Interpretation of Regulation 33 of the UK`s Payment Services Regulations 2017[1]

Background

The Japanese government is contemplating the amendment of the Funds Settlement Act (資金決済法) to introduce a new category of funds transfer service provider (資金移動業者) ("FTSP"), known as Type 1 FTSP ("第一類型). The key distinction with the existing categories of FTSP is that there will be no limit on the amount of funds that can be transferred/remitted[2].

The government has indicated that it will be adopting the concepts defined under Regulation 33 of the Payment Services Regulations 2017 of the United Kingdom (the "PSRs") and payment service providers ("PSPs") regulated under the PSRs.

There are a number of compliance and operational considerations that arise under Regulation 33 and the applicable regulatory guidance of the UK regulator, the Financial Conduct Authority (the "FCA"). Such considerations are likely to be relevant to an interpretation of the new Japanese regulation introducing the new Type 1 FTSP.

Regulation 33 provides: "*Any payment account held by an authorised payment institution or a small payment institution must be used only in relation to payment transactions.*"

The concepts to be applied include regulatory guidance with respect to Regulation 33 published by the FCA pursuant to Chapter 15 of the Guidance on the scope of the Payment Services Regulations 2017 ("PERG15").

The following guidance under PERG15 is of particular note:

1. In drawing a distinction between payment accounts under Regulation 33 and deposits:

PERG 15.2 "Q5. As a payment institution rather than a credit institution, are we right

[1] Based on advice from UK law firms Bird & Bird and Bryan Cave Leighton Paisner
[2] The current limit on transfers/remittances by FTSPs is JPY 1,000,000.

in thinking that our maintenance of payment accounts does not amount to accepting deposits?

……..Our view is that this means that a payment institution cannot hold funds for a payment services user ***unless accompanied by a payment order for onward transfer*** *(whether to be executed immediately or on a future date). Funds cannot be held indefinitely.* ***They should not be held longer than is necessary for operational and technical reasons****.*

The fact that a payment account operated by a payment institution can only be used for payment transactions distinguishes it from a deposit…."

2. In responding to the question of whether positive balances may be a breach of Regulation 33:

PERG 15.2 "Q6. Sometimes our customers will have a positive balance on their account because they have *accidentally overpaid or because of refunds****. Would this put us in breach of the requirement in Regulation 33 that payment accounts held by payment institutions may be used only in relation to payment transactions?***

No. In our view, this does not amount to a breach of Regulation 33 nor does the handling of credit balances in the circumstances constitute the activity of accepting deposits."

General Question

What factors does the FCA take into consideration when determining whether the activities of payment institutions are compliant with the regulations?

Answer

A definitive analysis of what constitutes a 'payment account' under the PSRs is not possible because the FCA looks at multiple factors to determine whether or not activities are compliant or not. The policy reason for this is the PSRs are intended to be neutral in terms of technologies and business models. Hence, it would be difficult to set out 'hard-wired' rules on these points, given the variety of payment technology, products and business models in the market.

Having said that, the key factor under the PSRs is that the purpose of the relevant account holding the funds must be for payment transactions. In other words, funds in the account must be held "with a view to" receiving or making payments.

This is a question of fact and the FCA has regard to all circumstances in determining whether this is met. When determining whether or not an account is a payment account, the FCA has stated that it is appropriate to focus on the underlying purpose of the account. This includes:

1. Considering the purpose for which the account is designed. For example, there should be an intention that the money in the account will be used for the purposes of executing payment transactions.
2. The functionality of the account. The greater the scope for carrying out payment transactions on the account, the more likely it is to be a payment account.
3. The ability to place and withdraw funds from the account. The more limitations or restrictions on the ability to place or withdraw funds may indicate that the account is not a payment account (for example, a term deposit account which requires a certain period of notice before withdrawals can be made).
4. The extent to which customer use the account's payment service functionality in practice.

<u>**Individual Questions and Answers**</u>

1. <u>With respect to Q5 of PERG15</u>:
   i. <u>Payment Order</u>:
      ① Question: The payment order must be for the onward transfer of funds, but there is no guidance on how far forward the order must be.

      Answer: There must be a genuine intention that the money in the account will be used for the purposes of executing payment transactions. For example, if an account has 1000 pounds, with instructions to be paid out in instalments throughout the year, an argument could be made that that the funds are held with a view to payment, even though they may be held as long as one year and so long as no interest is paid on the funds, or they would be deemed a deposit.

② Question: How does the payment order requirement work for the receiver of funds? In other words, at what point does that receiver have to generate a payment order for the onward transfer of funds in the recipient account? Alternatively, is there a requirement to withdraw the funds within a certain timeframe?

Answer: The PSP of the payee is subject to the same requirement (for purposes of Regulation 33). That is, the account for the payee must also be a payment account (i.e. not an account for receiving deposits). That means the PSP cannot allow the funds to remain in the payee's account indefinitely. So the funds therein must, as instructed by the payee, either be paid out for purchasing goods/services or transferred to other accounts of the payee at e.g. a bank (which can hold deposits).

In short, within the context of Regulation 33, it is irrelevant whether the PSP is servicing the payer or the payee. The same question for both is whether a particular account is a 'payment account'.

ii. Operational and technical reasons:

Question: Is there any regulatory or other guidance as to the precise length of time that may be accepted as necessary for operational and technical reasons or the scope of operational and technical reasons that may be acceptable?

Answer: There is no definition of the period of time that funds can stay in a \`payment account\` without affecting the nature of the account and no specific guidance or guidelines on the above points. Again, this is mainly because the analysis is a multi-factor assessment and specific to each individual case.

2. With respect to Q6 of PERG15:

① Question: The two circumstances cited in the Question (accidental overpayment and refunds) are actions that would be initiated by the payer (customer). Would it be fair to extrapolate that, provided the cause of the positive balance was due to the customer\`s actions, there would be no breach of Regulation 33 by the payment institution?

Answer: As noted above, each case has to be looked at individually and takes into account all relevant circumstances and factors.

For example, in a hypothetical extreme scenario, if there is a large accidental overpayment, then that overpayment simply stays in the customer's account for months and months and the PSP also grants interests on it and the PSP routinely does this. That would make it look increasingly like a 'deposit' (assuming there are no other mitigating factors).

② Question: Other circumstances that may give rise to a balance include:

- Errors in payment instructions such as amount, or counterparty bank a/c details
- Bank holidays or bank cut-off times
- Inability to return or pay funds due to absence or closure of a sender or receiver`s bank account
- Stoppages/blocks due to security, fraud, credit/risk limits, AML/Sanctions concerns
- Fixed amount payments that are subject to subsequent adjustment, leaving a balance in the account.

Would these be acceptable reasons for holding a positive balance that would not infringe Regulation 33?

Answer: All of the above may potentially be considered an acceptable reason. However, as noted above, all relevant circumstances and factors should be considered. It may not be helpful to look at these points on a stand-alone basis, as there may or may not be other factors that tip the balance.