



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

fscs

Financial Services
Compensation Scheme

Memorandum of Understanding between the Bank of England and the Financial Services Compensation Scheme Ltd.

Purpose and Scope

1 The Financial Services Compensation Scheme (the Scheme) exists to provide protection for eligible customers of failed financial services firms. The Scheme is established under the Financial Services and Markets Act 2000, as amended (FSMA), and is administered by the Financial Services Compensation Scheme Ltd as the scheme manager (FSCS). It supports regulatory objectives under FSMA.

2 The Bank of England (exercising its prudential regulation functions) authorises firms and sets rules relating to the Scheme and the FSCS. These functions are undertaken alongside the Financial Conduct Authority (FCA). References in this document to the Prudential Regulation Authority (PRA) shall be read as references to the Bank acting in its capacity as the PRA.

3 This Memorandum of Understanding (MoU) sets out the framework agreed between the PRA and the FSCS. It has been agreed pursuant to section 217A(1) and (2) of FSMA, which places both parties under a duty to take such steps as they consider appropriate to co-operate with each other in the exercise of their functions under Part 15 and 15A of FSMA and to maintain a memorandum describing how they intend to comply with that duty.

4 This MoU replaces the previous MoU which was adopted in 2013 and does not affect any arrangements under other MoUs. This MoU is separate from the Cooperation Protocol between the Bank of England (acting as a resolution authority) and the FSCS.

Roles and responsibilities of the PRA

5 The PRA is responsible for the authorisation and prudential supervision of deposit takers (including banks, building societies and credit unions), insurers (including friendly societies) and certain designated investment firms. Its objective is to promote the safety and soundness of firms it regulates, and it is required to advance this objective primarily by seeking to minimise any adverse effects of firm failure on the UK financial system and to ensure that firms carry on their business in a

way that avoids adverse effects on the system. In the case of insurers, the PRA has the additional objective of contributing, through its prudential supervision of insurers, to secure an appropriate degree of protection for those that are or may become policyholders.

6 As set out in the FSMA (Financial Services Compensation Scheme) Order 2013, the PRA is responsible for making rules that determine the arrangements for providing protection in relation to deposits and insurance provision, including rules around the funding of this protection, as part of the PRA Rulebook (Depositor Protection Part, Dormant Account Scheme Part and the Policyholder Protection Part). The FCA is responsible for making rules for all other types of financial activity covered by the Scheme.

7 The PRA (jointly with the FCA) is responsible under section 212(2) FSMA for ensuring that the FSCS is capable of exercising its functions.

8 Under section 212(4) FSMA, the directors of the board of the FSCS are appointed and liable for removal from office by the PRA (jointly with the FCA). The approval of HM Treasury is required with respect to the appointment of the Chair and the Chief Executive. In accordance with section 212(5) FSMA, the directors are appointed on terms that secure their independence from the PRA and FCA in the operation of the Scheme. As and when required, the PRA, FCA, HM Treasury and FSCS will agree on an appropriate process for the appointment and approval of directors to the Board to ensure that timely approvals and appointments can be made.

Roles and responsibilities of the FSCS

9 The Scheme protects customers that incur financial losses when firms authorised by the PRA and regulated by the PRA and/or FCA are unable, or likely to be unable, to satisfy claims against them. The FSCS and its Board is operationally independent from, but accountable to, the PRA for the effective operation of the Scheme in relation to the Depositor Protection Part, Dormant Account Scheme Part and the Policyholder Protection Part.

10 The FSCS' specific functions under FSMA include, with respect to the PRA:

- establishing and implementing procedures to enable it to deliver its responsibilities to administer the Scheme;
- determining and collecting levies to cover management expenses and the costs of delivering depositor and policyholder protection eg payout or continuity; and
- reporting to the PRA, as described in this MoU, on how it has met its responsibilities.

11 Under section 224ZA FSMA, the FSCS must also have regard to the need to ensure efficiency and effectiveness in the discharge of its functions and the need to minimise public expenditure attributable to loans made or financial assistance given to it for the purposes of running the Scheme.

Regular engagement

12 Annually the PRA will outline to the FSCS its priorities in relation to the FSCS. The FSCS will put in place appropriate strategies and plans to deliver the priorities proposed.

13 In carrying out its duty to ensure that the FSCS is at all times capable of discharging its functions under FSMA, the PRA will regularly discuss with the FSCS the approach to and performance of its responsibilities in relation to the PRA, including against the FSCS' management plans and its budget, supported by relevant information about the key drivers for the budget and any investment proposed. This should be supported by relevant information about Scheme activities, eg the number of claims by type of business received, decisions taken and pay outs made. The FSCS will keep the PRA informed on the risks to delivery of the identified priorities.

14 This engagement will take place via regular bilateral (and where necessary, trilateral with the FCA) meetings at working and senior level, and will factor in the FSCS' annual strategic planning and budget process.

15 In addition to the regular bilateral meetings between both parties, the FSCS Chair will be invited to attend a relevant meeting of the Prudential Regulation Committee (PRC) at least once a year. Both parties will, on a regular basis, provide the other's Non-Executives with the opportunity to attend induction briefings, to ensure that all Non-Executives have an up-to-date understanding of the duties of the other organisation, its role in the regulatory environment, and their respective duties.

Information sharing

16 Both parties undertake to share information to allow them to fulfil their respective responsibilities, subject to any legal obligations or restrictions.

17 The FSCS will keep the PRA informed in relation to matters which may pose risks to its delivery of its functions under FSMA with respect to its obligations to the PRA. This includes the following:

- issues concerning the interpretation and effectiveness of the Depositor Protection Part, the Dormant Account Scheme Part and the Policyholder Protection Part, including those on disclosure;
- the eligibility of claims;
- its assessment of firms' capacity to support or assist it in paying out quickly;
- the intended timing, planning, and results of stress tests of its plans and systems in accordance with and to support the Depositor Protection Part, or of its plans and systems for policyholder protection. The PRA will where possible support such stress tests as appropriate;
- cases in which it becomes aware that firms are not in compliance with the Depositor Protection Part and the Policyholder Protection Part in ways that may impact the delivery of FSCS' responsibilities;
- any legal or process issues that could materially affect its funding needs or ability to levy;
- any actual or likely material litigation on its behalf (or against it), particularly those it pursues in respect of the Depositor Protection Part and the Policyholder Protection Part in order to make recoveries and those that could have a material adverse effect on its funding needs; and
- any material issues that arise relating to co-operation with other European Union Deposit Guarantee Schemes (DGSs) or protection schemes in other countries or jurisdictions.

18 The PRA will keep the FSCS informed of any regulatory or market developments that may affect the current or future planning or operation of the Scheme. In times of market disruption, or as the likelihood of a specific firm failing increases, both parties acknowledge that information sharing will become more intensive.

- The PRA will engage with FSCS (and firms) as necessary to address any issues identified by FSCS (or firms) affecting the operations of FSCS and the discharge of its responsibilities.
- Both parties will where possible provide copies to the other of reports and other submissions made to the European Banking Authority and European authorities regarding the FSCS and/or depositor and/or policyholder protection. In addition, the FSCS should inform the PRA when it signs up to a co-operation agreement with another European Union DGS in order that the PRA can, in its capacity as the designated authority, notify the European Banking Authority as required by the Deposit Guarantee Schemes Directive.

Confidentiality

19 Both parties will protect the confidentiality and sensitivity of all unpublished regulatory and other confidential information received from the other party (including information received initially

from third parties) in accordance with requirements imposed by or under FSMA, applicable data protection law or other relevant legal obligations.

20 Where one party has received information from the other, it will consult before passing the information to a third party, unless it is being shared with relevant UK governmental or regulatory organisations, including HM Treasury and the FCA.

Some relevant information may be received from third parties. Each party's ability to share such information with the other may in some instances be constrained by legal obligations. Both parties will seek to ensure that these instances are minimised.

21 The FSCS and the PRA will liaise, where relevant, on responding to enquiries from the public, including requests under freedom of information legislation. The FSCS and the PRA will also liaise concerning requests made by individuals for access to data held about them under the applicable data protection law. Each party will consult the other, or seek consent if necessary, before releasing information originally belonging to the other.

Policy making

22 Respecting each other's roles and experience, the parties will collaborate on policy matters of mutual interest. Where either party is engaged in domestic or international fora which will involve the discussion of policy, operational effectiveness or delivery, and planning or testing, or matters of common interest which may impact either party's ability to deliver on their functions under FSMA in respect of depositor and policyholder protection, they should seek advice or views from the other party and share relevant information.

23 Both parties agree to allow reasonable time, where appropriate, for each other to provide considered comments on material policies, consultations, publications and rules, as well as press releases and announcements, before they are made public.

Supporting the resolution of regulated firms

24 The FSCS will provide information, where requested, to support the PRA's assessment of a firm's resolvability and the likelihood that any failure would be orderly.

25 The PRA will notify the FSCS as soon as reasonably practicable upon becoming aware that a deposit-taker or insurer has financial difficulties or there is activity in the sector which may

reasonably likely to require either: (i) FSCS intervention; or (ii) a requirement for the FSCS to contribute funding. This will primarily be through, but not limited to, the operation of the Proactive Intervention Framework.

26 For deposit-takers, the FSCS will:

- assist in the assessment of deposit-takers' systems to conduct a payout, including through the verification of deposit-takers' ability to provide a Single Customer View (SCV) and exclusion file;
- keep the PRA informed of its preparedness to deliver on rapid payouts that are within its capability including if it believes there is a material risk that it would not be able to meet the target of seven days for pay out for the majority of depositors; and
- ensure that, at all times, the PRA is kept informed of the FSCS's procedures for coping with a significant failure of a firm that is beyond the capability of its existing dedicated staff and resources.

27 With regard to the resolution of credit unions, in its capacity as a competent authority the PRA will inform the FSCS when it detects problems in a credit union that are likely to result in FSCS intervention and provide all relevant information reasonably available to the PRA to enable the FSCS to plan accordingly.

28 During and/or following the handling of a failure, the FSCS will report to the PRA with regard to its progress. Both parties may jointly carry out lessons learned exercises following failures to identify whether the causes of failure and the specific nature of the failure might identify the need for future policy or rule changes or FSCS operational changes.

Supporting the resolution of regulated firms: Deposit takers (SCV)

29 The FSCS conducts SCV reviews in respect of selected deposit takers (including credit unions) to ensure that it is able to make timely pay outs to depositors under the Scheme, and to support supervisory oversight of such firms. The FSCS will carry out a number of SCV reviews to be annually agreed with the PRA, and according to agreed standards, and will report its observations, issues and themes. The FSCS will ensure the security of the data.

30 The PRA will promptly advise the FSCS of new deposit-takers (in terms of new UK firms, non-UK firms passporting in via branch, and UK firms passporting out of the UK via branch) and waivers

relating to the Depositor Protection Part. This will ensure that the FSCS has the chance to comment on and understand any SCV and cross-border implications and funding issues.

Supporting the resolution of regulated firms: Insurers

31 The PRA and the FSCS will coordinate around actual or potential insurance failures to ensure that policyholder protection can be provided in accordance with the relevant rules.

32 The PRA will:

- provide the FSCS with relevant information, where available, on a timely basis about the type of firm, its policyholders, lines of business, assets, jurisdictional locations and claims handling arrangements, and other issues that may assist the FSCS;
- keep the FSCS informed of actions taken to prevent a firm’s financial position deteriorating, where this might affect/enable the FSCS’s ability to meet obligations under the relevant rules; and
- seek to ensure that failure (should it occur) is orderly and will provide information where available to assist the FSCS with contingency planning for a likely or active failure and declaring defaults.

33 The FSCS will, on receipt of information provided by the PRA as described above:

- consider the available payment and continuity options and associated costs and benefits and any key risks and mitigations in relation to any identified firm; and
- ensure that, at all times, the PRA is kept informed if the failure of an insurer may be beyond the available resources of the FSCS;

34 The FSCS will also inform the PRA if the type and volume of enquiries it receives indicates high or unusual public concern about particular firms and notify the PRA if it becomes aware of problems in any insurer subject to the PRA policyholder protection rules (insofar as may jeopardise its solvency and the PRA is not already aware).

35 During and/or following the handling of an insurer failure, the FSCS will update the PRA on its progress, considering the requirements set out in the Policyholder Protection Part. Both parties may jointly carry out lessons learned exercises following failures to identify whether the causes of failure and the specific nature of the failure might identify the need for future policy or rule changes or FSCS operational changes.

Funding, levying and treasury management

36 As set out under FSMA, the PRA makes rules to set the FSCS's management expenses levy limit (MELL) for each financial year. The limit should be set before the end of the preceding financial year. In order for the PRA to be able to consult on the limit, the FSCS will provide to the PRA its proposed budget and its plan for review and discussion. The PRA, the FCA and the FSCS will co-ordinate the publication dates of the public consultation on the MELL and the FSCS's budget.

37 In support of this consultation process, the PRA and the FSCS will engage throughout the year at working and senior levels as agreed to ensure that the PRC can have suitable sight of, and input into, the assumptions made by the FSCS in determining its proposal for the following year's MELL. The FSCS will provide its final budget in good time ahead of its presentation to the PRC.

38 The FSCS will advise the PRA if circumstances change so that it is or may become unable to deliver its responsibilities within the current limit on management expenses. The FSCS will not incur expenditure in excess of its agreed MELL unless there is an exceptional and unavoidable cause (such as an unforeseen rise in claims volumes), about which it will quickly inform the PRA in order that the PRA (with the FCA) can give urgent consideration to consulting on, raising the MELL or consider an emergency rule change.

39 The FSCS will determine the Scheme levies in accordance with the PRA's rules so that it has sufficient funds to cover its management expenses and to identify, assess and pay out eligible claims and compensation costs. Proposed levies will usually be announced by the FSCS around the beginning of each financial year.

40 Interim compensation costs levies may be necessary where matters are not fully known in time for the announcement of the main annual levy. The PRA will discuss in advance, with both the FCA and the FSCS, whether the levy has or may have any significant effect on the market, a particular sector or individual firms and, where this is the case, what (if any) action might be reasonably practicable and appropriate to address that effect.

41 The Board of the FSCS is responsible for its treasury management policies, which cover the handling of cash balances and other invested funds. It will keep the PRA informed of these policies.

Compensation cost levies

42 The FSCS will maintain and publish a statement of its policy on raising compensation cost levies, having taken into account the views of the PRA and stakeholders, to include the policy on:

- raising annual and interim compensation cost levies, and those compensation cost levies that are to be allocated to the retail pool;
- estimating expected compensation costs;
- holding funds to meet expected compensation costs and refunding recoveries and other surpluses; and
- borrowing, which includes borrowing from commercial sources or the National Loans Fund, and for such purposes as for short term liquidity and longer-term funding needs.

Compensation cost levies – deposit takers

43 Should a situation arise that may require the payment of compensation under the Scheme, or to finance steps taken to resolve a deposit taker in financial difficulties, which (in either case) may result in material levies being imposed on deposit takers, the PRA will promptly, and urgently if required, consider the potential effects of proposed contributions on this class.

44 The PRA is required under Regulation 8 of the Deposit Guarantee Scheme Regulations 2015 to consider whether the FSCS is able to raise sufficient contributions from the deposit taker class via levies before the available financial means may be used. If the PRA determines that the FSCS is unable to raise a deposit compensation cost levy the FSCS may request to borrow an amount from HMT via the National Loans Fund (NLF). The PRA and FSCS will co-operate to ensure that FSCS has the appropriate funding for deposit taker failures.

45 Following the approach outlined in PRA's Statement of Policy – 'Calculating risk-based levies for the Financial Services Compensation Scheme deposits class' the PRA will provide the Aggregate Risk Weight (ARW) for each DGS member to the FSCS by 31 May of each year, for each deposit compensation cost levy. The FSCS should disclose this ARW to each DGS member when it is invoiced. Following the Statement of Policy the FSCS will ensure that the required levy is raised for each cycle.

Reporting to the PRA

46 As required under FSMA, the Board of the FSCS will report to the PRA on the discharge of its functions on an annual basis and will prepare and publish an Annual Report to support this. The report will be made within four months of the end of the financial year being reported on. The FSCS agrees to give reasonable time to allow the PRA to provide considered comments on drafts of its Annual Report and Accounts.

47 The FSCS will provide in the Annual Report a statement regarding its finances and a statement or summary of transactions of the deposits provision, general insurance provision, and life and pensions provision classes during the year.

48 Under section 74 of the Financial Services Act 2012, there are circumstances in which the PRA must carry out an investigation and report on a possible regulatory failure. If requested, the FSCS will provide a comprehensive report to the PRA, setting out the facts and circumstances of its involvement, to aid the PRA's fulfilment of its statutory duty. The PRA may also request reports after pay outs or other failures.

Disaster recovery

49 The FSCS will keep the PRA informed about the disaster recovery arrangements to be adopted in any event leading to the FSCS not being able to carry out its usual activities for any material time (either directly or by third parties). The FSCS will also notify the PRA as soon as possible if there is an event that leads to the arrangements being invoked.

Power to require FSCS to act in relation to other schemes

50 In accordance with Part 15A FSMA, in the event of the FSCS receiving a notice from HM Treasury requiring the FSCS to exercise certain functions (on behalf of the manager of a relevant scheme), the FSCS will engage with the PRA in determining whether to act in the event that there are implications to the PRA's obligations and objectives.

Review of MOU

51 Both parties will review the operation of the MoU and the effectiveness of co-operation and co-ordination on a biennial basis, consulting Bank's Resolution Directorate as appropriate to ensure its continued or enhanced effectiveness.

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