UK Finance

Response to HM Treasury Review

Payment and Electronic Money Institution Insolvency Regulations

29 May 2025

UK Finance response to: Independent Review of the Payment and Electronic Money Institution Insolvency Regulations 2021

1. Introduction

1.1 UK Finance is the collective voice for the banking and finance industry. Representing 300 firms, we're a centre of trust, expertise and collaboration at the heart of financial services, championing a thriving sector and building a better society. UK Finance welcomes HM Treasury's independent review of the Payment and Electronic Money Institution Insolvency Regulations 2021.

1.2 UK Finance is providing this paper pursuant to paragraph 12 of the Terms of Reference: Independent Review of the Payment and Electronic Money Institution Insolvency Regulations 2021 published on 12 December 2024 (the "**ToR**").

1.3 Given the wide interest in this important review, and its complexity, UK Finance engaged two of the leading payment and electronic money law firms with experience of the PESAR and the IBSAR to provide their expertise into this consultation, Osborne Clarke LLP and Linklaters LLP, and we are very grateful for their assistance. In turn, Osborne Clarke LLP and Linklaters LLP have consulted with insolvency practitioners at FRP Advisory LLP, Interpath Limited, and Grant Thornton UK LLP, who also have experience and are experts of the PESAR and the IBSAR, and we are very grateful for their assistance.

1.4 This paper refers to the Payment and Electronic Money Institution Insolvency Regulations 2021 (the "**PESAR regulations**") and to the Payment and Electronic Money Institution Insolvency Rules 2021 (the "**PESAR rules**") collectively, the "**PESAR**".

1.5 **Executive Summary and Key messages**

(a) The PESAR has not achieved the objective of accelerating the return of relevant funds to customers.

(b) The differences between an electronic money institution and an authorised payment institution (each, an "**EMI/API**") on the one hand, and an investment bank on the other hand (and the differences in their customers, and in how and when those customers use their services) mean that, with the benefit of hindsight, a greater departure from the IBSAR regime may have been desirable in formulating the PESAR regime. The PESAR should not follow the IBSAR where divergence would better achieve the desired outcomes.

(c) UK Finance has been concerned that one of the PESAR's objectives, the return of funds to customers, might prevent the continuation of trading (and, for noting, the administrator must prioritise the objectives as they see fit, which leaves space to pursue other objectives in priority to that (PESAR regulation 12(7)). Where funding is available to support it, continuation of trading might be desirable for customers to continue accessing services, for payment service providers to clear payments, and to facilitate a transfer of business to a third party. For a variety of reasons, including the objective of returning relevant funds, the PESAR does not currently support continuity of trading. Other

obstacles to a continuation of trading include concerns that administrators might, in doing so, need to treat certain individual customers, or groups of customer, differently, and/or it may result in an increase in a shortfall. There is also the possibility that an EMI/API's systems might not be set up to allow the use of some (but not all) relevant funds, or allow the transfer of some (but not all) relevant funds.

(d) Various modifications could be made to the PESAR to, among other things, accelerate the return of relevant funds to holders and users, to facilitate continuity of trading, and to remove potential disincentives to administrators accepting appointments under the PESAR. Note that where an EMI/API has used the insurance safeguarding method, there might be a delay in receiving funds due to the steps needed to be taken to confirm the amount to be paid out, although this method does rely on business activities ceasing so that an amount for payout can be calculated from a particular moment in time. Without certainty on receipt of funds, it might be impossible for an administrator to decide whether or not to continue trading. The same might be true for EMI/API that used the segregation method, but there is a material shortfall and/or the administrators are dependent on having to make recoveries.

(e) Legislators might consider excluding EMI/APIs from the PESAR that do not operate payment accounts or come into possession of funds i.e. account information service firms and payment initiation services firms. Or, instead, the FCA might issue guidance that in most cases it would expect such firms to use an alternative insolvency procedure.

(f) Thought ought to be given to whether Objective 1 ("to ensure the return of relevant funds as soon as is reasonably practicable") lacks the necessary nuance and flexibility. There might be many instances where continuity of trade ought to be prioritised over the return of relevant funds where, for example, the EMI/API is of systemic importance.

2. The basis of PESAR

2.1 The explanatory statement for the PESAR regulations states:

*"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".*

2.2 The de minimis assessment for the PESAR (dated 30 October 2020) cross-refers very heavily to the IBSAR, and is predicated on the assumption that the same issues and considerations are relevant.

2.3 In our opinion: (a) an investment firm; and (b) an EMI/API are very different businesses, with different operating models and different issues to consider in an insolvency situation.

2.4 Investment firms are, among many other things, asset and wealth managers, typically offering brokerage services. Taking MF Global as an example, it provided brokerage services in relation to exchange-traded derivatives, such as futures and options as well as over-the-counter products such as contracts for difference, foreign exchange and spread betting. It held both client money and client (/custody) assets (as those terms are used in the FCA's Client Assets Sourcebook ("**CASS**") and Supervision Sourcebook ("**SUP**")). As such, it held a mix of identifiable assets on behalf of its clients that had different degrees of liquidity, as well as client money to provide liquidity to clients' trading activity and/or in to provide collateral in respect of open trading contracts.

2.5 However, an EMI/API that may be subject to the PESAR regulations instead issues e-money or provides payment services. They are required to safeguard monies received, either through segregation, investment in secure, liquid assets as the FCA may approve, or by insurance. It would not be possible for them to hold illiquid assets.

2.6 A further point is that clients of investment firms are usually investing for financial gain, and assets or monies held with such firms are not likely to be required by a person to pay for everyday essentials such as food, clothing or utility bills.

2.7 Moreover, even within the EMI/API community, there are different types of business, such as those who offer payment accounts (defined as "an account held in the name of one or more payment service users which is used for the execution of payment transactions"), those who provide acquiring services to merchants, those who issue card-based instruments, or those who offer money remittance services.

2.8 Accordingly, the reasons for customers engaging with an investment firm or an EMI/API may be very different, and therefore the preferred solution in an insolvency may also be different. Critically, customers of EMI/APIs rely on them not only to hold assets, but also to make payments (whether card based or credit transfers) and to effect withdrawals. They may be unbanked or underbanked. It is this ability to make payments which distinguishes EMI/APIs from investment banks.

2.9 Customers of EMI/APIs might be less sophisticated, and do not seek any form of return or appreciation from cash held by an EMI/API. While interest can accrue on client money, it cannot accrue on relevant funds in relation to electronic money (see regulation 45 of the Electronic Money Regulations 2011 ("**EMRs**")). EMI/APIs are also likely to have a higher prevalence of retail customers, and therefore a higher proportion of customers who may demonstrate characteristics of vulnerability. In Consultation Paper CP24/20 on changes to the safeguarding regime for payments and e-money firms ("**FCA CP24/20**"), the FCA states that "*40% of e-money account holders had at least one characteristic of vulnerability, such as a low resilience to financial shocks*", and that "*approximately 1 in 10 e-money holders in the UK are using e-money accounts as their main day-to-day transactional accounts*". Accordingly, such accountholders need to access cash very swiftly, and/or be able to continue using the services previously provided by that EMI/API. The uses for such funds can also be material, even if the amount of those funds appears to be relatively low.

2.10 For the above reasons, it seems to us that simply carrying over the same principles from the IBSAR to the PESAR without more extensive remodelling will have missed that different outcomes may be required for customers of EMI/APIs and the EMI/APIs

themselves. In particular, insufficient thought seems to have been given to whether the PESAR facilitates and promotes, where appropriate, continuity of trading in special administration, which may ultimately be to the benefit of the e-money or payments customers.

2.11 Exploring that issue further in an acquiring context, a merchant could possibly withstand losing a few days of receipts in an acquirer insolvency where the acquirer continued trading through a restructuring or sale as a going concern. However, if the acquirer ceased trading, the impact on the merchant would be far greater because it would not be able to accept card payments at all for several weeks or even months whilst it procured a new acquirer. Only the largest, most sophisticated merchants are multi-acquired.

3. Changes that would improve the PESAR

3.1 In summary, our suggestions to improve the PESAR are as follows:

(a) **Continuity of trading**: make it express that continued trading is permissible where that is reasonably necessary to rescue the EMI/API as a going concern, or to facilitate a transfer arrangement or a partial property transfer arrangement. This is not a complete panacea, as administrators might remain concerned that permitting the continued use of relevant funds might make a pro-rata distribution of relevant funds (after deduction of costs of the special administration) impossible, and/or because an EMI/API's systems cannot enable a "ruling off" of accounts (i.e. such that only a portion of relevant funds are available for use). One might consider allowing the use of post-administration receipts only (see PESAR regulation 16) so that customers at least have access to the service (if not to any relevant funds made subject to pooling). Consider excluding firms of systemic importance from the regime or the FCA being given express power to issue guidance regarding the use of other insolvency procedures for such institutions. Careful thought will need to be given, in this context, as to how the costs of such continued trading are to be met. Whilst other special administration regimes (such as those in the energy and infrastructure sectors) that focus on continuity of supply contain provision for such continuity to be supported by external (e.g. government) funding in appropriate circumstances, the costs of administering relevant funds falls to be borne out of the relevant funds themselves. Administrators may accordingly face challenges when seeking to facilitate continuity of trading, unless they are in a position from the outset of the administration confidently to know that their associated costs will be capable of being met from the relevant funds.

Thought should also be given to implementing a transfer tool (to a private sector purchaser, to a bridge institution, or to asset management vehicle), based on section 11(1) of the Banking Act 2009. This could be limited to EMI/APIs that are of systemic importance.

(b) **Distribution plan**: amend the distribution requirements in their current format, by dispensing with the requirement to prepare and obtain approval of a distribution plan at all, or by making it easier to obtain approval of a distribution plan. Alternatively, there could be express provision to permit the distribution

(or use) of a proportion of relevant funds prior to such preparation/approval. This is addressed further below at paragraph 4.2(a).

(c) **Administrator's remuneration for services in pursuit of Objectives 2 and 3**: this should be elevated above the Top-up Obligation (which we assume is a necessary disbursement under rule 98(1)(g) of the PESAR rules, but ought to be clarified).

(d) **Rule 111 Notice**: dispense with this requirement. The bar date and the hard bar date provide sufficient protection for users/holders.

(e) **Hard bar date**: dispense with the requirement to obtain court approval. This adds additional delay and cost, which can be disproportionate for less complex and smaller cases.

(f) **Discharge**: provide a means to obtain discharge from office without court approval.

(g) **Efficiencies generally**: introduce similar efficiencies to those contained in the Small Business, Enterprise and Employment Act 2015 (e.g. deemed consent, and so on).

(h) **Record keeping**: the PESAR seems to assume accurate, reliable record keeping by an EMI/API prior to its special administration, which is rarely the case. The PESAR should permit administrators to start a reconciliation "from scratch", potentially with the input from or agreement of strategy with the FCA. The FCA's safeguarding proposals (rightly) seek to mitigate this concern.

(i) **Other**: Some EMI/API are used to hold or transfer very minor balances. On Xpress (as defined below), for example, huge efforts had to be made in attempting to contact customers with potential claims for very minor amounts, and who were mostly disinterested in submitting any claim. We are informed that the costs of outreach were around £75,000, and in response eight relevant funds claims totalling only £4,577 were received. Consideration should be given to including a power to write off *de minimus* balances under, say, £5.00 or £10.00. Similarly, an administrator might be permitted to disregard balances/accounts that have been dormant for a number of years.

4. Questions raised in the ToR

4.1 ***How far are the regulations achieving their objectives (specified in regulation 12 of the Payment and Electronic Money Institution Insolvency Regulations 2021), how far are the regulations achieving the objectives specified in section 233(3) of the Banking Act 2009, and should the regulations continue to have effect.***

(a) We do not consider that the regulations are achieving Objective 1. The necessity of obtaining approval of a distribution plan (and a hard bar date), can be time consuming and expensive, and it seems to us that there has been no material change to the time taken to return relevant funds to customers, if that is the primary aim of such requirements. For noting, this is not a criticism of the PESAR, but rather a recognition that the resolution of EMI/APIs can be

complex, involving multiple parties, each of whom need time to ensure they are discharging their respective responsibilities.

(b) Of the PESARs to date (i.e. Viola Money (Europe) Ltd (December 2021), Xpress Money Services Ltd (February 2022) ("**Xpress**"), Moneo Ltd (May 2023), Rational Foreign Exchange Ltd (November 2023), Silverbird Global Ltd (March 2024), LCC Trans-Sending Ltd ("**LCC**") (June 2024), Contis Financial Services Limited (January 2025), Nvayo Limited (February 2025), and Blackthorn Finance Limited (April 2025)), only two (Xpress Money Services Ltd and LCC Trans-Sending Ltd) have had distribution plans approved (in February 2024 and March 2025, respectively). Other than Railsbank Technology Limited (in administration), we are not aware of any EMI/APIs that in that period entered an insolvency process but did not use the PESAR.

(c) In Xpress's case, this took circa two years.

(d) LCC used the insurance (rather than segregation) method of safeguarding, and the insurance policy promptly responded to its claim, which might in part explain the swift turnaround.

(e) Stakeholders with whom we consulted proposed that there should be a presumption of urgency in distribution plan applications. This would be particularly helpful in cases where there is a high proportion of vulnerable customers and where Objective 1 and the return of funds is paramount.

(f) We do not consider that the regulations have made any material change to achieving the objectives in Section 233(3) of the Banking Act 2009, viz. (a) identifying, protecting, and facilitating the return of, relevant funds, (b) protecting creditors" rights, (c) ensuring certainty for authorised electronic money institutions, small electronic money institutions, authorised payment institutions and small payment institutions, creditors, electronic money holders and payment service users, liquidators and administrators, (d) minimising the disruption of business and markets, and (e) maximising the efficiency and effectiveness of the financial services industry in the United Kingdom. That said, having a regime (however imperfect) for EMIs and APIs, does give those firms a degree of certainty.

(g) We consider that the regulations should continue to have effect, but that they should be remodelled.

4.2 ***What, if any, changes to law, practice, practical or non-legislative measures, would better deliver the objectives of the PESAR. In particular, are there any changes which could improve the effectiveness of the PESAR's statutory objective on return of customer funds***

(a) **Distribution plan**

The return of relevant funds (Objective 1, PESAR regulation 12(2)) might be accelerated by removing the requirement for the preparation and approval of a distribution plan.

For completeness, we note that stakeholders with whom we spoke appreciated the structure that a distribution plan gave to the proceeding.

Recommendation: The absolute requirement for court sanction ought to be removed. Instead, a distribution plan ought to be approved in the first instance (with or without modifications) by the FCA and/or by a requisite majority of customers (similar to an administrator's proposals). Returning to the PESAR being modelled on the IBSAR, the IBSAR (and therefore the PESAR) assumes there being a trust in place, and that a court application is required to "break" the trust. Per the decision in *Ipagoo LLP* [2022] EWCA Civ 302, there is no statutory trust currently deemed to be in place over relevant funds held by an EMI (and by extension, we assume, funds held by an API). Nonethless, we recognise that the court ought to retain some degree of control over the fairness of distribution plans and therefore we recommend that dissenting creditors be afforded the opportunity to apply to court (within a short window) to challenge a distribution plan where they consider its terms to operate unfairly – i.e. by analogy with the court's control of schemes of arrangement, restructuring plans and IBSAR distribution plans.

We note that the FCA might be reluctant to assume the responsibility of approving distribution plans, and that customers of some EMIs/APIs might not have the experience, knowhow or inclination to consider and approve a distribution plan. Court approval (on the application of the administrator) could remain the backstop. In any event, we consider that there should be a presumption of urgency for applications either seeking approval or, or challenging, distribution plans.

See below regarding the practical difficulty of "returning" relevant funds to unbanked or underbanked customers.

(b) **Hard bar date**

Under PESAR regulation 21, the administrator cannot set a hard bar date without the permission of the court. This seems unnecessary, and could delay the return of relevant funds. While an administrator might include this request in an application to approve a distribution plan, in some instances it might be necessary to make a standalone application.

Recommendation: This requirement for court approval ought to be removed (with any potential associated prejudice to customers perhaps being addressed by means of controls being imposed upon the timing of the hard bar date – for instance, it might be provided that the hard bar date could not be set within [x] months of the administrator's appointment). Thought should also be given to removing the requirement to distribute a PESAR Rule 111 notice.

In addition, if the requirement for court approval is to be retained, the wording *"(b) 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*" in PESAR Regulation 22(2)(b) sets an unnecessarily high bar. The wording in (a): "*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*" is sufficient.

In addition, thought should be given to removing the requirement (in Regulation 21(6)) that, *"[t]he administrator must, as soon as reasonably practicable after the hard bar date, make a final distribution of relevant funds from the asset pool to users or holders who are entitled to them under their claims made before the hard bar date".* Whilst that will often be the result of the occurrence of as hard bar date, this requirement can impact the availability of a hard bar date as a tool for the administrator, in circumstances where certain relevant funds have been claimed but cannot currently be returned for logistical or KYC reasons. Whilst this problem is ameliorated by the words *"as reasonably practicable"*, we nonetheless suggest that uncertainty about prospective compliance with this provision may deter administrators from using the hard bar date. In any event, we consider the provision to be unnecessary, given the broader requirement for administrators to return relevant funds as soon as reasonably practicable.

(c) Discharge

By the PESAR regulations, Paragraph 98 of Schedule B1 to the Insolvency Act 1986 ("**IA 1986**") is applied to the PESAR, but modified to read as if:

"(b) sub-paragraphs (2)(b) and (ba) and (3) were omitted."

The effect of that is that paragraph 98 is to be read as follows:

"The discharge provided by sub-paragraph (1) takes effect:

(a) in the case of administrator that dies, on the filing with the court of notice of his death.

(c) in any other case, at a time specified by the court.

Therefore, an application to court is required in each case. This seems unnecessary, albeit is on foot with a court-appointed administrator.

Recommendation: consideration should be given to allowing an administrator to obtain their discharge from the creditors' committee (if there is one) or from the customers and creditors (on foot with an out-of-court appointment where the administrator did not make a paragraph 52(1)(b) statement). We recognise that this recommendation could probably be made with equal force in respect of Schedule B1 administration where the administrator is court-appointed, given that paragraphs (2)(b) and (ba) and (3) do not apply to such an administrator in any event.

(d) Small Business, Enterprise and Employment Act 2015 ("SBEEA 2015")

Various provisions of the IA 1986 are applied, but excluding changes made by SBEEA 2015, i.e. removing the need to hold physical meetings in every case, the use of deemed consent (or a decision process), permitting opt out, the power for administrators to bring wrongful and fraudulent trading claims, and the power for administrators to assign officeholder claims. For noting, if the distribution plan was to be approved by customers, the deemed consent procedure might be helpful.

Recommendation: Consideration should be given to applying those provisions to the PESAR (and to the IBSAR).

(e) **Continuity of trading**

See further below. In our opinion, continuity of trading is not currently possible in most cases under the PESAR. In order to change that, wholesale revision of the PESAR would be required. Careful thought will need to be given, in this context, as to how the costs of such continued trading are to be met. This might include provision for the administrator to seek a "day one order" that they may be permitted to use a proportion (i.e. at a level that the administrator is comfortable will not exceed each customers" claim entitlement) of relevant funds in the asset pool – albeit it is unlikely that any such application will be realistic on "day one", unless the circumstances are such that significant contingency planning has been possible prior to the commencement of the administration. Consideration ought also to be given to whether firm's systems would be able to "rule off" a proportion of relevant funds in this way, although this could potentially be dealt with by giving the FCA power to give directions to regulated EMIs/APIs under the PESAR, for example to provide for the FCA to implement rules requiring EMIs/APIs to have systems in place to allow for an interim return in the event of an insolvency.

While it is a broader point, for EMI/APIs that are large and/or of systemic importance, it might be desirable to introduce a special resolution regime similar to the regime that applies to banks. This could lead to a line of enquiry for policy makers to consider, concerning the lack of a model for systemic/large non-banks to access emergency liquidity "lender of last resort" funding.

(f) **Interim distribution**

Recommendation: Administrators should, where they feel comfortable doing so, be in a position to make an interim return of part of the relevant funds, in advance of a final distribution plan being put before the court. We note, for instance, that IBSAR appears to permit interim distributions prior to a distribution plan being put before the court, so long as no bar date has yet been set – see IBSAR Regulations 11(4) and 11(4A). For noting, and by way of comparator, where a bank, credit union or building society fails, the FSCS aims to make a payment within seven business days (see rules 9.2 and 9.3 of the PRA Depositor Protection Rulebook). Our assumption is that is driven by a policy decision that many customers would be unable to function without access to cash, and the same might be true of many EMI/API users.

(g) **Reconciliation**

The PESAR seems to assume that administrators enter office with regular and accurate reconciliations having been carried out, where in reality administrators often find incomplete record keeping or record keeping which is not of sufficient quality to make a quick determination as to the amount of relevant funds that (a) ought to have been safeguarded; and (b) have actually been safeguarded. See, for example, PESAR Regulation 13(3), which requires the administrator to use the method adopted by the institution (which might be flawed), and PESAR Regulation 13(5), which requires the reconciliation to be based on the records of the EMIA/PI as they stood immediately after the last reconciliation (those records might be incorrect, or reliant on information which is still to be forthcoming from third parties, for example in relation to refunds or chargebacks for purchases made using a payment card, which can take some time to come to fruition). Administrators should not be required to start from an inaccurate

starting point (which is what the PESAR Regulations seem to require). For the avoidance of doubt, this proposal is not that funds that were not safeguarded should be retrospectively treated as safeguarded, but rather an administrator should not be bound by reconciliation records that are inaccurate.

UK Finance has been very supportive of improving record keeping through the interim state rules proposed by the FCA in FCA CP24/20 and believes that the combination of measures, from monthly reporting to the FCA through strengthened reconciliations requirements, and stronger safeguarding audit requirements, will be of huge benefit to IPs.

Recommendation: consideration should be given to whether the administrator should not be bound by those PESAR Regulations where reconciliation was deficient and/or inaccurate. In such instances, an administrator might be required to liaise with the FCA to approve a strategy which facilitates them making the best use of the information at hand. The interim state rules should be implemented in full (though we note further policy work is needed in relation to the large/complex firms that may need a more tailored reconciliation approach).

4.3 ***What impact has the PESAR had on individual customers, payment and e-money firms, insolvency practitioners, and other stakeholders, in administration cases where it has been used. These impacts must be benchmarked against the difficulties experienced during administration cases of payment and e-money prior to the introduction of the PESAR.***

(a) **Customers**

We do not consider that the PESAR has improved (or worsened) customer outcomes. Under the PESAR, it remains difficult to effect a prompt return of relevant funds, and indeed it is not possible to effect a return of funds within the same timeframe (seven working days) of the Financial Services Compensation Scheme ("**FSCS**") making a payout from the date of an insolvency of a business covered by the FSCS. Moreover, it seems to us that the PESAR does not permit continuity of trading, which might be a source of great anguish for retail customers reliant on the EMI/API to access their own source of funds, particularly vulnerable customers. Furthermore, businesses relying on EMIs/APIs, such as merchants relying on acquirers, might prefer to have their acquirer continue as a going concern rather than having to spend time entering into new arrangements with new acquirers – which may cause significant disruption to their business if, for example, they are unable to accept anything other than cash payments for an interim period.

(b) **Insolvency Practitioners**

The PESAR has created some practical considerations or difficulties for insolvency practitioners, and these might discourage insolvency practitioners from accepting PESAR appointments. Specifically, insolvency practitioners might be concerned that they will not recover (potentially material) costs that they incur in pursuit of Objectives 2 and 3.

PESAR rule 98 sets out the expenses to be paid out of the EMI/API's assets (summarising, expenses incurred in pursuit of Objective 2 and 3). PESAR rule 99 sets

out the expenses to be paid out of the relevant funds (summarising, expenses incurred in pursuit of Objective 1). Relevant funds claims do not take priority over the costs of distribution (PESAR regulation 18(5)). The "costs of distribution" comprise the expenses set out in PESAR rule 99 (see PESAR Rule 99(5)).

The phrase "costs of distribution" is not defined in the PESAR regulations or in the PESAR rules, and we must therefore look elsewhere for guidance on its meaning. In *Re Allied Wallet Ltd (in liquidation)* [2022] EWHC 1877 (Ch) ICC Judge Burton considered, among other things, what costs should properly be considered to fall within the scope of regulation 24(2) of the Electronic Money Regulations 2011 (and regulation 23(15) of the Payment Services Regulations 2017) as the "costs of distributing the asset pool". Allied Wallet Ltd (in liquidation) had failed to safeguard monies, and so its liquidators received claims far exceeding the assets available to meet them. This issue was decided against that backdrop, that is to say, there being a material shortfall in the asset pool.

Three different interpretative scenarios were proposed, namely:

> *(1) As, with the benefit of hindsight, the only purpose of the [liquidation] [could] now be seen to have been to be investigate, ascertain, collect in and distribute…to asset pool creditors, all of the fees and expenses incurred by the [liquidators] are …"costs of distributing the asset pool"…,*
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> *(2) The "costs of distributing the asset pool" includes the costs of administering and distributing the asset pools and the fees and expenses of the [liquidators] in undertaking work which, while not directly related to the asset pools, [was] necessary for the proper administration of the liquidation, and*
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> *(3) The "costs of distributing the asset pool" are strictly limited to those costs which are directly attributable to the administration and distribution of the asset pool (including its reconstitution).*

In ICC Judge Burton's judgment, scenario 2 was the appropriate basis of interpretation in this case, and this would not include, for example, statutory reporting, any costs associated with any non-regulated business, any costs incurred in dealing with trade, expense and preferential creditors, and, for the most part, any costs incurred in dealing with employees. In practical terms, that meant that circa £1,560,000 (97.7%) of costs were recoverable, and £35,000 (2.2%) of costs were irrecoverable.

In our opinion, the Top-up Obligation is a necessary disbursement under PESAR rule 98(1)(g) (viz. any necessary disbursements incurred by the administrator in the course of the special administration (including any expenses incurred by members of the creditors' committee or their representatives and allowed for by the administrator under rule 84, but not including any payment of corporation tax)). In reaching that tentative conclusion, we have revisited the judgment in *Re Nortel GmbH (in administration) and others*; *Re Lehman Bros International (Europe) (in administration) and others* [2013 UKSC 52], which concerned the status of certain pension related liabilities in an insolvency. Obligations under a Financial Support Direction (FSD) and/or a Contribution Notice (CN) are similar in some respects to the Top-up Obligation in that they are obligations imposed by statute to remedy a shortfall in a specific pool of assets. However, there are important differences, meaning that

although FSD and CN obligations were found to be provable debts (and not necessary disbursements), we consider that the Top-up Obligation is likely to be regarded as a necessary disbursement.

In particular, we note the following:

- the Top-up Obligation is contained in the same statute that enacts the PESAR. The obligation is mandatory (not discretionary), and imposed on the administrator personally (e.g. PESAR regulations 13(1) and (8) provide that "*the administrator must*…").

- unlike an FSD and/or CN, the Top-up Obligation can only crystallise upon an insolvency of the company, and not in any other circumstances.

- if the Top-up Obligation is not an expense of the special administration, the effect of PESAR regulations 13 (and Objective 1 generally) would be greatly diminished, and it seems improbable that that is what the draftsperson intended.

This is important because the Top-up Obligation, as a necessary disbursement, must be paid before the administrator's remuneration under PESAR rule 98(1)(i), so where there is a shortfall in relevant funds an administrator might find that they are unable to recover certain, or any, of their Objective 2 and 3 costs. ICC Judge Burton in Re Allied Wallet said:

"I am not blind to the fact that excluding from payment the costs and expenses that are considered to refer only to the claims of general creditors and to steps that the liquidators are obliged to take, but which cannot be said to be associated with the asset pools, is an unattractive conclusion for the court to reach. In every liquidation there are a number of tasks that statute requires the office holder to undertake. The effect of my judgment is that any office holder appointed to an insolvent electronic money institution or payment institution would be obliged to carry out those tasks and to incur fees and expenses in doing so, for which, in the event of an ultimate shortfall in the asset pool(s), they would not be paid and reimbursed. My decision consequently provides diminished incentive for practitioners to accept such appointments". (emphasis added)

More generally, in circumstances where little or no cash or realisable assets are contained within the insolvency estate of the company itself, the allocation of expenses as between rule 98 and rule 99 can operate so as to put the administrator in a difficult position, particularly if the task of distributing relevant funds is complex and time consuming. For instance, whilst the administrator might (in such circumstances) have brought the administration to a swift conclusion absent the need to deal with relevant funds, the fact that the company holds relevant funds may mean that the administration needs to continue for an extended period of time nonetheless. This may mean that the administrator incurs costs that, putting aside an interpretation along the lines of ICC Judge Burton's first interpretive scenario above, are difficult to characterise as falling within Objective 1 (e.g. rental costs, certain employment costs, the costs of progress reporting to creditors etc.). If the insolvency estate contains no assets from which to fund such activities, they may have to be funded by the administrator himself. This may discourage potential administrators form accepting appointments in certain cases.

This submission is made because we understand that it is a genuine concern for insolvency practitioners. However, for balance, we acknowledge that the policy behind the framework is that customers should not be prejudiced by work that is conducted exclusively for the benefit of a different constituency of stakeholders viz. creditors.

Recommendation: Consideration should be given to reordering the waterfalls, such that it is clear that the Top-up Obligation ranks behind the administrator's remuneration. It might also be made clear that the Top-up Obligation is a necessary disbursement (or its place in the waterfall is otherwise clarified). In addition (or in the alternative), there should be statutory guidance on what constitutes the "costs of distribution", so that administrators and others do not have to infer this from case law.

4.4 ***To what extent would the PESAR effectively manage the failure of a large payment firm which falls in the scope of the PESAR regime, noting that the PESAR has so far been used for the administration of small to medium-sized payment and electronic-money institutions.***

The PESAR's ability to manage the failure of any EMI/API (large or small) is compromised by what we see as the impermissibility (and/or practical difficulty) of continued trading (see further below).

One might expect a larger EMI/API to have better compliance and monitoring systems in place, and such firms having a legitimate purpose, as compared to a small payment firm, where compliance and monitoring can be roughshod, and occasionally the firms are used for illegitimate purposes.

UK Finance supports the FCA's proposals in FCA CP24/20 for a codification of expected records and reconciliations requirements and more regular reporting proposed. A copy of UK Finance's response to FCA CP24/20 is appended to this paper.

4.5 ***In particular, is the requirement under the PESAR for the administrator to prioritise the return of customer funds objective over continuity of service appropriate for larger payment firms. Consideration should also be given on whether prioritising return of funds over continuity of service is appropriate for smaller firms***

(a) We do not consider that the PESAR does support continuity of trading (either as a subordinate objective to the return of funds or at all).

Draftsperson's intention

(b) The HM Treasury paper, Insolvency changes for payment and electronic money institutions: consultation (December 2020) stated:

"Under the Investment Bank SAR, a special administrator has an explicit objective to return client assets as soon as is reasonably practicable ("Objective 1"). <u>The special administrator has the option to transfer the assets to a solvent firm (so that the business can continue)</u> or return assets back to the clients".

(c) One might infer from that the draftsperson's intention was that business can only continue after completion of a transfer arrangement or a partial property

transfer agreement ("**PPTA**"). That said, the response to said consultation (April 2021) stated:

"Another respondent asked for further clarity on the extent of discretion to be exercised by the administrator, and questioned whether firms would be expected to continue providing regulated services unless otherwise notified by the administrator or the FCA."

(d) And:

"In response to concerns about disruption to services, it should be noted that in certain circumstances firms will be able to continue providing regulated services once they are placed into special administration. We believe this will provide more flexibility than under the current insolvency regime".

Interpretation of the PESAR

(e) Whatever the intention was (or now is), the reality is that the PESAR does not facilitate continued trading.

(f) Under regulation 12(2):

"Objective 1 is to ensure the <u>return</u> of relevant funds: (a) as soon as is reasonably practicable in accordance with regulations 13 to 15 and 17 to 34, or (b) promptly, in the case of post-administration receipts, in accordance with regulation 16".

The "return" of relevant funds is tantamount to the redemption of funds and that very often, there may be no obvious place for funds to be returned; see above, where an unbanked or underbanked customer will have only an e-money account and associated (prepaid) card, so a return of funds (even when possible) would not assist them in the interim.

(g) Consistent with that, under regulation 13:

"(1) The administrator must carry out a reconciliation <u>immediately after appointment</u>, subject as follows. (2) The purpose of the reconciliation is (a) to identify any shortfall or excess in an asset pool, according to the institution's own records, which it would have settled, had it not entered special administration, and (b) to settle this with the institution's own bank accounts".

(h) Regulation 14 describes how, based on that reconciliation, the administrator must constitute an asset pool. Crucially, regulation 15(4) states:

"The administrator must also <u>maintain any funds</u>, liquid assets or insurance policies or guarantees held within an asset pool".

(i) The use of "also" is peculiar in that setting (in not seeming to be additional to any other obligation), but putting that aside, the key point to note is that the administrator must <u>maintain</u> such funds.

(j) Under regulation 17, each user or holder's "claim entitlement" is to be calculated based on:

"…the precise time at which the institution entered special administration".

(k) Regulation 18(1), viz. "A user's or holder's entitlement to a distribution of relevant funds from an asset pool must be determined by reference to the amount of relevant funds which that person is entitled to claim against the institution (see regulation 17)" links back to that claim entitlement (i.e. "the precise time [of] special administration"). There does not appear to be any scope for adjustments made because of post appointment movements in and out of relevant funds.

Risks for administrators

(l) If customers were permitted to continue to make payments and receive funds (that they immediately transfer out to a third party payment services provider, if they have access to one) during the special administration, an administrator might find that certain customers have increased any potential shortfall. However, as set out above, there is no provision which enables the administrator to adjust their "claim entitlement". The continued use by some (but not all) customers of an EMI/API's services could produce inequitable results, as some customers would, in effect, receive a better than pro rata use/return of their funds.

(m) Administrators (if they could get comfortable that continued trading was permissible) might consider making, say, up to a maximum of 25 per cent of relevant funds available to users/holders if they could be (very) confident that any final distribution(s) would not exceed that amount. That might be difficult to predict with precision at the outset of a special administration, particularly before the bar date and the hard bar date.

(n) Moreover, we are aware that some EMI/API's infrastructure is not capable of permitting the use of some (but not all) of a user's relevant funds.

(o) As a further consideration, administrators might be concerned that the EMI/API's records are inaccurate, and as such they would be reluctant to make a distribution(s) until the bar date and the hard bar date.

Post administration-receipts

(p) Post administration receipts are dealt with differently; see regulation 16 (Post administration receipts). It states:

"(2) The administrator may only hold the funds in a relevant funds account which does not (or will not) contain relevant funds held when the institution entered special administration".

(q) Therefore, those funds sit outside the asset pool constituted under regulation 14.

(r) Regulation 16 goes on to say:

"(4) The administrator must promptly return the relevant funds to the user or holder, less any costs incurred by the administrator in returning them".

(s) This is buttressed by regulation 12(2)(b) which states:

"promptly in the case of post-administration receipts, in accordance with regulation 16"

(t) "Promptly" (in *Regency Rolls Ltd and another v Carnall* [2000] EWCA Civ 379 said to mean "with alacrity") should be contrasted with "as soon as is reasonably practicable" (as used in regulation 12(2)(a)). On our reading, "promptly" carries much more imperative. Note also that this regulation seems to assume that the deduction of costs from post-appointment receipts is a bilateral matter between the EMI/PI and the person that is entitled to the return of the post-appointment receipts, rather than costs being deducted from a common pool. Our reading is that this regulation was intended to capture funds received in error (hence the administrator being required to give them back), rather than to facilitate business as usual trading.

"Return"

(u) In discussing relevant funds, the regulations mostly uses the verb [to] "return". To us, it is difficult to read into that term a permission to "use", or "allow spend".

(v) For completeness, there is a single instance where the PESAR regulations say:

"The administrator is entitled to <u>deal with</u> and return relevant funds in whatever order the administrator thinks best achieves Objective 1" (regulation 12)

but that is incongruous with the remainder of the PESAR regulations.

Court approval

(w) Surprisingly, the PESAR regulations/rules are not absolutely clear on this subject, but it seems to us that the PESAR, taken as a whole, requires that a distribution plan must be approved before any distribution is made. In particular, readers should see PESAR rule 112 (and compare IBSAR Regulations 11(4) and 11(4A), as referenced above). It would be a peculiarity if an administrator was able to permit customers to use relevant funds at will, but cannot return the same relevant funds to them without court approval.

4.6 ***How effectively could the PESAR deliver continuity of service for a large payment firm, including how a firm's participation in a payment system may be impacted by entry into the PESAR.***

(a) See above.

(b) Regarding payment systems, various protections are built into the PESAR, e.g.:

Regulation 12(3): *"Objective 2 is to ensure timely engagement with payment system operators, the Payment Systems Regulator and the Authorities in accordance with regulation 35"*.

Regulation 13(14): *"Nothing in this regulation authorises an administrator to transfer funds from one of the institution's own bank accounts to a relevant funds account where to do so would interrupt a payment to a payment system operator to settle a payment transaction"*.

Regulation 17(3): *"The administrator may, when [determining claim entitlements] have regard to the particulars of…(c) any payment systems which the institution participates in (whether directly or indirectly)"*.

Regulation 34(1): *"A PPTA may not transfer property, rights and liabilities to the extent that doing so would have the effect of modifying, modifying the operation of, or rendering unenforceable (a) a market contract; (b) the default rules of the Payment Systems Regulator; or (c) any rules of the Payment Systems Regulator not dealt with under its default rules"*.

Regulation 35 sets out fulsome provisions regarding payment systems, market disruption and consumer protection.

Regulation 38(2)(b): *"A direction may only be given if the FCA is satisfied that the giving of the direction is necessary, having regard to the public interest in…(b) the maintenance of public confidence in the stability of the financial markets, payment systems and payment services and electronic money sectors of the United Kingdom."*

(c) We note that payment system operators ("**PSO**") are excluded from the definition of "Supplier" and therefore that a payment institution cannot assume continuity of service from a PSO (as is provided under PESAR regulation 36).

4.7 ***Does the co-operation between different government authorities, principally HM Treasury, the Bank of England, the FCA and the Insolvency Service, and the co-operation between government authorities and the insolvency practitioner, work effectively and can anything further can be done to improve collaboration.***

Putative administrators' concerns regarding continued trading in a special administration might be eased if HM Treasury and/or the FCA would consider indemnifying them against claims/losses arising from such continued trading, e.g. claims by customers that they have received differential treatment, or that they have breached the PESAR by allowing such continued trading. We recognise that a counter-argument might be made, querying the basis on which the taxpayer ought to bear such costs in the absence of a broader public interest justification (such as may be said to arise in the context of the special administration regimes, such as those in the energy and infrastructure sectors, the primary focus of which is continuity of supply).

We would (in any event) encourage HM Treasury to think more widely about the payments infrastructure that an EMI/API will have access to: very likely they will not be direct participant in payment systems, but rather be supported by an "agency bank" or similar which will "sponsor" them into the relevant payment system or card network, so dealing with PSOs alone will not suffice: consideration needs to be given to the position of the banks which provide such agency and sponsorship services.

4.8 ***How effective is the co-operation between UK authorities and authorities from other jurisdictions, where relevant to the use of the PESAR, and are there any ways in which this could be improved.***

While we cannot offer a solution for this, it is noted that various of the PESARs to date have necessitated obtaining recognition in other jurisdictions, which has added time and complexity, and potentially delayed the return to relevant funds. Of course, the same problem applies to any other insolvency procedure.

4.9 ***To what extent are the FCA's proposed changes to the safeguarding regime relevant to the PESAR***

Noting again that UK Finance does not support the "end state" proposals, it is supportive of the overall aims of the proposals, viz. more rigorous record keeping and reporting, to minimise harm in the event of failure. In many instances, record keeping of EMI/API in the PESAR have been poor. Please see comments above regarding the PESAR assuming records are kept in good order.

UK Finance is seeking to explore with the FCA how complex or large firms could adopt more nuanced approaches to safeguarding. In particular, that focus is likely to concentrate less on reconciling receipts to the client level but more on ensuring the firm's liquidity obligations at the portfolio level are safeguarded, support by detailed accounts at the client level (e.g. in the case of merchant acquiring ensuring the firm can meet its total "pay-outs" of card receipts from available safeguarded funds/assets and using the merchant accounts as the relevant record. Acquirers do not allocate card receipts to identified merchants, they only record obligations to merchants).

4.10 ***Given that the design of the PESAR was influenced by the Investment Bank Special Administration Regulations 2011 (IBSAR), are any findings regarding the PESAR directly relevant to the IBSAR?***

The inapplicability of changes made by SBEEA 2015 to special administration regimes (including the PESAR and the IBSAR) is surprising, and should be reassessed.

The point made above in respect of the paragraph 98 Schedule B1 discharge applies equally to IBSAR as it does to PESAR.

The point made above in respect of the challenges associated with identifying the costs of pursuing Objective 1 (as opposed to the costs of pursuing the other objectives of administration) applies equally to IBSAR as it does to PESAR.

The point made above in resect of the hard bar date and Regulation 21(6) applies even more acutely in the context of IBSAR than it does in the context of PESAR. That is because IBSAR Regulation 12B(5)(a) stipulates that *"Where the administrator sets a hard bar date, the administrator, after that date… must return client assets to eligible claimants"*. That arguably imposes an absolute obligation to achieve that objective (i.e. there is no equivalent of the *"reasonably practicable"* formulation that appears in PESAR Regulation 21(6)) and experience has shown that this can be an effective barrier to utilisation by administrators of the IBSAR hard bar date in circumstances where assets have been claimed but cannot currently be returned for logistical or KYC reasons.

4.11 ***Wider developments***

We would encourage HM Treasury to keep under review whether it would be appropriate to introduce a special administration regime for stablecoins. Stablecoins can be structurally similar to e-money and can carry similar risks for consumers. We acknowledge that the regulatory regime for cryptoassets is still under development but in due course, as the market develops, applying a version of PESAR to cryptoassets would give insolvency practitioners administering the insolvency of regulated stablecoin issuers more certainty to prioritise the return of funds to consumers, similar to their role under the insolvency of an e-money issuer.