Electronic money and payment institutions

Supporting your regulatory licence and authorisation journey

Building a better working world

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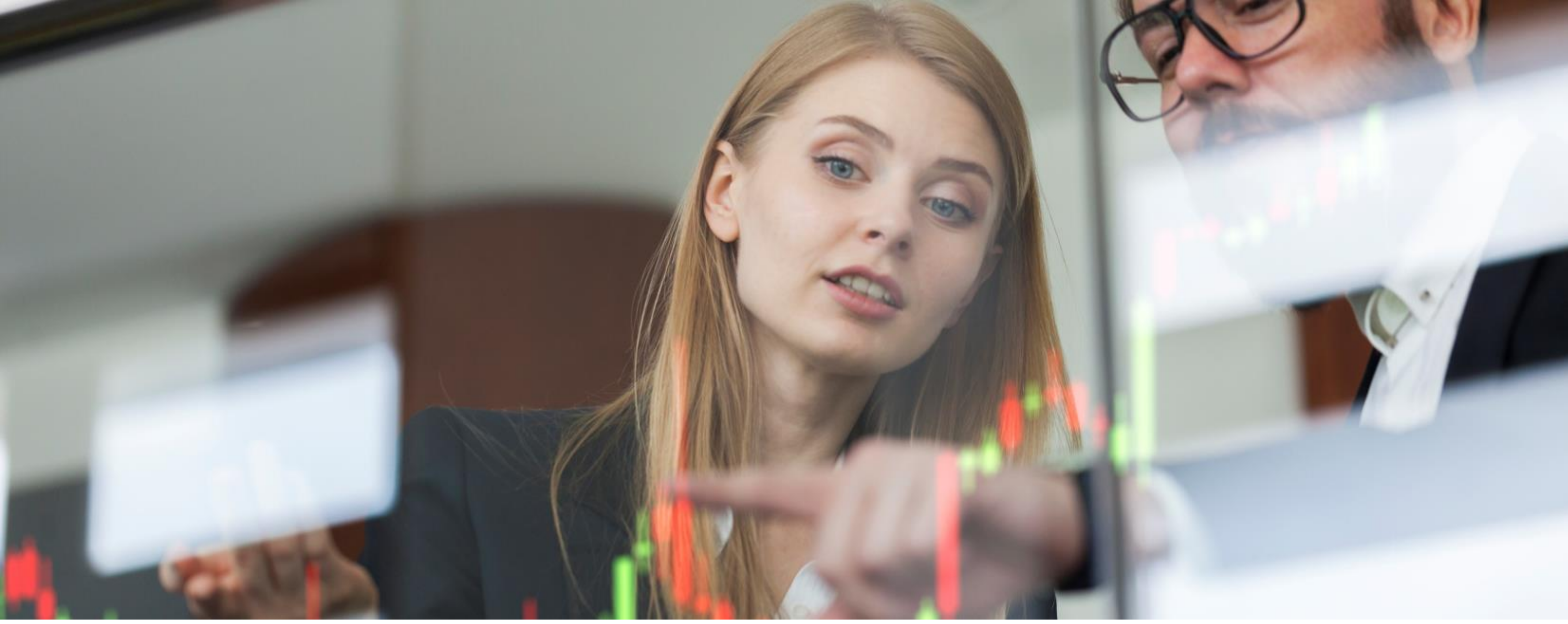


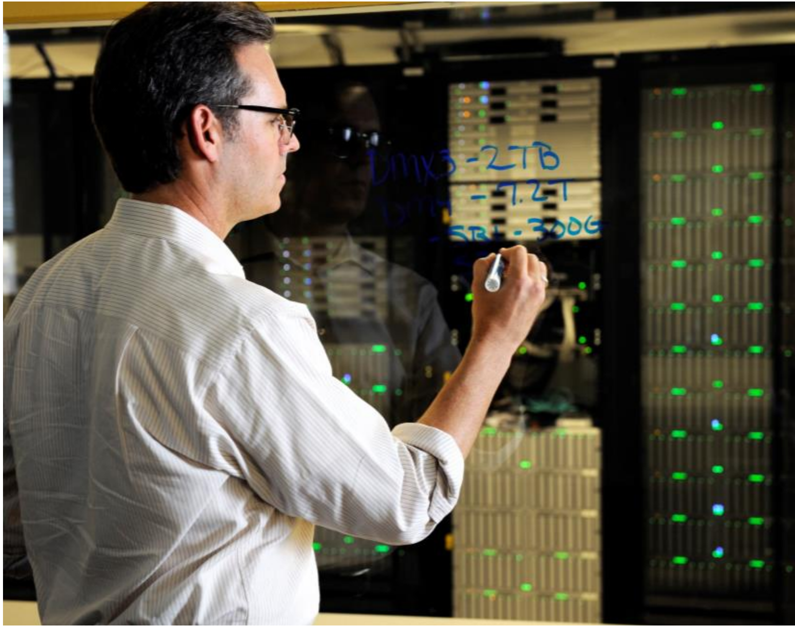
Introduction

Electronic money (e-money) and payment institutions are at the forefront of a digital revolution transforming the financial services sector. These firms are part of an ecosystem of fintechs adopting a digital-only approach to financial services.

Considerable growth within this sector over the last few years, coupled with a regulatory approach that encourages innovation, has led to an influx of firms seeking to apply for regulatory licences in the UK. Firms range from innovative start-ups entering the regulatory perimeter for the first time to established international groups looking to extend their offering in the UK market. Obtaining an e-money or payment licence has become attractive compared with a traditional bank licence.

Unlike banks, e-money and payment institutions are not authorised to accept customer deposits. However, they can provide services such as credit transfers, direct debits, electronic credit card transactions and money transfers. An e-money institution can also provide a digital 'wallet' to its customers. These firms are generally more agile, flexible and nimble than traditional financial institutions. They can streamline complex processes to prioritise efficiency and customer experience and offer broadly similar product offerings without the added complexity of being a bank. As a result, they have been able to plug a sizeable gap in the financial services market.

The rise of digital-first institutions has changed the way people think about managing their money and transactions. This has made them a popular go-to alternative, especially for millennials and customers seeking digital product offerings. The Financial Conduct Authority (FCA) has increased its scrutiny in this space, given the potential for significant consumer harm as a result of the rise of these firms.



Applying for authorisation

Obtaining an e-money or payments licence is a rigorous regulatory process requiring significant investment from the firm and its senior management. The process involves preparing a detailed application pack comprising the regulatory business plan (RBP) and comprehensive policies and procedures.

The firm will need to demonstrate significant progress before applying. The firm should be in a position to articulate its business model, competitive position and unique selling point. Senior management and key personnel will need to be in place. The firm will need a granular implementation plan and will be expected to build its operational capabilities before mobilisation.

Once an application has been submitted, the FCA will appoint a case officer, which starts the statutory timeframe for processing an application. If the FCA deems the application complete, then the FCA will have six months to decide or 12 months if the application is deemed incomplete. The FCA will review the application, provide feedback, highlight any gaps, ask questions and request additional information.

After assessing the application, the FCA will decide either to approve or reject the application and notify the firm of the decision. The firm will also have the option to withdraw.

To obtain authorisation, the firm must demonstrate that it meets the conditions for authorisation. In the case of approval, the notice will specify the activities the firm is approved to carry out, the requirements and conditions for approval and the date from which it takes effect.

Establishing a strong and transparent relationship at the outset is critical to securing authorisation and developing a long-term relationship with the FCA. The authorisation process can be lengthy and challenging. Firms seeking to start on the right foot and establish a collaborative relationship with the regulator will greatly benefit from the feedback process and increase their overall chances of success.

Key considerations for authorisation

- The application should be owned by the management of the firm.
- The senior management and key personnel will need to be in place early in the process to drive the application and stand up the new entity.
- Management should demonstrate that they have good governance at all stages of the application.
- Firms should invest adequate time and resources early in the application process to drive all application elements, including the design, build and mobilisation.
- Firms should provide accurate, up-to-date and comprehensive information in a timely manner.

The application pack

The RBP is the central document within your authorisation application and an opportunity to demonstrate your firm's business and operating model.

The FCA will use the authorisation process to assess whether the applicant is 'fit and proper' to be an authorised firm.

The cornerstone of the application is the RBP, which sets out in great depth the rationale for making the application, and the business and operating models. Equally, the application will be supported by a comprehensive suite of policies and procedures that will need to be drafted to a high quality.

The RBP should cover all key areas of your application and set out, at a minimum, the nature of your business plans, including business model and strategy, regulated activities, governance and risk management framework, key processes, systems and controls. It will also need to cover anti-money laundering (AML) and financial crime, technology, outsourcing, operational resilience and operations.

Submitting a complete application pack takes time, effort and careful planning. It would be beneficial to work through the documentation in a structured way, in terms of drafting, stakeholders, approval and sign-off, with ownership, timelines and milestones clearly defined.

It is your opportunity to showcase your business plans and create a good impression with the FCA. Failing to adequately prepare could be detrimental to your application.

Key elements of the application pack

Programme of operations Description of services to be provided.	**Business plan** Details of products, delivery channels and target markets.	**Structural organisation** Description of the organisational structure.	**Evidence of initial capital** Details of initial capital including audited accounts.	**Measures to safeguard customer funds** Description of safeguarding measures.
Governance, risk management and internal controls Risk governance framework, internal controls, policies and procedures.	**Security incidents** Procedures in place to monitor, handle and follow up on security incidents.	**Sensitive payment data** Processes in place to file, monitor, track and restrict access to sensitive payment data.	**Business continuity** Business continuity plan, list of critical services and details of testing plans.	**Statistical data** Description of the principles and definitions applicable to the collection of statistical data.
Security policy Security policy, risk assessment, details of IT systems, security measures and processes.	**Money laundering controls** AML/terrorist financing policy, description of internal controls.	**Qualifying holdings** Information on qualifying holdings including ownership structure chart.	**PSD/EMD individuals** Information for each person responsible for the management of the firm.	**Professional indemnity insurance** Details of PII cover and calculation of minimum amount.

The process on a page

The journey to FCA authorisation

1. Strategy, business and operating model
2. Regulatory business plan
3. Policies, procedures and application form
4. Approved person forms
5. Submit application/ FCA challenge

Define your strategy, business model and operating model

- How will the new entrant differentiate itself from other established firms in the market?
- What are the competitive position and unique selling points of the firm?
- How will the firm make money, and is the business model viable and sustainable?
- Define the target operating model, e.g., organisational structure, people, processes and technology.
- How will the will meet demonstrate compliance with the FCA's rules and requirements?

Draft the regulatory business plan

- Draft a comprehensive RBP clearly articulating the business and operating model. The tone and tenor of your RBP should complement and contextualise your overall application — it should tell the FCA a clear and credible story about your business proposition.

Draft the policies and procedures and the application form

- Draft the required policies and procedures as listed in the application form to a high standard.
- Ensure all relevant lines of business and functional stakeholders have been engaged to provide their inputs, review and challenge to the application pack.
- Obtain the relevant sign-offs from the management team, including the board and committees.

Prepare approved person forms

- Confirm individuals who will require regulatory approval and prepare forms for each one.

Submit application/FCA challenge

- Submit the application through the FCA's system, and respond to questions, feedback and challenge.

It could take a firm up to 12 to 24 months (or longer) to obtain authorisation

- Applicants should not underestimate the time and effort involved in getting to the point of submission. The timeline is influenced by several factors, in particular capacity, knowledge, resources and the nature, scale and complexity of your business.
- Firms will be expected to start developing their operational capabilities in parallel before submitting the application. The firm will need to demonstrate significant progress with the design and build of the new entity during the early stages of the application

FCA expectations

The FCA has indicated that the e-money and payment sectors are key areas of focus given the significant transformation over the last few years, accelerated by the COVID-19 pandemic. Recent high-profile failures, potential frauds and customer harm have put this sector front and centre of the FCA's mind, in addition to the increasing number of firms, products and services rapidly entering the market.

The FCA has expressed concern about the financial strength of many e-money and payments firms given the impact of COVID-19 – an FCA industry-wide survey found that this sector has the lowest proportion of profitable firms. Boards and senior management should familiarise themselves with recent FCA publications and take steps to proactively respond to the high-priority areas highlighted below to build trust and demonstrate compliance.

FCA areas of focus

Safeguarding Well-managed and appropriately identified customer funds that can be returned in a timely and orderly way in the event of failure.	**Prudential risk management** Adequate financial resources to meet own funds requirements and regulatory capital to incur losses while remaining solvent, or failing in an orderly way.	**Business strategy, models and viability** Sustainable and viable business models and strategy that considers products, customers and markets.
Financial crime Policies, procedures, processes, systems and controls that mitigate financial crime risks and comply with financial crime reporting obligations.	**Conduct risk** Financial promotions that are clear, fair and not misleading, consideration of potential consumer harm for products and services and compliance with Consumer Duty Regulation.	**Wind-down planning** Robust wind-down and contingency plans that consider all risks and maintain key operational services.
Risk, governance and oversight Robust and sound governance arrangements with well-defined, effective risk management procedures and internal controls.	**IT and security policies and procedures** Robust IT systems, governance, controls and security measures, including risk assessments and mitigation plans, processes and procedures for monitoring and reporting obligations.	**Outsourcing and operational resilience** Effective outsourcing arrangements and operational resilience framework.

Type of e-money or payment licence

Comparison between e-money and payment institution licences

	E-money institution		Payment institution	
	Small e-money institution	Authorised e-money institution	Small payment institution	Authorised payment institution
Capital requirements				
Initial capital requirement	No requirement up to €500k; 2% between €500k-€5mn	€350k	Not applicable	€20k-€125k
Client funds safeguarding	Client funds must be safeguarded in a segregated client bank account or an insurance policy	Client funds must be safeguarded in a segregated client bank account or an insurance policy	Optional	Client funds must be safeguarded in a segregated client bank account or an insurance policy
Ongoing capital requirement	No requirement up to €500k; 2% between €500k-€5mn	2% of average outstanding e-money issued	Not applicable	Calculated during application preparation and based on financial forecasts
Restrictions				
Payment volumes	Average payment transaction turnover cannot exceed €3mn per month	No restriction	Average payment transaction turnover cannot exceed €3mn per month	No restriction
E-money issuance	Passporting no longer permissible following Brexit		Not applicable	Not applicable
Other requirements				
Minimum number of employees	The total number of employees should reflect the nature of the activities carried out. As a minimum, CEO, MLRO based in the UK. Both must have suitable knowledge and experience to conduct their roles.			
Mind and management	Must have more directors in the UK than abroad. Day-to-day decision-making must be in the UK. MLRO/Compliance Officer must reside in the UK.			
Outsourcing	You may outsource operations. Outsourced functions must have a contractual agreement in place, i.e., a Service Level Agreement with governance and oversight in place from UK entity management.			
Application fee	£1,000	£5,000	£500	£2,500-£5,000

Changes to your licence

Direct authorisation is only one type of regulatory transaction relevant to e-money and payment institutions. As these organisations grow, there may be other regulatory transactions such as a variation of permission (VoP), change in control (CIC), change of legal status or a cancellation of permission that will be appropriate.

For new entrants, an increasingly popular option is to become an EMD agent of an authorised firm (Principal). An alternative may also be to acquire an existing regulated business or submit a CIC application and VoP to change regulatory permissions.

The optimal approach will depend on the nature, size and scale of activities sought to be carried on, as well as the maturity of the organisation.

Other regulatory transactions

Transaction	Description
Registration	Some firms may only need to be registered with the FCA rather than becoming fully authorised. This usually means that their activities are considered to be lower risk and therefore require less supervision.
Variation of permission	A firm may apply to vary its permission to allow it to carry out further regulated activities, remove a regulated activity it carries out or vary the description of its regulated activities (including by removal or variation of any limitations).
Change in control	A person planning to acquire or increase ownership of a regulated firm (controller) may be required to make a CIC application. It is a criminal offence not to obtain approval if required. The suitability of the proposed controllers and the impact on the firm itself will be assessed as part of the application.
Change of legal status	Firms that wish to change their legal status will need to submit either a new authorisation application or an SUP 15 notification to the FCA, depending on the legal structure of the previous entity and the new entity. The firm must cancel the previous permission and reapply for the new permission.
Cancellation	Authorised firms that wish to cancel their permissions must make an application to do so. Cancellation applies to every activity and specified investment the firm has been authorised in relation to. Changes to individual elements of a permission require a variation of permission rather than cancellation.

How EY UK can support you

EY's support starts at the beginning of your authorisation journey. We can help you plan backwards and build forward. This applies to all types of firms, from e-money and payment institutions to digital and challenger banks. Some early design features can save a lot of cost in the future and accelerate your development and growth.

The Financial Stability team within Ernst & Young LLP's (EY UK's) UK Financial Services Consulting practice supports clients in embedding key regulatory expectations through the life cycle of the firm and helping it to grow sustainably. Our services range from business consulting and advisory support to hands-on assistance with the authorisation process, and restructuring, through to wind-down planning.

As part of EY UK Consulting, we work closely with our wider Consulting network and our colleagues in Payments, Technology, Legal, Tax, Strategy and Transaction services to provide a holistic approach to supporting clients on their banking journey.

We have worked with a large number of e-money, payment and crypto firms at various stages of the growth cycle from: (i) designing and building a new entity, (ii) scaling and growing an existing entity and (iii) acquiring and merging with other entities.

We can support you in the following areas:

- Authorisation preparation and planning
- Pre-application support
- Drafting your regulatory business plan
- Drafting policies and procedures
- Reviewing draft authorisation submissions
- Preparation with regulatory interviews
- Support with regulatory responses
- Implementation support
- Approved Persons' applications

Our technical expertise covers:

- Business models and strategy
- Safeguarding arrangements
- Anti-money laundering and financial crime
- Wind-down planning
- Governance and risk management
- Regulatory reporting
- IT and security
- Outsourcing and operational resilience
- Customer migration
- Testing managed services
- Payments and technology

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