

CLIENT UPDATE

INSURANCE AND FINANCIAL INSTITUTIONS REGULATORY UPDATE: BANK OF ENGLAND PUBLISHES CONSULTATION AND DISCUSSION PAPERS ON RESOLUTION AND RESILIENCE ISSUES

LONDON

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The Bank of England has published three consultation papers and a discussion paper as part of the Prudential Regulation Authority's ("PRA") wider financial institutions resolution and resilience agenda. The three consultation papers – on policyholder protection rules, the ring-fencing of core UK financial services, and depositor protection – request comments by 6 January 2015. The discussion paper focuses on operational continuity for failed firms with comments due also by 6 January 2015.

POLICYHOLDER PROTECTION RULES

The PRA is proposing changes to the insurance limits for the Financial Services Compensation Scheme ("FSCS") compensation to increase protection for policy holders in the event of an insurer's insolvency. The proposals (click [here](#) for the consultation paper) include increased limits for compensation for certain insurance products, such as increasing cover to 100% for claims arising for pure protection long-term insurance products or alternatively increasing the limit for all long-term insurance to 100%. It is not proposed that the limits for other insurance products will be altered. The proposals also include operational changes to the FSCS, such as new powers of automatic assignment, electronic assignment and automatic subrogation of policyholder rights, which are expected to give the FSCS flexibility in the way it seeks recoveries from failed

insurers and third parties after paying out compensation. The PRA is proposing to extend the scope of the FSCS's power to obtain information from insurers to situations where the firm is in financial difficulty or where the FSCS is seeking to secure continuity of cover. Previously, the PRA could only require information from insurers when they have been declared in default. The proposals outlined in the consultation paper will affect UK insurers, those insurers in the European Economic Area that set up a branch in the UK and other PRA-authorized insurers. It is also relevant to firms that have assumed responsibility for liabilities from a foregoing PRA-authorized insurers as well as the FSCS, the Society of Lloyd's and policyholders. The policyholder protection rules are scheduled to come into effect in July 2015.

RING-FENCING OF CORE UK FINANCIAL SERVICES

The PRA is required under the Financial Services and Markets Act 2000 (as amended by the Financial Services (Banking Reform) Act 2013) to make policy to implement the ring-fencing of core UK financial services and activities. In this consultation paper (click [here](#) for the consultation paper), the PRA confirms that banking groups subject to ring-fencing will need to operate at least two 'subgroups' – one with a ring-fenced bank ("RFB"), and one with excluded activities – which will sit under a holding company. The paper proposes a variety of corporate governance requirements. One particular area of interest is how board members of RFBs will manage their duties towards the RFB and their parallel duties under company law to their parent companies. The PRA says that RFBs must set out "arrangements to identify and manage" any such conflicts. There are also requirements for RFBs' service continuity to ensure an RFB is not dependent on other group entities' fortunes. This consultation paper is particularly relevant to banking groups with core deposits greater than £25 billion, which will be required to ring-fence their core activities. However, it will also be of interest to insurers and other institutions who have dealings with these banks. The Government has stated its intention for ring-fencing to take effect from 1 January 2019. The PRA intends to undertake further consultations during 2015 and to publish final rules and supervisory statements in 2016 to provide firms with sufficient time for implementation.

DEPOSITOR PROTECTION

This consultation paper (click [here](#) for the consultation paper) sets out proposed changes to the PRA's rules in order to implement the recast Deposit Guarantee Schemes Directive (2014/49/EU) ("DGSD"). It also proposes new rules to ensure that depositors protected by the FSCS can have continuity of access to their accounts during the course of a resolution, as well as changes to the single customer view requirements on firms. This supports

orderly resolution and timely pay out of FSCS-covered deposits to depositors. Although this consultation paper is particularly relevant to UK banks, building societies and credit unions, as well as to overseas firms with a deposit-taking permission and UK branches of EEA credit institutions, it is also relevant to the FSCS, as the UK's Deposit Guarantee Scheme, and depositors, as beneficiaries of deposit protection.

OPERATIONAL CONTINUITY IN RESOLUTION

This discussion paper (click [here](#) for the discussion paper) sets out the PRA's preliminary views on the principles that firms' operational arrangements must satisfy in order to facilitate recovery actions, resolution or post-resolution restructuring of firms. In particular, the consultation addresses critical shared services (as opposed to critical economic functions), being services which support one or more of a group's material entities or business units in performing critical functions, and where the failure of the shared services would lead to serious disruption in the performance of material entities or business entities. This discussion paper will be relevant to all PRA-authorized banks, building societies and investment firms to which any eventual proposals may apply. It is also likely to be of interest to policymakers and practitioners involved in the resolution of failed firms, as well as insurance firms for which similar proposals may be extended after a separate consultation at a later stage. Following the end of the consultation period on this discussion, a consultation paper with draft rules may be published in 2015.

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Please do not hesitate to contact us with any questions.

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