

20 October 2020

Payments Landscape Review
Payments and FinTech Team
HM Treasury
1 Horse Guards Road
SW1A 2HQ



Dear Sir or Madam

Payments Landscape Review: Call for Evidence

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In July 2020, HM Treasury issued a Call for Evidence in relation to its Payments Services Landscape Review (the "Call for Evidence"). The Call for Evidence sets out HM Government's aims for payment systems and payments networks in the U.K. and seeks responses to questions relating to future opportunities and risks for new payments systems and cross-border payments as well as how regulators may adapt to and promote new payment networks.

1. Financial technologies based on distributed ledger technology

The Call for Evidence provides an overview of changes to payment systems and payments networks over the past few years, including an increasing shift towards electronic-money and digital wallets, and asks, in question 23, what further trends, opportunities and risks may arise in this area over the next decade. The FMLC notes that, while the Call for Evidence states that input in the areas of cryptoassets, including stablecoins and Central Bank Digital Currencies, will be sought separately, no consideration has been given to changes to payments services which maybe anticipated given the development of financial technologies based on distributed ledger technology ("DLT").¹ DLT—of which blockchain is a better known and specific application—is a virtual system that relies on peer-to-peer networking, distributed data storage, and cryptography. DLT arrangements have the potential to facilitate certain payments clearing system processes in ways that are less expensive and possibly more resilient than the existing highly centralised processes. On a DLT-based payments clearing system, the process of transmitting, reconciling and confirming orders can be either eliminated or condensed and can occur without the need for financial intermediaries, increasing the system's efficiency, particularly in relation to real-time retail payment systems.

Market participants and authorities around the world are exploring the opportunity for innovation and efficiency in this area. While new operators of DLT-based payment services are likely to face a substantial regulatory barrier to entry—under, *inter alia*, the provisions of Directive (EU) 2015/2366 on payment services in the internal market ("PSD II") and Directive 98/26/EC on settlement finality in payment and securities settlement systems (the "SFD")²—it remains to be seen whether these pieces of legislation are compatible with the actors participating in, and the activities constituting, DLT-based arrangements.³ For example, the conflicts of laws provision in Article 9(2) of the SFD refers to the law of the Member State in which the securities register, account or centralised deposit system is located. It is unclear how this provision would apply in the context of securities which are issued, held and

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transferred on a multi-jurisdictional distributed ledger. The notions of register, account or deposit system do not align well with DLT applications, which operate without a central register, accounts or deposits.

Existing payments networks which are exploring the possible creation of DLT-based alternatives may raise questions of privacy since participating entities own so-called "nodes" and share transaction information among themselves.⁴ While so-called privacy-enhancing technologies/techniques have emerged to address these questions, there remains uncertainty around how integral third party processes to ensure accountability, such as audits, will be arranged on DLT-based payment and settlement systems.

The FMLC would therefore urge HM Government to consider the uncertainties which may arise in relation to DLT-based innovation in the area of payments systems.

2. Limitations on the statutory and regulatory regimes applying to Payments Networks⁵

Separately, the FMLC has identified limitations and uncertainties in the existing statutory and regulatory regimes which currently (and will, in the future, increasingly) adversely impact upon the achievement of a number of principal aims expressed in, and touches upon the issues raised by Questions 4, 6 to 11, 13, 14 and 16 to 20 of, the Call for Evidence. Specifically, the Committee has identified a potential (likely unintended) "gap" in the statutory and regulatory regimes, as they apply to what we have called "**Broader Payments Network Activities**".⁶

Both Part 5 of the Financial Services (Banking Reform) Act 2013 ("**FSBRA**") and Part 5 of the Banking Act 2009 ("**BA09**") were enacted prior to the expansion of the concept of "payment services" by PSD2 and the UK Payment Services Regulations 2017 to incorporate payment initiation services and account information services. This suggests that the sole or primary focus of both statutory regimes was to regulate or supervise only those systems that support funds transfer services. This was the accepted scope of payment services at the time the relevant provisions became law. It was not to regulate or supervise services that are one or more steps removed from the processing, clearing and settlement of payment orders instructing or requesting the transfer of funds or money. The Committee has therefore identified that, in light of the recent proliferation of new payments firms, using new technology to provide new payments-related services or functionality (which do not form part of a "payment system"), it is not clear that the existing regulatory regimes under FSBRA and the BA09 ensure appropriate regulation and supervision of these Broader Payments Network Activities.

The FMLC would therefore urge HM Government to consider whether such regulatory regimes ought to be amended to expand their scope to cover the Broader Payments Networks Activities and bodies which manage or administer such activities within a payments network ("**Payments Network Administrators**"). Such an expansion would help to minimize or remove any concern or uncertainty that:

- (a) the statutory and regulatory frameworks may not (in certain key respects) provide a well-founded, clear and robust legal basis for the Broader Payments Network Activities; and
- (b) the operation and administration of the Broader Networks Activities by Payments Network Administrators in the payments ecosystem are properly

subject to regulation by the Payment Systems Regulator under FSBRA and/or supervision by the Bank of England under the BA09.

The potential limitations which exist in the current FSBRA and BA09 statutory frameworks, stem from:

- (1) the narrow scope of the functions and facilities covered by the concept of a "payment system" (as defined in section 41(1) of FSBRA and section 182(1) of the BA09, respectively);
- (2) the associated restrictions on the scope of the functions that may be properly performed by an "operator" of a payment system (as defined in, or interpreted in accordance with, section 42(3) of FSBRA and section 183(a) and (b) of the BA09 respectively); and
- (3) the restricted scope of those persons who are identified as "participants", and in particular "payment service providers", in or in relation to a regulated payment system (under section 42(2) and (5) of FSBRA).

The FMLC would therefore encourage HM Government to seek to address the limitations identified above in order to provide a regulatory environment that can properly support the promotion and development of new and existing payments networks, as well as ensuring a well-founded, clear and robust legal basis for such developments.⁷

The Committee believes that implementation of appropriate statutory changes to FSBRA and the BA09 to address this "gap" should contribute to the UK regulatory landscape remaining fit for purpose for the medium to longer term. The FMLC would also recommend that consideration be given to the regulatory treatment of cross border payments in fiat currencies which involve a fiat-to-digital currency exchange and a digital-to-fiat currency exchange at the points of origination and receipt, which are effected between these points on a digital platform in a cryptocurrency. These situations can give rise to legal uncertainty—for example, in relation to the application of consumer protection and conduct of business requirements—given that the payer and payee are dealing in fiat currency but the transfer itself is made outside a traditional payments system via a cryptocurrency platform.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours faithfully,

A handwritten signature in black ink that reads "Joanna Perkins". The signature is written in a cursive style with a large initial 'J'.

Joanna Perkins
FMLC Chief Executive⁸

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- ¹ The FMLC has considered questions around governing law in the context of DLT in a 2017 Paper. FMLC, Report: Distributed Ledger Technology and Governing Law, (27 March 2018), available at: <http://fmlc.org/report-finance-and-technology-27-march-2018/>.
- ² In the UK, PSD II was implemented by means of the Payment Services Regulations 2017. The SFD was implemented in the U.K. by the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (SI 1999/2979) and “onshored” in preparation for Brexit, by the Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2018.
- ³ The FMLC has considered this question in Part II of its response to the European Commission’s Consultation Document on an E.U. framework for markets in cryptoassets. See FMLC, Response to European Commission Consultation: Framework for Markets in Cryptoassets (17 March 2020), available at: <http://fmlc.org/response-to-european-commission-consultation-framework-for-markets-in-cryptoassets-17-march-2020/>, paragraphs 2.14-2.15.
- ⁴ A DLT network is established via peer-to-peer “nodes” or devices running the requisite software.
- ⁵ The Committee notes, and agrees with, the approach of the Call for Evidence document that distinguishes between what it refers to as a “payments network” (as described in paragraph 2.1 of the document) and a “payment system”. We think this distinction is correct and is required because in a “payments network” there are broader players, processes and systems that operate outside the perimeter of a “payment system”. Examples include the new-generation of “overlay services” administered by system operators and other fintechs, pioneered by the Payment Strategy Forum as part of their vision for more innovative and consumer-focused payment services, which operate as part of a payments network but which are one or more steps removed from the functions and facilities provided or performed as part of the core retail payment system itself, see the NPA Design and Transition Blueprint published by the Payments Strategy Forum in December 2017.
- ⁶ “Broader Payment Network Activities” for the purposes of this paper, refers to those processes and systems that operate as a “payments network” (or similar term) but which do not form part of a “payment system” (as defined in section 41(1) FSBRA or section 182(1) BA09, respectively).
- ⁷ Payments Network Administrators that manage or administer a “payments network” operated or administered outside the perimeter of a “payment system” (as defined in FSBRA and/or the BA09) will wish to have complete confidence as to the legal and regulatory basis under which they perform their management, governance, standard-setting or other functions under or in relation to the network. Participants or potential participants in such payments networks will equally wish to know that in performing such functions under or in relation to the network, such Payments Network Administrator is subject to regulation by the PSR (with respect to the service-user, innovation and competition objectives) and, potentially, supervision by the Bank of England (with respect to the financial stability objective).
- ⁸ The FMLC is grateful to Natalie Lewis (Travers Smith LLP) for her assistance in drafting this paper and the following members of the [Infrastructure](#) and [FinTech](#) Scoping Forums for their assistance in reviewing this paper: Arun Srivastava (Paul Hastings LLP), Jonathan Gilmour (Travers Smith LLP) and Deborah Sabalot (Deborah A. Sabalot Regulatory Consulting).