Gem Briefing Note

March 2010

GEM Compliance Consulting

Transitioning Money Service Businesses -
What you need to know about FSA Authorisation

Introduction

The Payment Services Regulations (‘PSR) 2009 was implemented in the UK on 1st November 2009. This meant that UK money transfer businesses came under FSA supervision for the first time.

Firms who provided money transfer services after that date either had to be authorised or registered with the FSA by that date - unless they could the conditions of transition rules and longer deadlines applied.

Further guidance from the FSA to Money Services Business on their approach to firms covered by the Regulations is attached below.

http://www.fsa.gov.uk/pubs/other/PSD_approach.pdf

Transitioning firms – key dates

For transitioning firms who can qualify for the criteria as a small payment institution and wish to apply for FSA registration (instead of authorisation).

- 24 September 2010. Last date for submitting applications to ensure that they are considered in time for 25 December 2010.
- 24 December 2010. Transitional period ends for payment service providers who meet the criteria for registration.

All such payment service providers who need to be registered must be registered on or before 25 December 2010.

For transitioning firms who wish to be or are required to be FSA authorised.

- 29 Jan 2011. Last date for submitting applications to ensure that they are considered in time for 30 April 2011 (providing the application is complete).
- 30 April 2011 - Transitional period ends for payment service providers who require authorisation.

All payment service providers that do not qualify for registration, and are not otherwise exempt must be authorised on or before 1 May 2011 or cease providing payment services.

NB. All transitioning firms need to allow sufficient time in advance of these deadlines to prepare a full application pack for registration or authorisation. Further guidance on the application process can be given.

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Compliance with Principles and Rules

Once under FSA supervision, firms need to continue to comply with the original conditions of authorisation or registration. They need to be in control of their own compliance and monitor that rules are being met - and can be evidenced.

The FSA expects firms to comply with the spirit of its Principles for regulated firms. In this respect Principle 3 is particularly important. It states:

'A firm must take reasonable care to organise and controls its affairs responsibly and effectively, with adequate risk management systems'.

Capital Adequacy

Capital Adequacy is a key aspect of FSA regulation central to maintaining market confidence and providing consumer protection.

'Capital adequacy' means making sure that authorised firms are financially sound and have a minimum level of 'own funds'. Financial soundness has to be satisfied both at authorisation and on an ongoing basis.

Registered firms do not have specific capital requirements. However the FSA will also expect that such firms are generally financially sound.

The FSA considers that if firms are financially sound, this reduces risk to market confidence in the financial services industry as a whole and also protects consumers.

Under these rules, customers will be protected by firms having to 'safeguard' client funds. This means that firms have to keep client funds separate from the funds of the firm as a protection if the firm is unable to meet its commitments.

However, the aim of capital adequacy is to reduce the risk of firms getting into financial difficulties in the first place – or, if they do, minimising the impact on the industry and customers by having sufficient 'own funds' set aside to allow for orderly winding down of the business.

Levels of 'own funds'

For authorised firms, part of the authorisation process includes evidencing initial own funds of at least €20,000. After authorisation, the ongoing amount is likely to be higher depending on the size of the business. There are three different methods that may be used to determine the minimum level of own funds that a firm must hold on an ongoing basis.

These are broadly based either on:

- annual fixed overheads
- value of average monthly transactions
- annual income from money remittance business

Dealing with complaints

Transitioning firms have already been covered by the FSA's complaints rules since 1 November 2009. The FSA's supervisory approach for money transfer businesses is currently 'complaints led supervision'. This means that rather than spreading their attention equally across the whole industry, they focus their supervision on 'riskier' firms and firms who come to their attention because 'things are going wrong'.

These are likely to be firms where there is a high level of complaints or a high level of, or increase in, cases being referred to the Financial Ombudsman Service ('FOS'), the referral body for customers for FSA regulated complaints.

To minimise regulatory attention, and FOS costs, it is best to firstly avoid actions which could result in a complaint, but also to ensure that complaints received are investigated and handled appropriately and customers are treated fairly.

FOS publishes industry newsletters containing 'case studies' and a previous issue focused on complaints from money transfer business carried out by banks. A few of the cases featured are summarised below.

Case Study 1 - Failure to successfully recall a payment

The customer had requested a transfer to purchase a second-hand car from Hungary. Having done so, he realised that the car's value had been misrepresented. Within 1.5 hours, he requested that the bank recall the transfer. However the bank only actioned this 2 days later by which time the recipient had withdrawn the funds. The customer's initial complaint to the bank had been unsuccessful.

FOS upheld the customer's complaint about the delay. They considered that the request to recall the funds had been carried out swiftly by the client but the bank had not actioned it. It was this delay that had allowed the funds to be withdrawn. In addition to a refund of the full amount of the transfer, the customer also received interest and compensation.

Case Study 2 - Transfer carried out incorrectly due to inaccurate details

The customer needed to transfer funds to Moscow, Russia. Having asked the bank to identify an appropriate recipient bank, his funds were transferred to a bank in Moscow, USA, in error. The customer had to make a duplicate payment to the correct bank and although the original amount was refunded, money had been lost due to the dollar conversion.

FOS upheld the customer's original complaint, and requested the bank reimburse the cost of the duplicate transfer, any funds lost on the original transfer due to conversion rates and also compensation for the mistake. FOS considered that the bank had not exercised reasonable care, and skill in selecting a recipient bank for the customer.

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Case Study 3 - Misleading exchange rate details

The customer wanted to transfer funds from their account in Ireland to the UK for a property purchase. The customer complained that on the basis of a conversion rate offered by the bank, they decided that it would be better to transfer the funds in Euro then convert to Sterling on receipt in the UK. When the transfer went ahead, a different conversion rate was used, less funds were received – and a transaction charge had been applied.

FOS did not uphold the original complaint. On the basis of the bank's records of the transaction, this evidenced that no specific conversion rate had been agreed or guaranteed with the customer. Instead FOS considered that the customer had seen this rate online and had relied on their own assumptions.

Case Study 4 - Funds delayed due to incorrect details

A customer requested funds to be transferred from their UK account to their French account to pay builders working on their French property. The transfer took three weeks to complete. In response to the customer's complaint, the bank claimed that the delay had been due to the customer's error in providing the transfer account details.

FOS partly upheld the complaint. In reviewing the records, it was clear that the customer had provided the correct details to the bank and so that it was the bank who had made an error with the input. FOS instructed the bank to reimburse the customer for any justifiable additional costs incurred, and pay compensation. It did not uphold that all the costs claimed were justified.

Conclusions

To avoid potential complaints – and to support any relevant defences – firms should:

- be clear about currency conversion rates, including possible fluctuations
- be clear about the timescales involved and any potential circumstances outside the firm's control
- be clear about any additional charges (known or potential) that could apply
- make sure there is a clear record of instructions received and transactions carried out
- make sure there is a clear understanding of the customer's needs and clarify anything unusual
- keep the customer updated if there are going to be any delays or if errors needed to be corrected
- make sure that defending a complaint is justified and the reasons can be evidenced if it is referred to FOS

The full newsletter is available on the FOS website: www.financial-ombudsman.org.uk