EXPLANATORY MEMORANDUM TO

THE PAYMENT AND ELECTRONIC MONEY INSTITUTION INSOLVENCY (AMENDMENT) REGULATIONS 2023

2023 No. 1399

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument extends the application of the insolvency regulations for the special administration procedure established by the Payment and Electronic Money Institution Insolvency Regulations 2021 ("the Regulations 2021"). This extension relates to institutions formed in Northern Ireland and limited liability partnerships formed in Scotland.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

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

3.1 The preamble of the instrument refers to the authority to make the instrument as being, in part, section 259(1) of the Banking Act 2009. Section 259(1) is relied on, for instance, to extend the application of regulation 12(10) of the Regulations 2021 (which makes different provision for small institutions and follows, and relates to, provision made under sections 233 and 234 as extended by S.I. 2020/175) and of Schedule 4 of the Regulations 2021 (which makes provision which is consequential to provisions made under sections 233 and 234 of that Act as extended by S.I.2020/175).

3.2 The Treasury considers that it may rely on, and cite, section 259(1) even though it was not expressly extended for the purpose of making provision about payment and electronic money institution insolvency (sections 233 and 234 of the Regulations 2021 which were expressly extended by S.I. 2020/175). This is because the opening words of section 259(1) refer to "A statutory instrument under this Act" and the Treasury considers that provisions of the instrument are made under the Act - that is, sections 233 and s34 of the Act - albeit that those provisions are made under the Act as extended by S.I.2020/175.

Why the Regulations 2021 continue not to apply to Scottish Partnerships

3.3 This SI does not apply the insolvency procedure to Scottish partnerships as they are sequestrated under the Bankruptcy (Scotland) Act, which is a devolved matter for the Scottish Government. In addition, Scottish Partnerships, apart from limited liability partnerships formed in Scotland, do not currently enter administration.

Statutory Instrument Practice

3.4 The SI amends The Payment and Electronic Money Institution Insolvency Regulations 2021, S.I. 2021/716 make minor drafting improvements or remove inconsistencies in policy. HMT has complied with the requirement in paragraph 4.7.6 of the Statutory Instrument Practice to consult with the SI Registrar.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales, Scotland and Northern Ireland.

4.2 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland.

5. European Convention on Human Rights

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

"In my view the provisions of the Payment and Electronic Money Institution Insolvency (Amendment) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 The Treasury make these Regulations in exercise of the powers conferred by sections 233 and 234 of the Banking Act 2009, as applied and modified by regulation 24A of, and paragraphs 2 and 3 of Schedule 2ZA to, the Electronic Money Regulations 2011 ("EMR 2011") and regulation 23A of, and paragraphs 2 and 3 of Schedule 3A to, the Payment Services Regulations 2017 ("PSR 2017"), and section 259(1) of that Act. Insolvency rules were made for England and Wales by the Electronic Money Institution Insolvency (England and Wales) Rules 2021 (S.I. 2021/1178 and 2022/847) and for Scotland by the Payment and Electronic Money Institution Insolvency (Scotland) Rules 2022 (S.I 2022/1239).

6.2 The Treasury have consulted in accordance with section 235(3) of the Banking Act 2009 as applied and modified by regulation 24A of, and paragraph 4 of Schedule 2ZA to, the EMR 2011 and regulation 23A of, and paragraph 4 of Schedule 3A to, the PSR 2017.

7. Policy background

What is being done and why?

Problem under consideration

7.1 Payments across the UK have seen rapid change over recent years with people increasingly using card, mobile and electronic wallets to make transactions. These changes offer opportunities for businesses and consumers, with many making payments faster, cheaper and more securely. However, and as will always be the case with a rapidly changing technological landscape, they also present new challenges and risks.

7.2 The payment and electronic money institutions providing these services have diverse business models that range from small money remittance firms to non-bank current

account providers targeting SMEs, the under-banked, and the digital generation. Consumers and businesses are increasingly using payment and electronic money institutions as their transactional banking provider to, among other things, access their salaries and savings as well as make payments.

7.3 However, there is evidence that the previous insolvency process for payment and electronic money institutions is suboptimal with regards to consumers. Recent administration cases involving payment and electronic money institutions have taken years to resolve in some cases, with customers left without access to their money for prolonged periods and receiving reduced monies after the cost of distribution.

Rationale for intervention

7.4 To manage these risks, the Regulations 2021 established a new special administration regime for payment and electronic money institutions in England and Wales, and for companies in Scotland (the pSAR). This was followed by the Payment and Electronic Money Institution Insolvency (England and Wales) Rules 2021 and the Payment and Electronic Money Institution Insolvency (Scotland) Rules 2022, which established the rules for the pSAR in England and Wales and Scotland respectively.

7.5 These Regulations amend the Regulations 2021, so that they apply in Northern Ireland and to limited liability partnerships formed in Scotland. This is to ensure effective insolvency frameworks are in place should payment and electronic money institutions in either Scotland or Northern Ireland fail.

7.6 This will give insolvency practitioners administering the insolvencies of payment or electronic money institutions in Scotland and Northern Ireland an expanded toolkit. This will allow the insolvency practitioner to keep an insolvent institution operational with the aim of ensuring continuity for consumers and prioritising the return of their funds.

7.7 The existing Special Administration Regime for Investment Banks ("IBSAR") has been utilised as a model for this new regime, with appropriate amendments to reflect the operational and regulatory differences between the sectors. The IBSAR has been successful in returning client assets more quickly and at reduced cost, and similar outcomes are anticipated for consumers of institutions in the payment and electronic money sectors.

7.8 In order to explain the content of these Regulations this explanatory memorandum first summarises the substantive content of the pSAR, as currently applied in England, Wales and to Scottish companies. It then secondly explains how the pSAR is in turn applied to firms in Northern Ireland and limited liability partnerships formed in Scotland via the provisions in these Regulations.

Main provisions of the pSAR

Special administration objectives

7.9 The pSAR creates three special administration objectives which administrators will have a duty to follow:

- Objective 1 is to ensure the return of relevant funds as soon as is reasonably practicable

- Objective 2 is to ensure timely engagement with payment system operators, the Payment Systems Regulator and the Bank of England, HM Treasury and the FCA; and
- Objective 3 is to either rescue the institution as a going concern, or wind it up in the best interests of the creditors.

7.10 The administrator has the flexibility to prioritise these objectives as appropriate in order to achieve the best result overall for customers and creditors.

7.11 The pSAR aims to provide administrators with clarity and direction to resolve the institution, without needing to approach the Court on a frequent basis.

7.12 Below follows a detailed explanation of the most important tools the regime grants. It does not provide any additional information on the scope, extent or objectives of the legislation outlined above and is provided for those who wish to more fully understand the tools the legislation provides for.

FCA's power of direction

7.13 Under the pSAR, the FCA, after consulting with HM Treasury and the Bank of England, has the power to direct the administrator to prioritise certain objectives over others, if it is necessary to:

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

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

Treatment of asset pools

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

- Sums received from, or for the benefit of, a payment service user for the execution of a payment transaction; and
- Sums received from a payment service provider for the execution of a payment transaction on behalf of a payment service user.

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

that shortfall or excess. However, this requirement does not apply where the administrator cannot identify any occasion on which the institution carried out a reconciliation or where the institution is also an investment bank.

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

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

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

- the identity of every user or holder on behalf of whom the institution was required to safeguard relevant funds; and
- for each such person, the amount of relevant funds which it was required to safeguard.

7.20 Before the pSAR was introduced, there was a lack of clarity in insolvency law over how shortfalls in an asset pool should be allocated to clients. This uncertainty can delay the return of relevant funds and increase the costs of administration. The pSAR thus provides that the administrator must ensure that any shortfall in an asset pool is borne pro rata by all users or holders for whom the institution holds relevant funds within the asset pool. The inclusion of this provision aims to return relevant funds quicker, thereby resulting in a less costly administration for creditors and consumers.

7.21 The pSAR codifies the treatment of asset pools to ensure that the special administrator has sufficient certainty on the actions to take when pursuing Objective 1 and has a reduced need to go to the Court for directions.

Bar dates for claims to relevant funds

7.22 It is challenging for an administrator to start returning relevant funds until they have complete information on all claims to those funds. The pSAR gives an administrator the option of setting a "bar date" (a deadline by which claims need to be submitted) if they think it is necessary to expedite the return of relevant funds. Without this, there could be a severe delay before the administrator can start paying out claims. The bar date mechanism enables the administrator to make distributions based on relevant fund claims received by a given date. The administrator can set bar dates in which interim distributions can be made and a 'hard' bar date (a final deadline) for the submission of final relevant funds claims.

7.23 The hard bar date enables an administrator to more efficiently transfer unclaimed assets (or the proceeds of their disposal) to the failed firm's general estate and close the client estate. Any rights that are not satisfied before residual assets are transferred may be pursued as unsecured claims against the general estate.

7.24 The bar date must be set out in a notice and a reasonable time must be given after the notice has been published for affected clients to be able to calculate and submit relevant funds claims before the bar date. The administrator must not set a hard bar date without the approval of the Court given on application by the administrator. The Court may approve the setting of the hard bar date only if:

- It is satisfied that the administrator has taken all reasonable measures to identify and contact persons who may be entitled to the return of relevant funds; and
- It considers that if a hard bar date is set there is no reasonable prospect that the administrator will receive claims for the return of relevant funds after that date.

7.25 A late claimant is not allowed to challenge the distribution of the administrator as long as it is conducted in good faith. This is to give certainty to clients who receive back their assets that they will not be challenged at a later date by a third party for the return of those assets.

Continuity of service arrangements

7.26 The Government is seeking to ensure that suppliers of services which are key to the effective administration of payment and electronic money institutions, and to the meeting of the special administration objectives, cannot withdraw their services until the administrator has had time to make suitable alternative arrangements. The pSAR adapts the provisions of section 233 of the Insolvency Act 1986 to require continuity of supply of IT and other key services. When a payment or electronic money institution goes into administration, the supplier cannot make it a condition of the supply that any outstanding charges owed by the firm to that supplier and incurred before the date of administration are paid. Suppliers of the following are covered:

- services relating to the safeguarding of relevant funds (for example, the provision of a bank account for relevant funds);
- computer hardware or software or other hardware used by the institution;
- financial data;
- infrastructure permitting electronic communication services;
- data processing (for example, data storage);
- secure data networks provided by an accredited network provider; or
- access to a relevant system by a sponsoring system participant.

7.27 The supplier can stop providing a service if: any charges in respect of the supply that are incurred after commencement of special administration remain unpaid for more than 28 days; the administrator consents to the termination of the service; or the supplier has the permission of the Court. The latter may be given if the supplier can show that the continued provision of the supply would cause the supplier to suffer hardship.

Transfer arrangements

7.28 Under the procedure for the special administration objectives, an administrator may arrange transfer of whole or part of the payment or electronic money institution's business to another payment or electronic money institution.

7.29 The pSAR provides that a special administrator may not enter into a transfer arrangement unless certain conditions are met.

7.30 The transfer provisions provide, among other things, for certain contracts to be read, immediately after the transfer, as if they had been made by the transferee rather than the institution (a process referred to as novation). They also provide for the power to override customer, agent and distributor consent requirements where there is a whole business transfer or there is a partial transfer that meets certain conditions. This includes the condition that all of the relevant funds held by the institution and all of the rights and liabilities under the corresponding payment or electronic money institution contracts are transferred.

7.31 In the case of a partial property transfer agreement that does not meet the conditions for overriding consent requirements set out in the pSAR, the need for notice and consent from customers, agents or distributors is unchanged. In the case of all partial property transfer agreements, users or holders must receive notice of their right to demand a transfer back to the institution of any relevant funds which are transferred (their right to a "reverse transfer").

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

The application of the pSAR to firms in Northern Ireland and limited liability partnerships formed in Scotland

7.33 These Regulations extend the special administration regime to Northern Ireland and to limited liability partnerships formed in Scotland.

7.34 Specifically Regulation 3 amends regulation 3 of the Regulations 2021 to clarify that those Regulations extend to Northern Ireland, as well as to England, Wales and Scotland.

7.35 Regulation 4 amends regulation 5 of the Regulations 2021 to bring the insolvency of limited liability partnerships formed in Scotland within the application of those Regulations.

7.36 Regulation 5 amends the definitions in regulation 6 of the Regulations 2021. The amendments insert abbreviated definitions for the Company Directors Disqualification (Northern Ireland) Order 2002 and the Insolvency (Northern Ireland) Order 1989 (I(NI)O 1989). It also amends the existing definitions of contributory, court enactment, special administration insolvency rules, Schedule B1 and Schedule B1 administration order and statement of proposals to ensure these definitions reflect the relevant legislation as it applies in different parts of the United Kingdom.

7.37 Regulation 6 amends regulation 8 of the Regulations 2021, which sets out how an application to the court for a special administration order may be made. Specifically, in Northern Ireland an application can be made by the chief clerk in exercise of the power conferred by section 35(4A) of the Criminal Justice Act (Northern Ireland) 1945 or by a clerk of petty sessions in exercise of the power conferred by Article 92A of the Magistrates' Courts (Northern Ireland) Order 1981.

7.38 Regulation 7 sets out the grounds for an order by amending regulation 9 of the Regulations 2021, to specify that sources of information listed in Article 104A of the I (NI)O 1989 may be used by the Secretary of State to determine whether applying for a

special administration order to put an institution into special administration is expedient in the public interest.

7.39 Regulation 8 extends the powers of the court as set out in regulation 10 of the Regulations 2021 so that it may make a special administration order in respect of an institution established under the law of Northern Ireland.

7.40 Regulation 9 specifies that arranging for the giving of the notice in order to satisfy the first condition for a Schedule B1 administration order may be treated as a step with a view to minimising the potential loss to the institution's creditors for the purpose of Article 178 of the I(NI)O 1989.

7.41 Regulation 10 applies the meaning given by paragraph 1 of Schedule 1A in the I(NI)O 1989 to the expression "capital market arrangement" where it is used in the Regulations 2021.

7.42 Regulation 11 amends the Regulations 2021 to make clear that the modifications of the Insolvency Act 1986 made by regulation 37 of those Regulations apply to special administration of institutions established in England and Wales and Scotland only. Regulation 12 inserts into the Regulations 2021 (as a new regulation 37A) equivalent modifications of the I(NI)O 1989 that apply instead to the special administration of institutions established in Northern Ireland.

7.43 Regulation 13 disapplies certain provisions of the I(NI)O 1989 where the FCA has given a direction to the administrator under regulation 38 of the Regulations 2021 (prioritising one or more special administration objectives). These provisions relate to a statement of the administrator's proposals, the initial creditors' meeting, revision of administrator's proposals and failure to obtain approval of administrator's proposals. Regulation 14 inserts in regulation 39 of the Regulations 2021 references to provisions of the I(NI)O 1989 that apply in relation to the administrator's statements of proposals in the event of an FCA direction under regulation 38 of the Regulations 2021.

7.44 Regulation 15 relates to certain circumstances where a direction of the FCA is withdrawn. It applies certain procedural requirements from the I(NI)O 1989 where the administrator proposes a revision to the statement of proposals and the administrator thinks that the proposed revision is substantial.

7.45 Regulation 16 relates to cases where the administrator considers that failure-related costs have been incurred in consequence of a failure by the institution to safeguard relevant funds. The administrator must seek the agreement of a creditors' committee established under the I(NI)O 1989 (as applied and modified by the Regulations 2021) to the amount incurred in consequence of the default.

7.46 Regulation 17 amends the Regulations 2021 so that in the event of a successful rescue of the institution, the administrator must make an application in accordance with paragraph 80 of Schedule B1 in the I(NI)O 1989 (as applied and modified). On the basis of such an application, the High Court may provide for the appointment of the administrator to cease to have effect.

7.47 Regulation 18 applies provisions of the I(NI)O 1989 (as applied and modified) to the dissolution or voluntary arrangement requirements as set out in regulation 44 of the Regulations 2021.

7.48 Regulation 19 applies the CDD(NI)O 2002 with modifications where a special administration order is made under the Regulations 2021 and sets out the process for disqualification of directors.

7.49 Regulation 20 extends the application of Schedule 1 to the Regulations 2021 to include limited liability partnerships formed in Scotland. It also introduces Schedule 1A to the Regulations 2021 which makes provision about how special administration applies to limited liability partnerships formed in Northern Ireland. Regulation 20 also introduces Schedule 2A to the Regulations 2021 which makes provision about how special administration applies to partnerships formed under the law of Northern Ireland.

7.50 Regulation 21 amends Schedule 3 to the Regulations 2021 to apply with modifications other specified legislation in relation to companies in Northern Ireland entering or being placed into special administration.

Payment and Electronic Money Institution Special Administration Rules

7.51 There will be insolvency rules for the pSAR for Northern Ireland. These rules will set out the procedural rules which the administrator has to follow in order to comply with the Regulations. Responsibility for making these rules sits with the Northern Ireland Executive.

8. European Union Withdrawal and Future Relationship

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

9. Consolidation

9.1 These are the first Regulations to amend the Regulations 2021, which contained mainly free-standing provisions. Consolidated versions of the legislation amended by these Regulations are available on commercial websites. However, there are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 The Government consulted on introducing the special administration regime in all parts of the United Kingdom. The consultation ran from 17 December 2020 to 28 January 2021, during which time the Government received fifteen written responses.

10.2 The consultation document set out the Government's intention to introduce Regulations for Scotland and Northern Ireland as part of a new special administration regime for payment and electronic money institutions (a position the Government re-stated in the Payments Services Regulations: Review and Call for Evidence in January 2023). The consultation also contained a summary of the provisions that the Government proposed to incorporate into the Regulations.

10.3 Most respondents expressed support for the introduction of a special administration regime for payment and electronic money institutions. Respondents provided detailed and useful comments which enabled the refinement of policy including its application to Scotland. Responses to the consultation covered a range of different aspects of the proposed insolvency changes. However, many responses particularly focused on the transfer provisions and distribution principles of the pSAR, including concerns about the hard bar date. Some respondents also expressed concerns about potential costs to

industry, the length of the consultation period and that the consultation did not contain a full set of drafted provisions. The Government outlined its response to these detailed submissions in the consultation response document published on 26 April 2021 .

10.4 Since 2021, the Government has regularly engaged with officials from the Scottish Government and Northern Irish Executive, to ensure the Regulations work with the insolvency laws within these jurisdictions.

11. Guidance

11.1 HM Treasury do not plan to issue guidance.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 The net impact of the instrument on business is considered to be less than £5m, and a de-minimis Impact Assessment has been undertaken and published alongside this explanatory memorandum.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses. As changes that primarily affect businesses that are entering an insolvency process, the Government does not anticipate that the costs will over-burden small businesses.

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

14. Monitoring & review

14.1 Section 236 of the Banking Act 2009 provides for HM Treasury to review the special administration regime insolvency regulations within two years of them coming into force. The review must consider how far the Regulations are achieving the objectives specified in section 233(3) and whether the Regulations should continue to have effect. HM Treasury will ensure that arrangements for review are consistent with better regulation policy going forward.

15. Contact

15.1 Edward Henley at HM Treasury email: edward.henley@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 George Barnes, Deputy Director for Banking Assets and Resolution Strategy, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

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