

## DEPOSITORS' COMPENSATION SCHEME 2008<sup>1</sup>

The purpose of this document is to provide a general explanation of the workings of the Depositors' Compensation Scheme ("DCS") in the Isle of Man following the recent introduction of amended Regulations by Tynwald on the 23rd October 2008.

This explanation is produced to provide a general summary of some of the relevant procedures. **NOTE: this general explanation does not constitute legal advice nor should it be relied upon as such; nor should it be relied upon as a substitute for reference to the Compensation of Depositors Regulations 2008 (as amended) ("the Regulations"). The Commission does not accept any liability for any loss or damage caused to any person relying on any information or omission in this publication.**

### General

The purpose of the Regulations is to give a measure of protection to customers of certain deposit takers (in the Regulations known as **Participants**) licensed to undertake this activity within the Isle of Man should a deposit taker be unable, or likely to be unable, to pay claims against it. This is described as being "in default".

The Scheme Manager (under the Regulations this is the Financial Supervision Commission) is charged with the administration of the DCS. The Scheme Manager can only help depositors if a **Participant** is in default, and it may conduct an investigation to establish this.

Once the Scheme Manager has determined that there has been a default, the DCS will be triggered.

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<sup>1</sup> Compensation of Depositors Regulations 2008 (coming into operation on 9<sup>th</sup> October 2008) as amended by the Compensation of Depositors (Amendment) Regulations 2008 (coming into operation on 23<sup>rd</sup> October 2008)

## **Who is a Participant?**

Most licensed deposit takers in the Isle of Man are members of the DCS. Those that are not members of the DCS fall into two categories, being:

- those few which are listed in the Schedule at the end of the Regulations [Regulation 7]. The specific deposit takers listed in the Schedule do not take deposits on the Island from the general public; or
- deposit takers which are building societies. There are only 3 building societies licensed to take deposits on the Isle of Man. It is important to note that deposit taking subsidiaries of building societies that are licensed on the Island are **Participants** – it is only their building society 'parents' that are not **Participants**.

## **What is covered?**

If a **Participant** is determined to be in default and a depositor has an **eligible protected deposit** with that **Participant**, then the Scheme Manager must determine to pay compensation to that depositor (subject to the level of the **Fund** and the number of claims that there are on that **Fund**) provided that the depositor is not within a class that is **excluded** [Regulation 8].

The level of compensation that a depositor can receive [Regulation 11] is 100% of the **eligible protected deposit** up to a maximum of:-

- £50,000 where the depositor is an individual beneficially entitled to the deposit;
- £20,000 in any other case.

The Scheme Manager is required to deduct from the amount of any compensation which would otherwise be payable to a depositor the following sums [Regulation 10 (5)]:-

- the amount of any liability of the depositor to the **Participant** in respect of which a right of set-off existed at the time of the default;

- the amount of any payment made to a depositor under any scheme for protecting or assisting depositors or investors in respect of the relevant **eligible protected deposit** or any dividend or distribution relating to that deposit.

It should be noted that under the current scheme on 23<sup>rd</sup> October 2009 the maximum level of compensation will reduce to £20,000 for ALL depositors. In other words, if the DCS is activated in the first 12 months of the Regulations, the higher sum for individuals will apply irrespective of whether it may in reality take more than these 12 months in which to fully pay out this higher sum. If a **Participant** defaults after 23<sup>rd</sup> October 2009 then the maximum compensation for all depositors will be £20,000.

### **What is an eligible protected deposit?**

An **eligible protected deposit** is the total liability of the **Participant** to the depositor at the time of the default provided that one of the **exclusions** does not apply. The total liability includes capital and interest on all deposits (of any currency) in the name of the depositor at the time of the default and made with an Isle of Man office of the **Participant** [Regulation 9]. This sum is calculated based on the following [Regulation 9 (3)]:-

- separate deposits with the **Participant** in the Isle of Man in the same name are aggregated. For some common categories of deposit account their possible treatment is as follows, albeit please note that individual products and the detail of the underlying documentation supporting them will require to be considered by the Scheme Manager before any definitive determination is made:
  - deposits held within a life policy wrapper, often known as insurance bonds, are generally deposits of the insurance company and not its underlying clients. Therefore such deposits are likely to be treated as a single deposit made by the insurance company, and not multiple deposits held by the insurance company's underlying clients;
  - deposits held by a liquidator of a company are held by the liquidator for and on behalf of the company as an officer of the Court, and any claim will be made by the liquidator as such on behalf of the company in

liquidation not by the liquidator in his individual personal capacity. Separate claims could thus be made by a liquidator for each company under an individual liquidator's control holding accounts with the failed deposit taker treating each as a separate deposit;

- joint accounts (other than partnership accounts) are divided equally between account holders;
- a deposit may be considered for protection regardless of the depositor's residential status;
- a client account, which is titled as such, is treated as representing separate deposits made by persons, corresponding to the amount to which each is entitled irrespective of whether these accounts are pooled or individual client accounts;
- special provisions apply to the treatment of certain trust accounts; in general, these are determined by the terms of the trust and it will usually be necessary for the Scheme Manager to have sight of the relevant trust documentation before a definitive decision can be reached. For some common categories of trust account their potential treatment could be as follows, however it is impossible to give any definitive guidance as to their possible treatment:
  - SIPPs and SSASs (Self Invested Personal Pensions and Small Self Administered Schemes) – on the basis that the identity and right to benefit of each beneficiary can be conclusively established (Regulation 9(3)(e)), then each beneficiary thus established will be regarded as holding a separate deposit, otherwise the trustees will be regarded as holding only one deposit;
  - discretionary trusts – on the basis that beneficiaries under a discretionary trust do not have a conclusive right to benefit then deposits held in the names of the trustees of a discretionary trust will be treated as one deposit only;
  - executors / administrators of an estate – any specifically identifiable beneficiaries in existence at the date of death, although perhaps not specifically named in any will, would be treated as having separate deposits if they can be conclusively established;

In addition to the criteria for the calculation of an **eligible protected deposit**, there are 2 pre-conditions for the Scheme Manager:-

- the Scheme Manager may require that a proof of the debt has first been lodged with the liquidator, receiver or administrator of the **Participant** in respect of the **eligible protected deposit** [Regulation 9(2)];
- no compensation will be paid unless the depositor has agreed that his existing rights in respect of his **eligible protected deposit** will vest in the Scheme Manager [Regulation 16(2)]. This is known as **subrogation**.

### **Who is excluded?**

A depositor's application for compensation will be rejected if any of the following apply [Regulation 10]:-

- the application for compensation is submitted more than 6 months after the depositor became aware, or should have become aware, of the default, unless the Scheme Manager determines that special circumstances should apply;
- the application for compensation is submitted more than 18 months after the date of default;
- the depositor holds a secured deposit;
- no protection is given to deposits by persons who in the opinion of the Scheme Manager had any responsibility for, or may have profited from, the **Participant's** default;
- no protection is given to deposits made by licenceholders of the Financial Supervision Commission authorised to undertake the regulated activities of deposit taking or investment business or to banks which are authorised, licensed or recognised in a country or territory outside the Isle of Man;
- no protection is given to deposits made by any person who was at the time of the default, a shareholder, director, controller or manager of the **Participant**, or who exercised such functions, or was an associate of such person (for the definition of such persons see the Financial Services Act 2008);

- no protection is given to any company that at the time of the default was a parent or subsidiary of the **Participant**, or a company in common ownership with the **Participant**.

### **How is the Scheme funded? – The Fund**

When a **Participant** is deemed to be in default, a **Fund** is created for the payment of compensation to depositors [Regulation 6]. There is no standing fund under the DCS – the **Fund** is created as the need arises.

Until 23<sup>rd</sup> October 2009 the **Fund** will be made up of contributions, or levies, imposed on **Participants** as well as Government funding [Regulations 12 & 12A]. After that date Treasury funding [Regulation 12A] will cease under the current scheme regulations. In addition, the Scheme Manager has a power to borrow money for the purposes of the DCS [Regulation 6(3) and section 25(2)(c) of the Financial Services Act 2008].

The amount of the contributions which may be levied on a **Participant** in any one financial year is subject to limits:-

- the minimum levy is £35,000;
- the maximum levy is the lesser of £350,000 and 0.125% of the **Participant's** average sterling and foreign currency deposit base as calculated in accordance with the Regulations [Regulation 12];

The total sum that can be levied on **Participants** until 23/10/09 is £200,000,000.

Special levy provisions may apply where a **Participant** is in the process of transferring its business and assets to another member of the same group of companies which is also a **Participant** [Regulation 13].

In addition to the levies imposed on **Participants**, if there is a default, Treasury will until 23<sup>rd</sup> October 2009 pay to the Scheme Manager a sum calculated on the level of deposits with the **Participant** up to a maximum global sum of £150,000,000.

### **How long is it likely to take to recover the compensation?**

The length of time between making a claim and the payment of compensation by the Scheme Manager depends on the particular circumstances. Under the Regulations, the Scheme Manager will consider payment of compensation to a depositor as soon as he is satisfied that the depositor has an **eligible protected deposit** and that the **Participant** is unable or is likely to be unable to meet that liability [Regulation 8]. However, once the Scheme Manager has decided to make a compensation payment, it will not necessarily be possible for that compensation to be paid in full or in part immediately. The method of funding the DCS imposes certain constraints on the actual payment of compensation and in particular the Scheme Manager must have regard in any one financial year to:-

- the amount of contributions from **Participants**;
- any Treasury funding;
- other claims which may be made on the **Fund** [Regulations 8 and 11(3)].

Accordingly, if the full amount of compensation is not payable in any one financial year then any partial payment of compensation must be apportioned pro rata between depositors [Regulation 11(4)].

### **What is subrogation?**

Before compensation can be paid to a depositor in respect of an **eligible protected deposit**, that depositor must have agreed that his rights in respect of that liability shall vest in the Scheme Manager [Regulation 16(2)]. Where the depositor so agrees, the entire liability to the depositor of the **Participant** is extinguished and there is conferred on the Scheme Manager a right of recovery against the **Participant** being a right otherwise identical to the depositor's right in respect of the liability agreed to be vested in the Scheme Manager [Regulation 16(3)].

Out of any sums recovered by the Scheme Manager from the liquidator, administrator or receiver of the **Participant**, by virtue of the rights vested in it by a depositor, the Scheme Manager is entitled to retain an amount equal to the aggregate of:-

- the amount of compensation paid to a depositor in respect of their **eligible protected deposit**; and
- the costs of recovery of any such sums [Regulation 16(5)].

Any amounts recovered which exceed the amount which the Scheme Manager is entitled to retain shall be paid to the depositor [Regulation 16(4)].