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Taking security in relation to e-money and e-money accounts

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This note looks at the nature of e-money, whether security can be taken in relation to e-money, the type of security that can be taken in relation to e-money and how that security can be perfected and enforced.

Scope of this article

The emergence of electronic money institutions and electronic money (e-money) over the past decade has been one of the key advancements in the fintech sector. Recent data submitted to the Financial Conduct Authority (FCA) indicates there is €9.7 billion of e-money funds in issue in the UK. Although operating in a similar way to a traditional payment system, there are distinct differences between the two which pose novel legal issues.

This note looks at the nature of e-money, whether security can be taken over e-money, the type of security that can be taken in relation to e-money and how that security can be perfected and enforced.

Nature of e-money

E-money is defined as the monetary value that is represented by a claim on the issuer which has all of the following characteristics:

- It is stored electronically, including magnetically.
- It is issued on receipt of funds.
- It is used for the purposes of making payment transactions.
- It is accepted as a means of payment by persons other than the issuer.
- It is not otherwise excluded by the Electronic Money Regulations 2011 (SI 2011/99) (EMR 2011).

E-money is issued by a financial institution authorised to issue and manage e-money on behalf of its customers. These financial institutions are known as electronic money institutions (EMIs).

When a customer places cash into an e-money account, the cash 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 funds.

The EMR 2011 are the primary legislation governing e-money and EMIs in the UK. Under the EMR 2011, EMIs are under a statutory obligation to allow customers to redeem the monetary value of the e-money at par value and at any time (subject to any agreed conditions to redemption, such as redemption fees, that must be prominently stated in the contract between the EMI and customer). This is the equivalent of customers withdrawing cash at a bank. Thereafter, the customer can use the money for payment transactions with persons other than the EMI. (For more information on the EMR 2011, see Practice note, Understanding the scope of the Electronic Money Regulations 2011.)

Is it possible to take security over e-money?

Yes, security can be taken over e-money and e-money accounts by taking security over the claim that the customer has against the EMI for the redemption value of its e-money and the proceeds of that claim (for more information, see What type of security may be created in relation to e-money and e-money accounts?.

The main difference between taking security over cash held at a bank and traditional bank accounts and security over e-money and e-money accounts is that the EMI cannot agree to, or acknowledge, a blocked account mechanism, that is, it has to allow redemption (see E-money accounts cannot be blocked).

For information on taking security over a traditional bank account, see Practice note, Taking security over cash deposits.

E-money accounts cannot be blocked

It is not possible to block e-money accounts as EMIs have a statutory obligation to allow redemption by the customer at any point (subject to the customer complying with any agreed conditions) and, in order

to be e-money, the balance must be capable of being used for the customer's payment transactions (definition of "electronic money" in regulation 2, *EMR 2011* and *regulations 39 and 40, EMR 2011*).

An EMI can set conditions on the following:

- The use and spending of the e-money (for example, the EMI can refuse a payment instruction if they think it is fraudulent or the customer has not entered all of the required information).
- The redemption of the e-money back to fiat currency (for example, the customer must request a redemption via a specified process or the customer can only redeem if it pays a fee (note that there are rules on the types of fees that an EMI can charge consumers)).

Both of these "restrictions" on use and redemption must be part of the original contract and therefore disclosed and agreed to prior to the customer being bound by them.

A customer can agree with a lender not to redeem the e-money. The fact that a customer has elected not to use or redeem the e-money, or that it would breach a separate contract by doing so, does not make the e-money incapable of use or redemption at any point, and therefore it is still e-money from the EMI's perspective. A lender should therefore be able to get protection without compromising the EMI's regulatory position by including a negative undertaking in the security agreement from the customer whereby the customer agrees (for the benefit of the lender) that it will not redeem that e-money.

E-money accounts may not, therefore, be considered suitable accounts for a lender to take security over if they will be relying on fixed charge security over bank accounts as part of their transaction structure and who will therefore require blocked bank accounts (for example, in the case of a lender requiring a blocked rent account in a real estate finance transaction). For information on taking a fixed charge over an e-money account, see What type of security may be created in relation to e-money and e-money accounts?.

Security over safeguarding accounts

EMIs are subject to a regulatory requirement to safeguard the cash deposits paid by customers by backing-up the electronic store of monetary value represented by an e-money account and complying with the safeguarding regime (regulation 21 and 22, *EMR 2011*).

An EMI can comply with the regulatory requirement to safeguard customers' cash deposits by doing one of the following:

- Segregating the money into traditional deposit accounts held with third-party credit institutions for the purpose of keeping the funds separate from the EMI's own money.
- Investing the money in secure, liquid, low-risk assets which have been approved by the FCA and are held in a separate account by a custodian.
- Holding an insurance policy or bank guarantee in relation to the safeguarded funds, and setting up a segregated account to hold any proceeds from a pay-out under these.

Safeguarding accounts (and the cash in those accounts) are ringfenced in the event of the insolvency of the EMI.

The safeguarding regime does not allow any security to be taken over an EMI's safeguarding accounts or the cash in these accounts (as this would undermine the purpose of them). In addition, money in the safeguarding accounts is not the customer's and it is not held on trust for the customer, so a customer has no interest in a safeguarding account over which a lender could take security. This is despite the fact that the Prudential Regulatory Authority has recently changed its Depositor Protection Rules to allow customers to potentially benefit from Financial Services Compensation Scheme (FSCS) cover in the event the deposit taker at which a safeguarding account is held becomes unable to repay the safeguarding balance (for information on the FSCS, see Practice note, Financial Services Compensation Scheme (FSCS): overview).

What type of security may be created in relation to e-money and e-money accounts?

Due to the nature of e-money (see Nature of e-money), security in relation to e-money and e-money accounts is taken by taking security over an account holder's rights against the EMI to redeem the balance held in its e-money accounts and the proceeds of that claim against the EMI. These rights and proceeds constitute choses in action and for more information on taking security over choses in action, see Practice note, Taking security over choses in action.

For information on the provisions a security taker may wish to include in the relevant security document to protect its security, see Documentary considerations.

Floating charge

It is possible to take a floating charge over an account holder's claim against an EMI and the proceeds of that claim. For information on taking a floating charge, see Practice note, Taking security: Floating charge.

Fixed charge

It is also possible to take a purported fixed charge over an account holder's claim against an EMI and the proceeds of that claim.

It is crucial to the nature of a fixed charge that the security taker has control over the charged asset (see Practice note, Taking security: Control is crucial). In the case of a traditional bank account, a security taker will often use a blocked account mechanism to ensure that it can take a fixed charge over a bank account. However, as noted above (see E-money accounts cannot be blocked), e-money accounts cannot be blocked and an e-money account holder must be free to redeem its e-money so reducing the control a security taker might exercise over the account holder's claim against the EMI. There is currently no case law on the control required to create a fixed charge over an e-money account holder's rights against an EMI to redeem the balance held in its e-money accounts and the proceeds of those claims against the EMI. Therefore, a purported fixed charge over an account holder's claim against an EMI could be subject to challenge or re-characterisation as a floating charge (because the position remains untested).

A security taker wishing to take a fixed charge over an account holder's claim against an EMI (and the proceeds of that claim) should, therefore, consider taking a floating charge alongside any purported fixed charge.

How can security in relation to e-money and e-money accounts be perfected?

Perfecting a security interest is important to ensure the security is valid against any relevant third parties and to ensure the security has the intended priority over other creditors of the security provider (although it does not guarantee validity and priority in all circumstances). For more information on perfecting security generally, see Practice note, Perfection and priority of security.

Perfecting security in relation to e-money and e-money accounts may involve the following:

Registration at Companies House

A fixed or floating charge in relation to e-money created on or after 6 April 2013 by a company or limited liability partnership registered in England and Wales may be registered at Companies House (section 859A, Companies Act 2006).

Although registration at Companies House is voluntary, there are consequences for both a security taker and the security provider if the particulars of a charge are not delivered within the specified 21-day time limit (see Practice note, Registration of charges created by companies and limited liability partnerships on or after 6 April 2013: What is the effect of failure to deliver a section 859D statement of particulars before the end of the period allowed for delivery). These consequences mean that both the security provider and the security taker will want to see that particulars of such a charge are delivered to Companies House within the time limit.

For more information on registering charges at Companies House, see Practice note, Registration of charges created by companies and limited liability partnerships on or after 6 April 2013.

Giving notice to the EMI

As the security taken in relation to e-money and e-money accounts is over choses in action (see What type of security may be created in relation to e-money and e-money accounts?), giving notice of that security to the EMI serves to protect the security taker in a number of ways. For more information, see Practice note, Taking security over choses in action: Notice.

In particular, if a security taker wants to take a fixed charge, it is good practice to give notice of that security to the EMI because this assists with demonstrating the requisite level of control for upholding fixed charge security. Any such notice should be tailored to reflect that the security granted is over e-money and e-money accounts and not over cash held at a bank and bank accounts. For more information on giving notice of security to an EMI, see Documentary considerations.

How can security in relation to e-money be enforced?

The enforcement options available to a security holder will vary depending on a number of factors including the type of security taken, the terms of the relevant security document and whether the security document has been executed as a deed.

A security document will typically contain detailed enforcement provisions that govern how and when the security holder can enforce its security. Ideally enforcement powers will be as broad as possible and will be tailored to reflect the nature of the secured assets and the enforcement methods the security holder may require given the assets over which it is taking security.

In the case of security in relation e-money, the key methods of enforcing security that a security holder is likely to wish to use are appointing an administrator and appointing a receiver.

For more information on enforcing security generally, see Practice note, Enforcing security: overview.

Appointing an administrator

To be able to appoint an administrator using the out-of-court process (which is cheaper and more flexible than appointing an administrator by applying to court), a

security holder must hold a qualifying floating charge. The chargor must be a company, a limited liability partnership or a partnership. For these purposes, a person is a qualifying floating charge holder if they hold one or more charges and other forms of security (at least one of which must be a qualifying floating charge) in relation to the whole or substantially the whole of the chargor's assets and undertaking (paragraph 14, Schedule B1, Insolvency Act 1986).

An administrator acts as the chargor's agent, and can therefore redeem the e-money in an e-money account for the benefit of the security holder (subject to any prior ranking claims ahead of the security holder's claims according to the order of priority on insolvency).

For more information on the power of a qualifying floating charge holder to appoint an administrator, see Practice note, Administration: Routes into administration.

Appointing a receiver

A fixed charge holder may appoint a receiver over the secured assets to enforce its security. This may require the charge to be crystallised if it is re-characterised as a floating charge.

A receiver acts as the chargor's agent and can therefore redeem the e-money in an e-money account, but for the benefit of the security holder (subject to any prior ranking claims ahead of the security holder's claims according to the order of priority on insolvency).

For more information on appointing a receiver, a receiver's powers and the duties of a receiver, see Practice note, Enforcing security: overview: Appointing a receiver.

Does taking security in relation to e-money raise any regulatory issues?

Regulatory issues may affect taking security in relation to e-money and have an impact on a person taking such security.

For example, EMIs are subject to a special administration regime under the Payment and Electronic Money Institution Insolvency Regulations 2021 (SI 2021/716) (EMI Insolvency Regulations 2021) These regulations provide that an administrator is obliged to take reasonable steps to identify any relevant funds held as funds in the institution's own accounts, and transfer those funds into an appropriate relevant funds account to make up any shortfall of funds (regulation 14(2)(b) , *EMI Insolvency Regulations 2021*). If the administrator fails to do this, a customer could take action against the administrator. The "relevant funds" are defined as funds which are received in exchange for e-money that has been issued which should have been safeguarded under regulation 14(2)(a) of the EMI Insolvency Regulations 2021. In order to establish the amount of the relevant funds that must be deposited to the safeguarding account to make up the shortfall, the administrator must assess the difference between the fiat currency par value of the current e-money balances and compare this to the safeguarded balances.

It is not however possible to take security over the asset pool itself, but it means customers' claims against the EMI should be met (to the extent there are funds in the general accounts of the EMI to transfer to the asset pool).

It is not yet definitive if the obligation of the administrator to transfer those funds to make up any shortfall of the customer takes priority over the claims of other creditors of the EMI, in particular secured creditors. Recent case law has, however, gone some way to clarifying the situation. In Ipagoo LLP (In Administration), Re [2022] EWCA Civ 302, the Court of Appeal held that whilst the money, other assets, insurance policy or guarantee received from its customers are not held by an EMI on trust for them (and therefore remain the assets of the EMI), on any insolvency of the EMI the customers are granted rights over that asset pool in priority to other creditors of the EMI. Further, if there is a shortfall in the asset pool that shortfall is to be made up from other assets of the EMI. It is worth noting that the *Ipagoo* case pre-dates the EMI Insolvency Regulations 2021 coming into force and in all likelihood the EMI Insolvency Regulations 2021 would apply today in the case of a situation with the same fact pattern as the *Ipagoo* case. However, ruling in the *Ipagoo* case would apply if an EMI was subject to a normal, not a special administration. For more information on *Ipagoo*, see Legal update, Court of Appeal upholds ruling that EMRs do not create a statutory trust in favour of electronic money holders.

Key considerations for a lender taking security in relation to e-money and e-money accounts

When looking at a transaction involving taking security in relation to e-money and e-money accounts, a lender should consider the following issues:

Identify the e-money accounts

The lender should identify the e-money accounts held by the intended security provider and conduct the necessary due diligence on those accounts. Due diligence should include confirming the following:

- The relevant e-money accounts are assets of the security provider, that is, the e-money accounts are

made available to the security provider as a customer of the EMI and are held by the EMI in the security provider's name.

- The security provider is entitled to the funds in those e-money accounts (that is, they are not client accounts).

Terms and conditions of e-money accounts

The lender should review the terms and conditions of the e-money accounts, considering the following in particular:

- The governing law of the e-money accounts.
- Whether there are any restrictions on the grant of security by the security provider over its e-money accounts (that is, over its rights against the EMI to redeem the balance held in its e-money accounts or the proceeds of its claim against the EMI for the balance in its e-money accounts).
- The details of how the security provider can give instructions to the EMI concerning its e-money accounts and whether it can delegate its authority to give those instructions to others.
- Whether there are any restrictions or controls on the account holder either:
  - delegating authority in relation to who can operate the account on behalf of an e-money holder; or
  - granting a power of attorney in favour of the security holder.

Suitability of e-money accounts as secured assets

The lender should consider whether security over the security provider's e-money accounts will be suitable security for the proposed secured financing transaction. Note that, because of the way in which security must be taken in relation to them and regulatory requirements (see Is it possible to take security over e-money?), e-money accounts are not suitable for transaction structures which require blocked accounts.

Documentary considerations

In terms of documenting security in relation to e-money and e-money accounts, the lender will need to consider the following:

- Security in respect of e-money should be accompanied with a suite of negative undertakings in relation to the claim against the EMI and the security provider's operation of the e-money accounts (including as a minimum, a negative pledge, a non-disposal undertaking, and a permitted payments regime).
- The governing law of the security document should align with the governing law of the terms and conditions of the e-money account.
- The security document should include a power of attorney executed by deed in the security holder's favour (which, amongst other things, should provide for the right for the attorney to redeem the e-money and transfer the funds into a traditional blocked account in a default scenario).
- The lender should consider including additional events of default and undertakings in the related facilities agreement in relation to the insolvency of, or insolvency proceedings in relation to the EMI.
- The lender should consider setting out in the security document circumstances in which it can require the security provider to redeem the e-money and deposit the cash into a traditional bank account that is subject to fixed charge security in favour of the lender (for example, on an event of default (or other enforcement trigger) or on giving advance notice).
- The lender should include a requirement in the security document that the security provider engages with its EMI, before the transaction completes, to approve the form of any notice of security to be served under the security document. This is so that any amendments to the notice, or form of acknowledgement of the notice, required by the EMI can be taken into account before completion and to ensure that the security provider obtains the signed acknowledgement of the notice from the EMI.

To what extent are parties taking security in relation to e-money in practice?

E-money accounts are becoming more prevalent, and security over e-money is common in transactions involving start-ups and fintechs in particular.

In recent practice, security documents being entered into in financing transactions have tended not to make a distinction between traditional bank accounts and e-money accounts. It is important, however, for security documents in financing transactions to be tailored appropriately to enable a lender to take valid, effective, and enforceable security over e-money.