

E-money and e-money accounts – a guide for lenders



The development of the fintech sector over the last ten years has transformed payment systems with more individuals and businesses moving away from cash payments to using electronic money ("e-money"). In November 2022, Revolut announced it was processing more than 330 million transactions per month and had surpassed 25 million retail customers globally. The total amount of e-money transactions made in the EU reached 4.8 billion in 2019. The use of e-money accounts, rather than traditional bank accounts, in secured financing transactions poses novel legal issues. Without thorough analysis and understanding of these issues, security documents may not create valid or effective security over the e-money deposits and may fail to provide adequate protection to the lenders.

In this note, we explain the operation of e-money accounts and some practical steps for lenders to consider when taking security over e-money.



What is e-money and how is it deposited?

E-money is the fintech version of 'cash at bank'. Electronic money institutions ("EMIs") (such as Revolut, Starling, and Modulr) are each a type of financial institution authorised to issue and manage e-money on behalf of their customers. An e-money account is an electronic store of monetary value which is represented by a claim against the relevant financial institution (the EMI) which a third party will accept as being equivalent to real cash.

A customer's cash is converted to e-money on being deposited into an e-money account. The 'deposit' is used to buy an e-money balance with the EMI, with that balance being given a monetary value as represented by a claim against the EMI for the return of the cash deposit.

The Electronic Money Regulations 2011 (SI 2011/99) ("EMRs") are the primary legislation governing EMIs and e-money in the UK. Under the EMRs, an EMI is required to 'safeguard' its customers' funds. This means that when an EMI receives a cash deposit from a customer in exchange for issuing e-money to that customer, the EMI is required to back-up the electronic store of monetary value represented by an e-money account and comply with the safeguarding regime. One of the ways it can do this is by segregating the money into a special safeguarding account/s (being any traditional deposit account held with a third-party credit institution with the funds kept separately from the EMI's own money).



How is e-money withdrawn and used?

Under the EMRs, an EMI is under a statutory obligation to allow its customers to 'redeem' the monetary value of the e-money at par value and at any time – this is the equivalent of customers withdrawing cash at bank. Thereafter, its customers can 'use' the money for payment transactions.



Can a lender take fixed security over e-money and an e-money account?

In a secured financing transaction, it is standard practice for a lender to take a fixed charge from an obligor over cash at bank and traditional bank accounts and control the withdrawals from those accounts. It is well established now that without a requirement that the charged accounts are blocked, any purported fixed security is likely to be re-characterised as floating.



Can a lender take fixed security over e-money and an e-money account? (continued)

Security over e-money accounts and balances cannot be taken in the same way as traditional bank accounts. In particular:

1. security cannot be taken over e-money accounts or e-money; security can only be taken over the claim that the obligor has against the EMI for the redemption value of its e-money and the proceeds of that claim;
2. it is not possible to take security over the EMI's safeguarding accounts or the balances in those accounts; the obligor does not have any interest in these accounts; and
3. the statutory obligation on EMIs to allow their customers to 'redeem' the monetary value of the e-money referred to above is important, as it means that it is not possible to block an e-money account. In order to constitute e-money, the balance of the e-money account must be capable of being used for payment transactions at all times.



What should a lender consider when an obligor uses an e-money account?

When considering a transaction involving an e-money account, a lender should:

1. identify e-money accounts held by an obligor;
2. confirm that the e-money accounts are assets of the obligor, the e-money accounts are made available to the obligor as a customer of the EMI and are held by the EMI in the obligor's name, and the obligor is entitled to the funds (that is, it is not a client account);
3. check the terms and conditions of the e-money accounts, including:
 - (a) the governing law;
 - (b) whether there is a negative pledge (that is, a restriction on the grant of security by the obligor);
 - (c) the details of how instructions may be given by an obligor to the EMI in respect of its e-money accounts and whether the obligor can delegate its authority to others (this will inform any changes required to notices served on the EMI under the security document); and
 - (d) any restrictions on the obligor granting a security power of attorney;
4. consider the suitability of an obligor's e-money accounts for the transaction in terms of the required account structure, payment waterfalls, and blocked accounts;
5. consider:
 - (a) the amendments required to standard form security documents to reflect the points outlined above;
 - (b) what contractual restrictions can be imposed on the obligor's operation of the e-money accounts and redemption of the e-money (including a negative pledge, non-disposal undertaking, and a permitted payments regime); and
 - (c) the circumstances in which the lender can require the obligor to redeem the e-money and then deposit the real cash into a traditional bank account that is subject to fixed security in favour of the lender,(the provisions to be included in a security document should be considered on a transaction-by-transaction basis); and
6. consider including a requirement that the obligor engages with its EMI to approve the form of any notice to be served under the security document prior to completion of the transaction, to ensure that signed acknowledgements from the EMI are obtained and take into account any amendments required by the EMI.



Conclusion

Whilst it is possible for a lender to take valid, effective, and enforceable security over e-money, the e-money terms and conditions require careful review and the security documents will need to be adapted accordingly. Where fixed security over bank accounts and cash deposits is fundamental to a financing structure, such as a blocked rent account in a traditional real estate finance transaction or an issuer account in a receivables financing transaction, e-money accounts are unlikely to be suitable. Therefore, security arrangements and lenders' and borrowers' requirements need to be considered at the outset of each transaction.

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