key services. When a payment or electronic money institution goes into administration, the supplier cannot make it a condition of the supply that any outstanding charges owed by the firm to that supplier and incurred before the date of administration are paid. Suppliers of the following are covered:
- services relating to the safeguarding of relevant funds (for example, the provision of a bank account for relevant funds);
  - computer hardware or software or other hardware used by the institution;
  - financial data;
  - infrastructure permitting electronic communication services;
  - data processing (for example, data storage);
  - secure data networks provided by an accredited network provider; or
  - access to a relevant system by a sponsoring system participant.
- 7.29 The supplier can stop providing a service if: any charges in respect of the supply that are incurred after commencement of special administration remain unpaid for more than 28 days; the administrator consents to the termination of the service; or the supplier has the permission of the Court. The latter may be given if the supplier can show that the continued provision of the supply would cause the supplier to suffer hardship.

Transfer arrangements

- 7.30 Under the procedure for the special administration objectives, an administrator may arrange transfer of whole or part of the payment or electronic money institution's business to another payment or electronic money institution.
- 7.31 The pSAR provides that a special administrator may not enter into a transfer arrangement unless certain conditions are met.
- 7.32 The transfer provisions provide, among other things, for certain contracts to be read, immediately after the transfer, as if they had been made by the transferee rather than the institution (a process referred to as novation). They also provide for the power to override customer, agent and distributor consent requirements where there is a whole business transfer or there is a partial transfer that meets certain conditions. This includes the condition that all of the relevant funds held by the institution and all of the rights and liabilities under the corresponding payment or electronic money institution contracts are transferred.
- 7.33 In the case of a partial property transfer agreement that does not meet the conditions for overriding consent requirements set out in the pSAR, the need for notice and consent from customers, agents or distributors is unchanged. In the case of all partial property transfer agreements, users or holders must receive notice of their right to

demand a transfer back to the institution of any relevant funds which are transferred (their right to a “reverse transfer”).

- 7.34 The transfer provisions seek to facilitate the rapid transfers of relevant funds and assets to a solvent firm while ensuring that there are safeguards for users, holders and third parties.

*Payment and Electronic Money Institution Special Administration Rules*

- 7.35 There will be insolvency rules for the pSAR for England and Wales. We regard insolvency rules in Scotland as a matter shared by the Scottish Ministers and a Minister of the Crown under Articles 2 and 5 of The Scotland Act 1998 (Insolvency Functions) Order 2018. Insolvency rules for the pSAR will be made for Scotland on the condition that we receive the agreement of the Scottish Government.
- 7.36 Insolvency rules for the pSAR will be introduced separately under the negative procedure to come into force promptly after the Regulations come into force.
- 7.37 These rules will set out the procedural rules which the administrator has to follow in order to comply with the Regulations. The provisions will include rules regarding:
- the meeting of creditors;
  - representation on the creditor committee;
  - expenses of the special administration; and
  - the bar date procedure, with the incorporation of various safeguards and how late claimants are to be treated.

*FSMA 2000, Part 24*

- 7.38 The instrument also provides for Part 24 of FSMA to be applied to payment and electronic money institution insolvency. The extension of these provisions will provide the FCA with the same powers to participate and protect consumers in an insolvency process for payment and electronic money institutions as it does for other FCA supervised firms.

*BRRD Exit SI Amendment*

- 7.39 The instrument also corrects a minor error in the BRRD Exit SI. Regulation 42(4) of the BRRD Exit SI was made in error as it tries to amend provisions in the Banking Act 2009 which do not exist. The instrument omits regulation 42(4) of the BRRD Exit SI and makes a consequential amendment to omit regulation of 76(4) the BRRD2 SI. The correction does not alter the substance of either the BRRD Exit SI or the BRRD2 SI.

**8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union**

- 8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

**9. Consolidation**

- 9.1 Many of the regulations in this instrument are free-standing provisions. Consolidated versions of the legislation amended or modified by these regulations are available on



commercial websites. However, there are currently no plans to consolidate the relevant legislation.

## **10. Consultation outcome**

- 10.1 In December 2020, HM Treasury published a consultation document, ‘Insolvency Changes for Payment and Electronic Money Institutions’.
- 10.2 The consultation ran from 3 December 2020 to 21 January 2021, during which time the Government received fifteen written responses.
- 10.3 The consultation document indicated our intention to introduce a new special administration regime for payment and electronic money institutions and to extend the full suite of Part 24 FSMA provisions to these institutions. It set out a high-level description of the proposed insolvency changes and was accompanied by an annex containing legal drafting of some of the provisions of the pSAR and a summary of the additional provisions intended to be included in the Payment and Electronic Money Institution Insolvency Regulations. The Banking Liaison Panel (“BLP”) was convened in November 2020 to seek further views from key stakeholders.
- 10.4 A supplementary annex providing a summary of the provisions that the Government proposed to incorporate into the Payment and Electronic Money Institution Special Administration Regime Rules was published in December 2020. The consultation on this annex ran from 17 December 2020 to 28 January 2021.
- 10.5 Most respondents expressed support for the proposals, and many provided detailed and useful comments which enabled the refinement of policy. Responses to the consultation covered a range of different aspects of the proposed insolvency changes. However, many responses particularly focused on the transfer provisions and distribution principles of the pSAR, including concerns about the hard bar date. Some respondents also expressed concerns about potential costs to industry, the length of the consultation period and that the consultation did not contain a full set of drafted provisions. We have outlined our response to these detailed submissions in the consultation response document.
- 10.6 The consultation response document was published on 26 April 2021.

## **11. Guidance**

- 11.1 HM Treasury do not plan to issue guidance.

## **12. Impact**

- 12.1 There is no significant impact on business, charities or voluntary bodies.
- 12.2 There is no significant impact on the public sector.
- 12.3 The net impact of the instrument on business is considered to be less than £5m, and a de-minimis Impact Assessment has been published.

## **13. Regulating small business**

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses. As changes that primarily affect businesses that are entering an insolvency process, we do not anticipate that the costs will over-burden small businesses.

13.3 The de minimis impact assessment concluded that the net annual cost to businesses would be zero.

#### **14. Monitoring & review**

14.1 Section 236 of the Banking Act provides for HM Treasury to review the special administration regime insolvency regulations within two years of them coming into force. The review must consider how far the regulations are achieving the objectives specified in section 233(3) and whether the regulations should continue to have effect. HM Treasury will ensure that arrangements for review are consistent with better regulation policy going forward.

#### **15. Contact**

15.1 Dora Willcock at HM Treasury email: [Dora.Willcock@hmtreasury.gov.uk](mailto:Dora.Willcock@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

15.2 Joe Taylor, Deputy Director for Resilience and Resolution, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Economic Secretary to the Treasury, John Glen, can confirm that this Explanatory Memorandum meets the required standard.