



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP6/20

Financial Services Compensation Scheme – Temporary High Balances Coverage Extension

July 2020



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The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

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Responses are requested by Thursday 23 July 2020.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: CP06_20@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

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1 Overview

1.1 This Consultation Paper (CP) sets out the Prudential Regulation Authority's (PRA's) proposal to extend coverage under the Financial Services Compensation Scheme (FSCS) for Temporary High Balances (THBs) from six months to twelve months from the date of deposit, or the first date the THB becomes legally transferable to the depositor. The proposed extension of coverage would be for a temporary period, and is being proposed in response to the impact of Covid-19 on residential property and investment markets, and access to banking services for some depositors. THB coverage would revert back to six months from Monday 1 February 2021.

1.2 The proposal in this CP would result in consequential changes to the Depositor Protection Part of the PRA Rulebook ('Depositor Protection') (Appendix 1), and to paragraphs 30, 47a, and 47b of the Deposit Guarantee Scheme Statement of Policy (SoP)¹ to reflect the extension in THB coverage.

1.3 This CP is relevant to retail financial consumers who are currently, or who may become, THB depositors before Monday 1 February 2021. This CP is also relevant to the FSCS and to all PRA- authorised deposit takers.

Background

1.4 The PRA's THB rules currently extend FSCS coverage from £85,000 to £1 million for a period of six months from the point of deposit for certain qualifying life events, including the purchase and proceeds from residential properties, benefits payable on death, and life assurance pay-outs. These rules have a role in supporting the PRA's overall approach to maintaining confidence in banks, building societies, and credit unions, thereby promoting the safety and soundness of PRA- authorised deposit takers. Depositor Protection 10.2 sets out the list of categories of eligible deposits that may benefit from THB protection.

1.5 Under Depositor Protection 10.7 the protection for THBs runs for a period of six months starting from two possible start dates, whichever is the later: the first date on which a THB is credited to a depositor's account (or to a client account on a person's behalf), or the first date on which the THB becomes legally transferable to the depositor. The PRA considers that a deposit becomes legally transferable to a person at the point in time when that person becomes entitled to receive the money. This is likely to include the date of grant of probate, the date of completion of a residential property sale, or the date on which a judgement is made awarding damages.

1.6 Due to the impact of Covid-19, the residential property market stalled in late March.² Even as the market begins to show signs of reopening, it is challenging to predict how the market will react to Covid-19 in the coming months. For THB depositors seeking to purchase residential property, it may – in some cases – take longer than originally anticipated for them to be in a position to complete residential property transactions, during which time many may have lost their FSCS THB coverage. These depositors would lose protection for any deposits in excess of £85,000, which in many cases will be life-changing sums of money.

¹ April 2015: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/deposit-guarantee-scheme>.

² Page 50, Interim Financial Stability Report, May 2020: <https://www.bankofengland.co.uk/report/2020/monetary-policy-report-financial-stability-report-may-2020>.

1.7 The impact of Covid-19 has also resulted in reduced liquidity and heightened volatility in investment markets.³ While THB depositors in receipt of substantial insurance or life assurance payouts may choose to invest this money rather than split their deposits between institutions, these depositors may be reluctant to invest during periods of market instability.

1.8 Generally, in view of the current coverage for THBs, the PRA would expect THB depositors to either spend and/or invest their THBs within six months, or disperse any remaining excess over £85,000 between different deposit takers. While it remains possible for depositors in general to open new accounts and split the excess over £85,000 between different deposit takers, the PRA is concerned that some THB depositors may not be aware of the need to spread their THBs over various accounts, in order to maintain FSCS coverage after six months. The PRA is also concerned about the ability of depositors in vulnerable situations to open accounts at a time when their local branches may be unavailable to them.⁴

1.9 Given the Financial Conduct Authority's (FCA's) responsibility for consumer protection, the PRA has engaged closely with it on these issues. The FCA agrees that the impact of Covid-19 on the residential and investment markets, as well as access to banking services, poses a consumer protection issue for THB depositors. The PRA have also consulted the FSCS.

Summary of proposal

1.10 The proposal in this CP is to extend THB coverage up until, and including, Sunday 31 January 2021, from six months to twelve months, when it would revert back to a six-month THB coverage from Monday 1 February 2021.

1.11 The extension in THB coverage would be accompanied by consequential changes to Depositor Protection (Appendix 1), and to paragraphs 30, 47a, and 47b of the Deposit Guarantee Scheme SoP. The PRA would not require firms to update the information sheet in Annex 1 of Depositor Protection to reflect the extension to a twelve-month THB coverage. If firms do decide to amend their information sheets, then the PRA would expect firms to ensure that the information sheet is changed back before Monday 1 February 2021.

Responses and next steps

1.12 This consultation closes on Thursday 23 July 2020. The PRA invites feedback on the proposal set out in this consultation. Please address any comments or enquiries to CP06_20@bankofengland.co.uk.

1.13 The proposal to extend coverage for THBs from six months to twelve months from the date of deposit, or the first date the THB becomes legally transferable to the depositor, until and including Sunday 31 January 2021, has been designed in the context of the UK's withdrawal from the European Union (EU) and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the EU take effect.

³ Page i, Interim Financial Stability Report, May 2020: <https://www.bankofengland.co.uk/report/2020/monetary-policy-report-financial-stability-report-may-2020>.

⁴ In this context the PRA views 'depositors in vulnerable situation(s)' as including people who, in normal times, would be able to spread their THBs across multiple deposit takers, but due to personal circumstances or Covid-19 (or a combination of both) may find this difficult to do.

The PRA has assessed that the proposal would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 ‘The Bank of England’s amendments to financial services legislation under the European Union (Withdrawal) Act 2018’⁵ for further details.

⁵ April 2019: <https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018>.

2 Proposal

2.1 The PRA considers that the impact of Covid-19 on the residential property and investment markets, combined with reduced access to banking services, has created depositor protection issues. Due to these developments, the PRA anticipates that an increased number of THB depositors may need more time to split their deposits between deposit takers.

2.2 In light of these issues, the PRA proposes to extend THB coverage from six months to twelve months from the date of deposit or the first date the THB becomes legally transferable to the depositor – the maximum period permitted by the Deposit Guarantee Schemes Directive (DGSD)⁶ – until, and including, Sunday 31 January 2021. Aside from the length of coverage, other aspects of the THB rules would remain unchanged. Protection for THBs would continue to apply from the later of two possible dates: the first date on which a THB is credited to a depositor’s account (or to a client account on a person’s behalf), or the first date on which the THB becomes legally transferable to the depositor.

2.3 In light of the temporary nature of the proposal and that consumers would be better protected than under the current arrangements, the PRA does not propose that firms should be expected to update the Information Sheet in Annex 1 of Depositor Protection to reflect the extension to a twelve-month THB coverage. If firms do decide to amend their information sheets, they should ensure that the information sheet is changed back to reflect the reversion to six months’ coverage from Monday 1 February 2021.

2.4 The PRA expects the extended coverage to be supported by proactive FSCS-led messaging until coverage reverts back to six months on Monday 1 February 2021.

2.5 The proposal would extend coverage for eligible THB depositors, give more time for the residential property and investment markets to stabilise, and provide these depositors with additional time to reduce their THBs. The PRA considers this will help to mitigate the identified depositor protection issues to the extent possible under the DGSD.

2.6 The PRA will keep this temporary measure under review, and will consult again in the event that the issues identified in paragraphs 2.2–2.5 are likely to remain past Sunday 31 January 2021.

2.7 The proposed extension in THB coverage would apply to depositors with new and existing THBs. For example, if a depositor’s six month THB coverage was due to end in late August 2020, it would instead end in late February 2021. Similarly, if a qualifying THB is deposited in September 2020, coverage would run until September 2021, as opposed to March 2021. Examples of the impact of the proposal on THB coverage are set out in the table below:

⁶ Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

Table 1

Date of Deposit	Current Date of THB Coverage	Proposed Date of THB Coverage
1 September 2019	1 March 2020	1 September 2020
1 April 2020	1 October 2020	1 April 2021
1 November 2020	1 May 2021	1 November 2021
1 January 2021	1 July 2021	1 January 2022
1 February 2021	1 August 2021	1 August 2021

3 The PRA’s statutory obligations

3.1 In carrying out its policymaking functions, the PRA is required to comply with several legal obligations. Before making any rules, the Financial Services and Markets Act 2000 (FSMA)⁷ requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis (CBA);
- an explanation of the PRA’s reasons for believing that making the proposed rules is compatible with the PRA’s duty to act in a way that advances its general objective,⁸ insurance objective⁹ (if applicable), and secondary competition objective;¹⁰
- an explanation of the PRA’s reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;¹¹ and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.¹²

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government’s economic policy as recommended by HM Treasury.¹³

3.3 The PRA is also required by the Equality Act 2010¹⁴ to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

Cost benefit analysis

3.4 FSMA requires the PRA to publish a CBA of proposed rules, defined as an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made.

Benefits

3.5 Temporarily extending THB coverage from six months to twelve months would provide additional time for the residential property and investment markets to stabilise and for THB depositors to reduce their THBs. Extending THB coverage to twelve months would therefore temporarily mitigate the depositor protection issues set out in paragraphs 2.2–2.5. Given that THB rules provide coverage for THBs from £85,000 to £1 million, this would offer depositors a longer period of protection for what would likely be life-changing amounts of money.

3.6 Ensuring that THB rules are fit for purpose would reduce consumers’ potential losses in the event of firm failure, and bolsters consumer confidence in PRA-authorised deposit takers, and in the stability of the UK financial system.

⁷ Section 138J of FSMA.

⁸ Section 2B of FSMA.

⁹ Section 2C of FSMA.

¹⁰ Section 2H(1) of FSMA.

¹¹ Sections 2H(2) and 3B of FSMA.

¹² Section 138K of FSMA.

¹³ Section 30B of the Bank of England Act 1998.

¹⁴ Section 149 of the Equality Act.

Costs

3.7 FSCS and industry exposure to covering the costs of THB payouts would be temporarily extended from six months to twelve months under the proposal. As costs borne by FSCS levy-payers may ultimately be passed on to consumers in the form of higher prices, consumers more generally may indirectly contribute to part of any compensation levies raised in the event of firm failure.

3.8 Given that THBs are identified post-firm failure, the additional cost to levy-payers of temporarily extending coverage cannot be set out precisely. However, the PRA considers that the benefits of the proposal to THB depositors and to consumer confidence are likely to significantly exceed the potential additional costs to levy-payers during a disrupted period.

3.9 The PRA notes that in the event that a THB claim is paid-out due to firm failure, compensation payouts would be partially offset by recoveries made by the FSCS from the estate of the failed firm. As deposits covered by FSCS protection are super-preferred in an insolvency, the recoveries may cover a substantial proportion of any compensation payout-related costs. Any costs for firms would be levied in proportion to the volume of deposit-taking activities and reflecting the level of risk of each firm.

Summary

3.10 The PRA considers that the benefits of temporarily extending THB coverage from six months to twelve months, in the context of Covid-19, outweighs the potential additional costs placed on the FSCS and levy-payers.

3.11 By providing appropriate compensation in the event of the failure of a financial services firm, the PRA considers that these proposals help to maintain confidence in the UK financial system and promote the safety and soundness of deposit takers.

Compatibility with the PRA's objectives

3.12 The PRA must, when discharging its general functions, so far as is reasonably possible, act in a way that advances its general objective of promoting the safety and soundness of PRA-authorised firms.

3.13 The PRA considers that the proposed rule change advances this objective by ensuring that depositors with eligible THBs have an appropriate degree of coverage in the event of firm failure. These proposals support the PRA's overall approach to maintaining confidence in the banking sector, therefore supporting the safety and soundness of PRA-authorised deposit-takers.

3.14 When discharging its general functions, the PRA must also, so far as is reasonably possible, act in a way that advances its secondary objective: to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.¹⁵ The PRA does not consider that the proposals outlined in this CP would have a material impact on competition, given their temporary nature. As set out in the CBA, any costs for firms would be levied in proportion to the volume of deposit-taking activities and reflecting the level of risk of each firm; any costs would therefore not unfairly disadvantage any firm on the basis of its size.

¹⁵ Sections 2H(1), 2H(2), and 3B of FSMA.

Regulatory principles

3.15 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Three of the principles are of particular relevance:

The need to use PRA resources in the most efficient and economical way

3.16 The FSCS is operationally independent of, but accountable to, the PRA. This means that the PRA's resources are not directly involved in carrying out the proposed activities, aside from promoting the extension in coverage through its website; the PRA considers this to be an efficient use of resources given the potential benefits.

The principle that a burden or restriction should be proportionate to the benefits

3.17 The PRA considers that it has been proportionate in proposing a temporary extension of THB coverage, as this links any potential increase in exposure and costs for levy-payers to the impact of Covid-19 on relevant markets.

The principle that consumers should take responsibility for their decisions

3.18 The proposal provides THB depositors with the time necessary to reduce their THBs, given the impact of Covid-19 on the residential and investment markets, and access to banking services for some depositors. Without the impact of Covid-19, the PRA considers six months' coverage remains appropriate, and so coverage will revert back to six months on Monday 1 February 2021.

Impact on mutuals

3.19 The PRA considers that the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

3.20 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.¹⁶

3.21 The aspects of the Government's economic policy most relevant to the proposals in this CP are:

- (i) growth; and
- (ii) a better outcome for consumers.

3.22 The proposal is relevant to recommendation (i) as extending THB coverage would bolster consumer confidence and support the stability of the financial system. With regard to recommendation (ii), the PRA considers that the proposal would ensure that consumers will have appropriate coverage for their THBs during this period of instability in residential and investment markets as a result of Covid-19, to the extent possible under the DGSD.

¹⁶ Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at <https://www.bankofengland.co.uk/about/people/prudential-regulation-committee>.

Equality and diversity

3.23 The PRA considers that the proposals in this CP may aid individuals in certain protected groups that may have difficulty in opening new deposit accounts in the current environment. Beyond this, the proposals do not give rise to additional equality and diversity implications.

Appendix 1: Draft amendments to Depositor Protection Part of the PRA Rulebook

PRA RULEBOOK: CRR FIRMS, NON CRR FIRMS AND NON-AUTHORISED PERSONS: DEPOSITOR PROTECTION (TEMPORARY HIGH BALANCES) INSTRUMENT 2020

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers);
 - (3) section 213 (The compensation scheme); and
 - (4) section 214 (General).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: CRR Firms, Non CRR Firms and Non Authorised Persons: Depositor Protection (Temporary High Balances) Instrument 2020

- D. The PRA makes the rules in the Annexes to this instrument.

Part	Annex
Depositor Protection	A
Depositor Protection	B
Depositor Protection	C

Commencement

- E. Annex A comes into force on [DATE].
- F. Annex B comes into force on 1 February 2021.
- G. Annex C comes into force on 1 February 2022.

Citation

- H. This instrument may be cited as the PRA Rulebook: CRR Firms, Non CRR Firms and Non Authorised Persons: Depositor Protection (Temporary High Balances) Instrument 2020.

By order of the Prudential Regulation Committee

[DATE]

Annex A

Amendments in the Depositor Protection Part

In this Annex, deleted text is struck through and new text is underlined.

10 TEMPORARY HIGH BALANCES

...

10.7 Subject to 10.7A, the ~~The~~ protection for *temporary high balances* under 4.3 shall run for a period of six months from the later of:

...

10.7A The protection for *temporary high balances* under 4.3 shall run for a period of 12 months instead of 6 months where the later date under 10.7 (1) and (2) falls before 1 February 2021.

...

16 FIRMS' DISCLOSURE OBLIGATIONS - INFORMATION AND EXCLUSIONS

...

16.2A For the purposes of 16.2 (2), a firm's information sheet may be considered up-to-date notwithstanding that it does not refer to the 12 month period of protection for certain *temporary high balances* provided for in 10.7A.

...

ANNEX 1 – INFORMATION SHEET (CHAPTER 16)

...

² General limit of protection

...

In some cases eligible deposits which are categorised as “temporary high balances” are protected above £85,000 for six months after the amount has been credited or from the moment when such eligible deposits become legally transferable (temporarily extended to 12 months for eligible deposits which are credited or become legally transferable (whichever is later) before 1 February 2021). These are eligible deposits connected with certain events including:

...

Annex B

Amendments in the Depositor Protection Part

In this Annex, deleted text is struck through and new text is underlined.

16 FIRMS' DISCLOSURE OBLIGATIONS - INFORMATION AND EXCLUSIONS

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16.2A For the purposes of 16.2 (2), a *firm's information sheet* may be considered up-to-date notwithstanding that it does not refer to the 12 month period of protection for certain *temporary high balances* provided for in 10.7A. [Deleted.]

...

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...

Annex C

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[Deleted.]

...