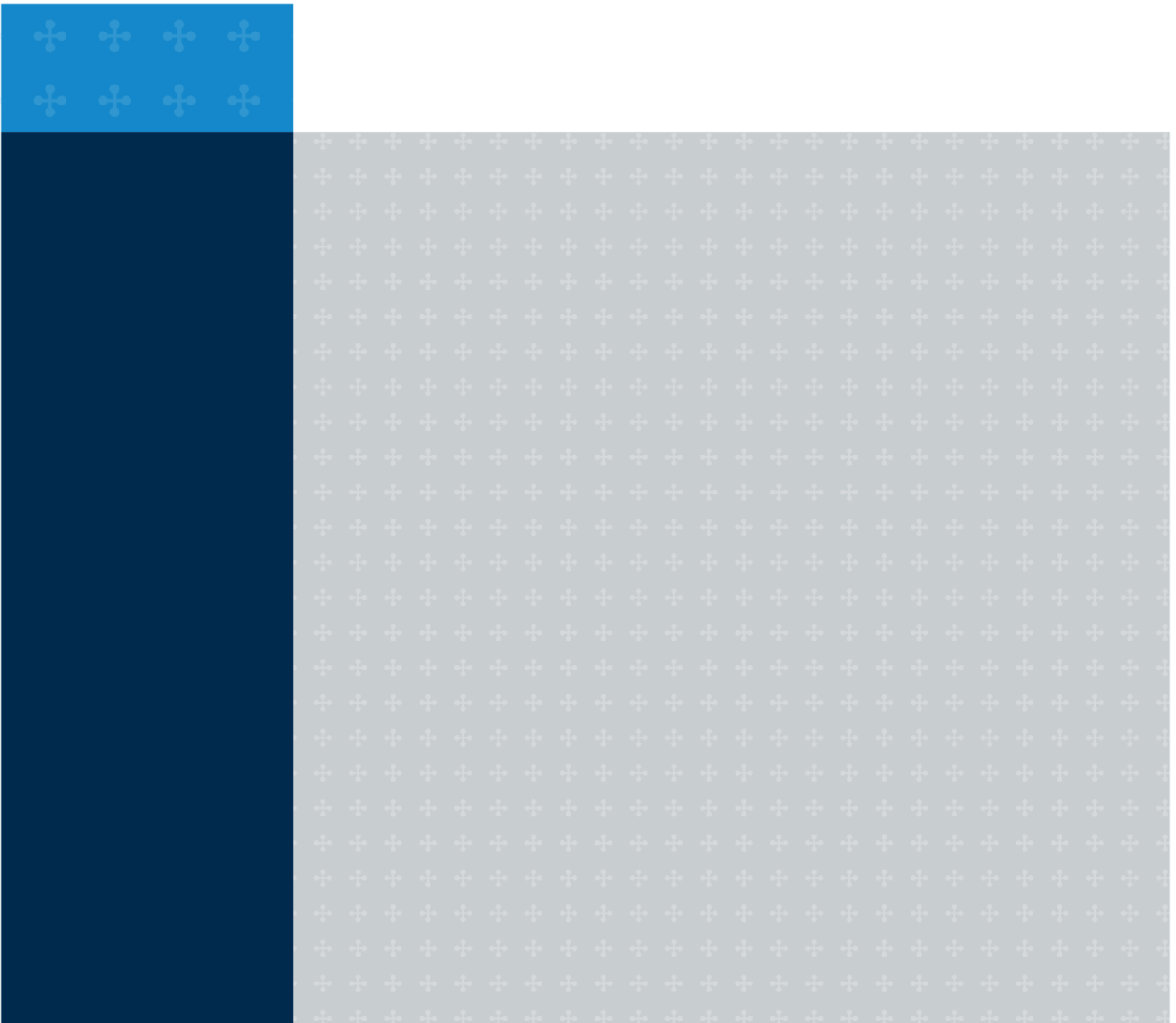




Consultation Paper | CP3/21

Depositor protection: Identity verification

January 2021





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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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 17 February 2021.

In light of current measures to help prevent the spread of Covid-19, please address any comments or enquiries by email to: CP03_21@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

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London
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1 Overview

1.1 This Consultation Paper (CP) sets out the Prudential Regulation Authority's (PRA) proposed rules regarding the timing of identity verification required for eligibility of depositor protection under the Financial Services Compensation Scheme (FSCS). It also proposes amendments to Supervisory Statement (SS) 18/15, including a new expectation that Insolvency Practitioners (IPs) should carry out identity verification in the event that a firm has failed to do so by the compensation date.¹

1.2 The proposals in this CP would result in changes to the Depositor Protection (DP) Part of the PRA Rulebook (Appendix 1) and SS18/15 'Depositor and dormant account protection' (Appendix 2).

1.3 This CP is relevant to the FSCS, all PRA-authorized deposit-takers and IPs. This CP contains no material of direct relevance to retail financial services consumers or consumer groups upon which they might need to act.

1.4 Under existing PRA DP rules, which implemented an EU Directive, if a depositor or ultimate beneficiary has not had their identity verified in accordance with the Relevant AML Requirements at the compensation date, their deposits are automatically ineligible for FSCS protection (through no fault of the depositor or ultimate beneficiary).

1.5 The proposed rule changes are intended to prevent FSCS eligibility issues in the event that a firm has failed to conduct identity verification in accordance with the relevant anti-money laundering requirements referred to in DP Rule 2.2(4)(f) (the Relevant AML Requirements) while continuing to ensure identity verification is carried out before any compensation is paid.²

1.6 The PRA has engaged closely with the Financial Conduct Authority (FCA) on these issues, due to the FCA's responsibility for consumer protection and role as competent authority for the UK's anti-money laundering regime. The PRA has also engaged with the FSCS.

Implementation

1.7 The PRA proposes that the implementation date for the changes resulting from this CP would be Wednesday 24 March 2021.

Responses and next steps

1.8 This consultation closes on Wednesday 17 February 2021. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP03_21@bankofengland.co.uk.

1.9 The proposals set out in this CP have been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references made to legislation, including that which is 'retained EU law', relate to the UK version.³

¹ 'Compensation date' means the date on which a determination is made by the PRA, the FSCS or a judicial authority that deposits held by a Deposit Guarantee Scheme (DGS) member are unavailable deposits such that the DGS member is in default. The compensation date is not the date at which compensation is paid out to depositors it is the date at which the compensation process is initiated.

² For example, regulation 30 of the Money Laundering Regulations, which requires identity verification to have taken place (with some limited exceptions) prior to establishing a business relationship or carrying out transactions.

³ For further information please see <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

2 Proposals

2.1 This chapter sets out the PRA's proposal to amend existing DP rules in order to allow deposits to become eligible for FSCS protection if identity verification is, in any case, carried out in the manner set out in Regulation 28 of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the MLR). This chapter also outlines the PRA's proposal to set out, by way of amendment to SS18/15 that the PRA considers that IPs should undertake post-compensation date identity verification, given their obligations and responsibilities under the Banking Act 2009.⁴

Post-compensation date identity verification

2.2 The PRA proposes to amend the DP Part of the Rulebook to allow identity verification to be carried out retrospectively, should a responsible person fail to carry out the identity verification at the compensation date, for the purposes of determining the eligibility of depositors and ultimate beneficiaries for FSCS protection.⁵

2.3 In the event that identity verification has not been completed in accordance with the Relevant AML Requirements, compensation would only be paid following identity verification being completed in the manner set out in Regulation 28 of the MLR.

2.4 The proposed rule changes are intended only to capture instances where there has been a failure to carry out these identity verifications in accordance with the Relevant AML Requirements.

The role of the Insolvency Practitioner (IP)

2.5 The PRA proposes that any post-compensation date identity verification should be undertaken by an IP in its role as 'officer of the court' and pursuant to its objectives and responsibilities under the Banking Act 2009.⁶ The PRA proposes to set out that it would be for the IP to determine the process for carrying out the identity verification as part of its role as 'officer of the court'.

2.6 While considering the changes, the PRA discussed this issue with a number of IPs who confirmed their understanding of their responsibilities as set out under the Banking Act 2009 would include the carrying out of post-compensation date identity verifications if the proposals are implemented. Those IPs confirmed that they would have the capability to perform these verifications.

2.7 The proposals in this CP are not intended to fix issues around firms' systems and will not make identity verification more efficient post-compensation date. The proposals are rather intended as a backstop to ensure that otherwise eligible depositors and ultimate beneficiaries are not denied FSCS protection due to a responsible person not complying fully with its obligations under the Relevant AML Requirements.

⁴ Including their responsibilities as 'officer of the court' in the event of firm failure, to carry out any identity verification required.

⁵ 'Responsible person' refers to a UK deposit taker and a member of the UK Financial Services Compensation Scheme (FSCS) that is required, under the MLR, to undertake identity verification on its depositors/ultimate beneficiaries at the start of their business relationship.

⁶ Section 99 of the Banking Act (2009) sets out that, in the event of firm failure, it is the primary objective of the IP to work with the FSCS to ensure each eligible depositor of the bank will either: (a) have the relevant account transferred to another financial institution; or (b) receive payment from (or on behalf of) the FSCS.

2.8 The proposals do not change the responsibilities of the responsible persons to adhere to the Relevant AML Requirements and ensure the quality of their single customer view (SCV) systems.⁷

3 The PRA's statutory obligations

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. Before making any rules, the Financial Services and Markets Act 2000 (FSMA)⁸ requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- 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,⁹ insurance objective¹⁰ (if applicable), and secondary competition objective;¹¹
- 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;¹² and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.¹³

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.¹⁴

3.3 The PRA is also required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.¹⁵

Cost benefit analysis

3.4 FSMA requires the PRA to publish a cost-benefit analysis 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 Enabling retrospective identity verification for the purposes of determining eligibility for FSCS protection would ensure that depositors and ultimate beneficiaries who have not had their identity verified prior to the compensation date could be deemed eligible for FSCS protection in the event of firm failure.

⁷ If there is a widespread issue of a responsible person not conducting identity verification for a significant proportion of its accounts, it may take significant time for an IP to fully address this issue and for depositors and ultimate beneficiaries to be deemed eligible for compensation.

⁸ Section 138J of FSMA.

⁹ Section 2B of FSMA.

¹⁰ Section 2C of FSMA.

¹¹ Section 2H(1) of FSMA.

¹² Sections 2H(2) and 3B of FSMA.

¹³ Section 138K of FSMA.

¹⁴ Section 30B of the Bank of England Act 1998.

¹⁵ Section 149.

3.6 The proposed rule changes would help to mitigate risks of a loss of confidence in the depositor protection regime, which could negatively impact UK financial stability. It is likely these risks may crystallise in the event a depositor/ultimate beneficiary, who would otherwise be eligible for FSCS protection, is deemed automatically ineligible for FSCS compensation as a result of a firm not completing identity verification in accordance with the Relevant AML Requirements.

Costs

3.7 Under these proposals, the estate of a failed firm may incur costs if the IP has to carry out identity verification post-compensation date. This may impact the level of recoveries received. Costs will be directly related to the number of unidentified depositors and ultimate beneficiaries at the compensation date.

3.8 The PRA does not anticipate large-scale failures in compliance with the Relevant AML Requirements. The proposals are intended to capture otherwise eligible depositors and ultimate beneficiaries that are missed by firms' existing systems and processes. As such, the PRA considers overall costs to the industry will be minimal.

3.9 The PRA considers that the benefits of the proposals to depositors and to consumer confidence are very likely to significantly outweigh any costs to failed firms' estates or to levy payers.

Compatibility with the PRA's objectives

3.10 The PRA must, when discharging its general functions, so far as is reasonably possible, act in a way that advances its general objective of maintaining UK financial stability.

3.11 The PRA considers that the proposals advance this objective by maintaining confidence in the banking sector through ensuring that depositors and ultimate beneficiaries that have not had their identity verified in accordance with the Relevant AML Requirements (through no fault of their own), and would otherwise be eligible for FSCS protection, would still receive compensation in the event that a firm fails.

3.12 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.¹⁶ The PRA does not consider that the proposals outlined in this CP would have a material impact on competition.

Regulatory principles

3.13 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Two of the principles is of particular relevance:

3.14 The principle that a burden or restriction should be proportionate to the benefits. The PRA considers that its proposals are proportionate; allowing identity verification to occur post-compensation date for the purposes of determining eligibility for FSCS protection is likely to bring substantial benefits, as set out in the cost benefit analysis, while imposing minimal costs on industry.

¹⁶ Sections 2H(1), 2H(2), and 3B of FSMA.

3.15 The principle that the PRA should exercise its functions transparently. The PRA considers that it is being transparent through updating the expectations in the SS to make it clear that IPs should perform the relevant identity verifications after the compensation date.

Impact on mutuals

3.16 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

3.17 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.¹⁷

3.18 The aspect of the Government's economic policy most relevant to the proposals in this CP is 'a better outcome for consumers'.

3.19 The proposals are relevant to the recommendation above as the PRA considers that the proposals would ensure that depositors and ultimate beneficiaries that have not had their identity verified in accordance with the Relevant AML Requirements (through no fault of their own), and would otherwise be eligible for FSCS protection, would still receive compensation in the event that a firm fails.

Equality and diversity

3.20 The PRA considers that the proposals do not give rise to equality and diversity implications.

¹⁷ 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>.

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1 Draft amendment to PRA Rule Instrument

PRA RULEBOOK: CRR FIRMS, NON-CRR FIRMS, NON-AUTHORISED PERSONS: DEPOSITOR PROTECTION (IDENTITY VERIFICATION) INSTRUMENT 2021

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, Non-Authorised Persons: Depositor Protection (Identity Verification) Instrument 2021

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

Commencement

- E. This instrument comes into force on [DATE].

Citation

- F. This instrument may be cited as the PRA Rulebook: CRR Firms, Non-CRR Firms, Non-Authorised Persons: Depositor Protection (Identity Verification) Instrument 2021

By order of the Prudential Regulation Committee

[DATE]

Annex

Amendments to the Depositor Protection Part

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

1 1 APPLICATION AND DEFINITIONS

...

1.4 Unless otherwise stated, in this Part, the following definitions shall apply:

...

MLR means the Money Laundering Regulations, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

...

2 2 ELIGIBILITY

...

2.2 The provisions in this rule determine whether a *deposit* is an *eligible deposit*.

...

(4) The following are not *eligible deposits*:

...

(f) a *deposit* the holder and any beneficial owner (as defined in regulation 3 of the ~~Money Laundering Regulations, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017~~MLR) of which have not, ~~at the compensation date~~ had their identity verified in accordance with:

(i) at any time in the manner set out in regulation 3028 of the Money Laundering Regulations, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017MLR by the DGS member or by a third party who falls within regulation 39(3) of the MLR;

(ii) if their identity was verified prior to 26 June 2017, in accordance with regulation 9 of the Money Laundering Regulations 2007 (in which case, the term beneficial owner in (f) above shall have the meaning given in regulation 6 of the Money Laundering Regulations 2007); or

(iii) in each case, equivalent:

(1) Gibraltar requirements, provided that, if their identity is so verified after *IP completion day*, the *deposit* referred to in (f) is held by a branch of a *DGS member*

established in Gibraltar pursuant to *Gibraltar market access rights*; or

- (2) *European Economic Area* requirements, provided that their identity was so verified prior to *IP completion day*.

...

3 6 PAYING COMPENSATION

...

6.2 The *FSCS* must pay any compensation to the *depositor*, with the following exceptions:

...

- (5) where the account holder is not absolutely entitled to the *eligible deposit*:

- (a) if another *person* (A) is absolutely entitled to the *eligible deposit*, A is the *person* entitled to compensation in respect of the *deposit*, and accordingly the *FSCS* must pay any compensation to A (or, where A (or a *person* who has authority to act on behalf of A) directs that any compensation be paid to another *person*, the *FSCS* may pay the compensation as directed by A (or a *person* who has authority to act on behalf of A), provided that A has been identified or is identifiable ~~before the compensation date~~; and
- (b) if no *person* is absolutely entitled to the *eligible deposit*, the *FSCS* must pay any compensation in accordance with such of 6.3, 6.4, 6.5 and 6.6 as applies.

...

2 Draft amendment to Supervisory Statement 18/15 'Depositor and dormant account protection'

This appendix outlines proposed amendments to SS18/15 'Depositor and dormant account protection.' Underlining indicates new text and striking through indicates deleted text.

...

2 Eligibility

2.1 The provisions in Depositor Protection 2.2 determine whether a deposit is an eligible deposit.

...

2.10 In the event that identity verification has not been carried out in accordance with the relevant anti-money laundering requirements referred to in Depositor Protection 2.2(4)(f) ahead of the firm's compensation date,¹⁸ the PRA considers that the relevant Insolvency Practitioner appointed by the court would be responsible for carrying out identity verification in accordance with Depositor Protection 2.4 for the purposes of determining eligibility for FSCS protection.

...

¹⁸ In line with the insolvency practitioner's objectives and responsibilities under the Banking Act 2009.