

16 March 2023

Dear Chief Executive Officer

**FCA PRIORITIES FOR PAYMENTS FIRMS**

You are receiving this letter as the Chief Executive of a firm supervised by the FCA within our payments portfolio. This includes firms authorised or registered under the [Payment Services Regulations 2017](#) ("PSRs") and the [Electronic Money Regulations 2011](#) ("EMRs") such as Payment Institutions ("PIs"), Electronic Money Institutions ("EMIs") and Registered Account Information Service Providers ("RAISPs")

We welcome the competition and innovation we have seen in the payments sector and the improved choice, convenience and value this can provide for customers. However, we remain concerned that many payments firms do not have sufficiently robust controls and that as a result some firms present an unacceptable risk of harm to their customers and to financial system integrity. We consider that the risk of customer harm is heightened by the tightening economic conditions and the cost-of-living crisis.

You should identify the messages in this letter that are relevant to your firm and take appropriate action to deliver three outcomes that we have set for payments firms:

- (i) ensure that your customers' money is safe;
- (ii) ensure that your firm does not compromise financial system integrity; and
- (iii) meet your customers' needs, including through high quality products and services, competition and innovation, and robust implementation of the FCA Consumer Duty.

**Outcome 1: Ensure that your customers' money is safe**

In our [2022/ 2025 Strategy](#), the FCA committed to focus on reducing harm from firm failure. We remain concerned that customer money may not be safe if payments firms fail in a disorderly way. To address this risk, our approach to ensuring customer money is safe is focussed on three priorities:

## Priority 1: Safeguarding

If your firm enters insolvency, adequate safeguarding arrangements should mean customers' funds are returned quickly. If customer funds are not adequately safeguarded, their return to customers could be delayed and customers may not get all their money back. We have identified a number of common failings in payments firms' safeguarding including:

- firms not having documented processes for consistently identifying which funds are 'relevant funds' (as defined in the regulations) and must be safeguarded;
- inadequate reconciliation procedures to ensure that the correct sums are protected on an ongoing basis; and
- a lack of due diligence and acknowledgement of segregation from credit institutions providing safeguarding accounts.

In July 2020, the FCA published [new guidance](#) (subsequently incorporated into the [Approach Document](#)) requiring payments firms which undertake a statutory audit to also conduct an annual audit of their safeguarding arrangements. We have seen evidence of audits resulting in improvements in safeguarding, but some firms have not yet appointed auditors and we are not being consistently informed of adverse findings or the actions being taken to address them.

Action to take:

We expect you to take make it a top priority to ensure that your customers' money is safe. You should ensure that your firm is safeguarding customers' funds in line with the PSRs/EMRs (as applicable) and guidance set out in our Approach Document. In particular your firm must:

- appropriately document its process to identify which funds are relevant funds for the purposes of safeguarding;
- undertake internal and external reconciliations at least once a day to ensure that safeguarded funds are adequate and not excessive;
- ensure that the accounts in which relevant funds are held (or the insurance policy or comparable guarantee) meet our requirements and are supported by the appropriate documentary evidence; and
- maintain appropriate records to enable the firm or a third party such as an insolvency practitioner to identify the customer to which the funds it holds relate.

A firm's auditor is required to tell us if it has become aware in its capacity as an auditor that, in its opinion, there is or has been, may be or may have been, a breach of any requirements imposed by or under the PSRs/EMRs that is of material significance to us. This includes a breach of the safeguarding requirements and the organisational arrangements requirement. For EMIs, this may be in relation to either or both the issuing of e-money and the provision of unrelated payment services. Firms should notify us in writing without delay if in any material respect they have not complied with or are unable to comply with safeguarding requirements. Where

deficiencies have been identified, firms should also be prepared to explain the remedy actions being taken taking to address them.

## Priority 2: Prudential Risk management

Financial resilience and prudential risk management in payments firms remains a focus of our supervisory work. Although many firms proved to be resilient to the financial impact of the Covid-19 pandemic, macroeconomic conditions remain challenging and many firms are unprofitable and reliant on external funding for survival. Our work has identified need for improvement in firms' prudential risk management. Common issues include:

- a lack of appropriate liquidity risk management, including inadequate identification and quantification of liquidity risks faced by the firm;
- a failure to consider whether the firm should hold capital above its regulatory requirement in order to adequately mitigate the risks it faces; and
- a lack of scenario planning and stress-testing.

Action to take:

We expect your firm to regularly review its prudential risk management arrangements. In particular you should ensure that your firm:

- meets its regulatory capital requirement at all times;
- considers the particular financial risks it faces, based on the business model it operates, and consider how those risks may be heightened by macroeconomic conditions;
- sets or reviews its risk appetite, including key risk indicators;
- forecasts its likely financial performance in a range of plausible scenarios, including stressed scenarios, and uses this analysis to validate the firm's assessment of adequate capital and liquidity resources;
- considers holding additional capital above the minimum requirement under the PSRs or EMRs where that would be prudent based on the firm's assessment of the risks it faces; and
- plans well ahead to ensure it has adequate financial resources on an ongoing basis. This may include arranging access to additional resources, such as credit lines, that can be drawn on when needed.

Guidance for firms on managing prudential risk is available in the Approach Document. Firms may also refer to our [Finalised Guidance FG20/1](#) which provides guidance on assessing the adequacy of financial resources.

### Priority 3: Wind-down planning

In July 2020, we issued guidance (now incorporated into the Approach Document – see 3.73 to 3.76) clarifying our expectation that all firms should maintain wind-down plans which should include clear triggers to commence an orderly, solvent winding down of your business in certain circumstances. Our supervisory work has identified that many firms have not yet created wind-down plans and the plans that we have reviewed frequently fail to meet our expectations. Common issues include:

- plans which appear over-optimistic about the time it would take to wind-down;
- insufficient detail about the steps for winding-down, to make the plan practical and usable in reality;
- a lack of consideration of appropriate triggers for winding-down; and
- a lack of adequate analysis of the costs and cash requirements for winding-down.

Action to take:

As explained in our Approach Document, we expect you to ensure that your firm has an appropriate wind-down plan in place and ensure that it is reviewed regularly and kept up to date so that it continues to meet our expectations. Although our [Wind-down Planning Guide](#) does not directly apply as guidance to payments and e-money firms, firms may also refer to it, and the findings of our recent thematic review of wind-down plans [TR22/1](#), as good practice and for information about what to consider when preparing wind-down plans.

### **Outcome 2: Firms do not compromise financial system integrity**

The FCA's 2022/2025 strategy has a strong focus on reducing and preventing financial crime. Over the past two years we have seen increasing evidence of financial crime in the payments portfolio. The ability to provide bank-like services, willingness to service high-risk customers, and weaknesses in some firms' systems and controls, make PIs and EMIs a target for bad actors. Our approach to ensuring that firms do not compromise financial system integrity is focussed on two priorities:

#### Priority 1: Money Laundering & Sanctions

All firms that are subject to the UK's Money Laundering Regulations must have in place systems and controls to identify, assess, monitor and manage money laundering risk. These must be comprehensive and proportionate to the nature, scale and complexity of a firm's activities.

With regard to economic and financial sanctions, firms must ensure that they operate effective systems and controls, in order to identify and manage any sanctions exposure and risk, associated with their customers and business activities.

Our work with firms over the past two years has identified material issues with financial crime systems and controls at PIs and EMIs. Common issues include:

- failure to carry out and/or to evidence adequate KYC/due diligence;

- business-wide risk assessments that are not supported by a robust and effective methodology;
- enhanced due diligence that is not adequately risk based and not commensurate to the risk event and/or the customer;
- failure to regularly review and refresh risk assessments and control frameworks in an evolving threat landscape;
- policies and procedures which are insufficiently detailed and tailored to firms' business models;
- failure to maintain and evolve the control framework, in line with or ahead of business growth;
- failure to ensure name screening solutions from third party providers are appropriately and adequately calibrated to meet their business requirements; and
- firms unable to reasonably justify and/or verify why their sanction screening solution does not generate alerts against certain names on the UK's Office of Financial Sanctions Implementation list.

#### Action To Take:

We expect you to ensure that your firm's anti-money laundering systems and controls are effective and commensurate with the risks in the business, including as it grows over time.

We expect your firm to conduct regular reviews to assess its compliance with anti-money laundering obligations and sanctions requirements, and to work swiftly to remediate weaknesses identified.

We expect your firm to comply with its responsibilities under the Proceeds of Crime Act 2002 and Terrorism Act 2000 through accurate and timely submissions of [Suspicious Activity Reports](#) (SARs) and to regularly review of themes from your SARs reporting.

#### Priority 2: Fraud

We have seen evidence of elevated fraud rates in some PIs and EMIs. We are also concerned that there could be a further increase in fraud as a result of the cost-of-living crisis. This makes it essential that firms take action now to address weaknesses in their systems and controls to prevent fraud. Common weaknesses we have seen include:

- insufficient emphasis on mitigating the risk of fraud against customers and insufficient customer education relating to fraud prevention;
- a lack of engagement with industry information sharing bodies;
- weaknesses in firms' anti-fraud systems and controls;

- backlogs that have led to fraud reports from consumers not being actioned within a reasonable timeframe by relevant staff; and
- a high proportion of customer accounts being used to receive proceeds of fraud.

Action to take:

We expect you to take immediate action to protect your firm's customers against the risk of fraud and to ensure that your firm is not being used to receive the proceeds of fraud. In particular, you should ensure that your firm:

- reviews its internal risk appetite statements and policies and procedures to ensure that these adequately address the risk of fraud to its customers;
- regularly reviews its fraud prevention systems and controls to ensure that these are effective; and
- maintains appropriate customer due diligence controls at onboarding stage and on an ongoing basis to identify and prevent accounts being used to receive proceeds of fraud or financial crime.

**Outcome 3: Ensuring that your customers' needs are met through high quality products and services (Implementation of the Consumer Duty).**

We have seen good examples of positive innovation by payments firms which has created tangible benefits for customers and the payments ecosystem including the development of Open Banking, which is now used by 6.5 million users in the UK.

However, we also continue to see examples of products and services which do not consistently deliver good customer outcomes and payment firms not acting in customers' best interests.

Action to Take:

We expect firms to ensure that customer needs are met through adequate implementation of the FCA's Consumer Duty ("the Duty"). [On 21 February we wrote to payments firms](#) setting out our expectations of their compliance with the Duty. We expect you to take appropriate action to ensure that your firm complies with the Duty as set out in that letter.

**Cross-Cutting Priorities**

We have also identified 3 priorities which underpin the 3 outcomes described above:

Cross-cutting priority 1: Governance and Leadership, including oversight of agents and distributors

As we highlighted in our [2020 portfolio letter](#), inadequate governance and oversight is a root cause of many of the regulatory issues in the payments portfolio. We continue to see significant issues with governance, oversight and leadership in the portfolio including:

- a lack of appropriately knowledgeable and experienced personnel to provide payments services and issue e-money, including amongst key functions such as Money Laundering Risk office and other compliance staff;
- governance arrangements, risk procedures and controls that are not comprehensive and proportionate to the nature scale and complexity of the business. Including a lack of appropriate Board oversight arrangements in some firms; and
- inadequate meaningful due diligence before onboarding agents and distributors and a lack of ongoing monitoring.

Action to take:

We expect you to take action to ensure that your firms governance and leadership meets our expectations. In particular your firm must:

- satisfy itself that directors and individuals responsible for providing payment services (including agents), are fit and proper and have appropriate knowledge and experience; and
- regularly review its governance arrangements to ensure that these remain robust and proportionate to the nature scale and complexity of the business. In doing so firms should continue to consider appropriate governance arrangements such as a three lines of defence model and the appointment of non-executive directors.

We also want to remind you about your responsibilities when using agents and distributors:

- it is the responsibility of the PI / EMI to ensure that its agents are registered with the FCA. PIs and EMIs must also take all reasonable steps to ensure, both at onboarding and on an ongoing basis that any agents they use comply with the PSRs/EMRs (as applicable), and that the PI or EMI has appropriate systems and controls in place to effectively oversee the agent's activities;
- EMIs using distributors to distribute and redeem e-money have to identify their proposed use of distributors to us (although individual distributors do not need to be registered). As with agents, an EMI is responsible for anything done or omitted by a distributor in carrying out activities on behalf of the EMI. Unlike agents, however, distributors are not permitted to provide payment services; and
- we expect PIs and EMIs to ensure that where their agents and distributors are advertising or promoting their regulated activities, their customer communications are fair, clear and not misleading, and also make clear for which PI or EMI the agent or distributor is acting.

### Cross-cutting priority 2: Operational Resilience

Ensuring the UK financial sector is operationally resilient is critically important for consumers, firms and financial markets. It ensures firms and the sector can prevent, adapt, respond to, recover and learn from operational disruptions.

SYSC 15A (which came into force on 31 March 2022) requires all firms, including payment firms, to identify their important business services and set impact tolerances. Firms are required to review their important business services at least once per year, or whenever there is a material change to their business or the market in which they operate.

As soon as possible after 31 March 2022, and by no later than 31 March 2025, firms must have performed mapping and testing so that they are able to remain within impact tolerances for each important business service. Firms must also have made the necessary investments to enable them to operate consistently within their impact tolerances.

We are proactively monitoring firms' progress in complying with these requirements and will take action where deficiencies are identified.

We also expect firms to monitor their dependency on providers of critical services (including technology and banking services) and to have appropriate contingency plans to move providers if necessary. We remind firms of the need to keep their contact details on the FCA Register accurate and up to date.

### Cross-Cutting Priority 3: Regulatory reporting

In our three-year strategy for 2022 to 2025 the FCA set out its intention to become a data-led regulator. An important component of this is our ability to collect accurate information from firms in a timely fashion.

Chapter 13 of our [approach document](#) sets out details of the reports that payment firms are required to provide to us. In March 2021 PS 21/4 extended the annual financial crime reporting requirement to all PIs and EMIs supervised by the FCA for Anti Money Laundering purposes.

We have seen sustained non-compliance with our reporting requirements. This is unacceptable and we will make more frequent use of our right to charge firms that fail to meet the reporting deadlines an administrative charge of £250, ongoing failure may result in a referral to enforcement for cancellation.

### **Our Approach at the Gateway**

To address the key risks of harm across the payments and e-money sector, we continue to have a robust approach to assessing firms looking to become authorised, registered, or to vary their permissions. We expect firms to be ready, willing and organised at the point of application. This includes (and is not limited to) submitting appropriate controls framework to meet the relevant requirements and having suitably experienced and knowledgeable individuals put forward when they apply. Firms that submit poor quality applications are likely to find their applications either rejected or refused.

### **Changes in Control**

We continue to see transactions where acquisitions or increases in control of payments services and e-money firms complete without prior FCA approval. As a reminder, *before* completing the acquisition proposed controllers must:

- (i) complete and submit to the FCA the requisite s.178 notice(s) and supporting documentation; and
- (ii) await FCA approval.

Controllers of regulated firms who decide to reduce or cease control of a regulated firm are also required to notify the FCA in writing *before* they dispose of control. This is a statutory requirement.

Failure to comply with either of the above requirements can have the following consequences which will impact the regulated firm:

- (i) The FCA may use its powers to object to the transaction. The FCA can object to the transaction on the basis that it completed without prior FCA approval, among other things. The FCA also has powers to impose restrictions on shares or voting power which have been acquired improperly, for example by directing that any transfer of such shares or voting power is void, or that no voting power is to be exercisable.
- (ii) The FCA may use its prosecution powers. It is a criminal offence to acquire or increase control without prior FCA approval. It is also a criminal offence to dispose of control without notifying the FCA.

Please see the FCA's [webpages](#) and [Approach Document](#) for further information regarding the change in control requirements. The statutory requirements can be found in [Part XII of the Financial Services and Markets Act 2000](#) (as applied and modified by [Schedule 3 of the EMRs](#) and [Schedule 6 of the PSRs](#), respectively).

## **Environmental, social and governance (ESG) & diversity and inclusion**

The FCA is committed to supporting the financial sector in driving positive change through its ESG strategy, including the transition to net zero. You should familiarise yourself with the FCA's [ESG Strategy](#) and ensure that your firm has appropriate governance arrangements for more complete and careful consideration of material ESG risks and opportunities.

We have also prioritised work on diversity and inclusion. Jointly with the Bank of England and PRA, we published a Discussion Paper (DP21/2) in July 2021 seeking views on our plans to improve diversity and inclusion in financial services. This consultation closed in September, and we are currently reviewing responses.

Diversity and inclusion will remain a core area of focus for us. We welcome feedback and data which could help us develop policy in this space.

## **Next Steps**

We expect your firm to take prompt action to address the risks that we have highlighted in this letter. In summary:

- we expect you to ensure your customers' money is safe with you, including in the event that your firm fails;

- we expect you to have robust controls to prevent your firm being used for financial crime, including money laundering and fraud;
- we expect you to ensure you meet your customers' needs, including through implementation of the Consumer Duty and robust operational resilience; and
- we expect you to have robust governance and to take action to support the ESG agenda and promote diversity and inclusion.

Your firm's Board or Executive Committee should consider which of the risks we highlight are applicable to your business and the action your firm will take to address them. We will expect your firm to explain the actions it has taken in response to this letter on request.

Where we identify issues, we will take swift and assertive action to protect customers and ensure market integrity in accordance with the approach to supervision and enforcement described in our Approach Document. The FCA 2022/2025 strategy has committed to act earlier and more assertively in dealing with problem firms. We will continue to intervene using our full range of supervisory tools. In cases where firms can't meet the conditions for authorisation, we will take more assertive action sooner and will remove or sanction firms who cannot or will not meet our standards.

Yours faithfully,

Matthew Long

Director, Payments & Digital Assets