

# HSBC FINED FOR HISTORIC DEPOSITOR PROTECTION FAILINGS

## LESSONS FOR BANKS

### 1. What has happened, in brief?

On 30 January 2024 the PRA published a final notice (“**Final Notice**”) imposing a financial penalty on HSBC Bank PLC (“**HBEU**”) and HSBC UK Bank PLC (“**HBUK**”) (together, “**the Firms**”) of £57,417,500 for historic depositor protection failings arising from the Firms’ failures over several years to properly implement the requirements set out in the Depositor Protection Part of the PRA Rulebook (the “**DP Rules**”).<sup>1</sup> These included the failure to accurately identify deposits that were eligible for protection under the Financial Services Compensation Scheme (“**FSCS**”). The failings occurred in HBEU between 2015 and 2022, and in HBUK between 2018 and 2021.

Within the UK, HSBC operates through (among other entities) HBUK, which is a ring-fenced bank that began trading on 1 July 2018 in advance of the introduction of the UK ring-fencing regime, and HBEU, which is a non-ring-fenced bank. The Firms are both Category 1 PRA-authorized firms, meaning that they have the capacity to cause significant disruption to the UK financial system if they were to fail, making their resolution planning particularly important.

The Firms’ cooperation throughout the PRA’s investigation, including the early admission of certain rule breaches, resulted in a 15% reduction to the penalty, and their agreement to settle at an early stage of the investigation meant that they qualified for a further 30% discount. Without these reductions the fine imposed by the PRA would have been £96.5m. Nevertheless, it remains the second highest fine imposed by the PRA.

<sup>1</sup> PRA Final Notice to HSBC Bank plc, HSBC UK Bank plc (29 January 2024). Available at <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/regulatory-action/final-notice-from-pra-to-hsbc.pdf>.

<sup>2</sup> See DP Rules 2, 4 and 11.

<sup>3</sup> See DP Rule 11.

### 2. FSCS deposit protection and the DP Rules

Eligible deposits held by UK banks under the FSCS are protected by the FSCS up to a deposit protection limit of £85,000 (£170,000 for joint accounts), and eligible and potentially eligible deposits (e.g. beneficially held, legally dormant, legally disputed or sanctioned accounts) must be marked as such.<sup>2</sup> Ineligible deposits include those sums deposited by credit institutions, investment firms, financial institutions or where the deposit holder’s identity has not been verified.

The ability of the FSCS to make timely pay outs to depositors is dependent on PRA authorised firms accurately identifying and marking eligible, potentially eligible and ineligible deposits, and being able to provide this data to the PRA and the FSCS in a timely manner. The PRA sets out requirements for regulated firms concerning the production of this information in the DP Rules.<sup>3</sup>

Under the DP Rules, UK banks, building societies and credit unions (among others) must maintain a ‘Single Customer View’ (“**SCV**”) which is a single, consistent view of a depositor’s aggregate eligible deposits with a firm.<sup>4</sup> UK deposit-takers must ensure they have appropriate systems and controls such that they are able to produce an ‘SCV File’, which is a firm’s SCV together with a firm’s ‘exclusions view’ which shows potentially eligible deposits that may qualify for FSCS compensation following investigation by the FSCS. Firms are further required to produce ‘SCV effectiveness reports’ which confirm how their SCV and exclusions view were produced and their effectiveness.<sup>5</sup>

Both the SCV and the exclusions view must be provided to the PRA or the FSCS within 24 hours of either (i) the relevant deposits becoming unavailable; or (ii) a request from either the PRA or the FSCS.<sup>6</sup>

<sup>4</sup> See DP Rule 12.

<sup>5</sup> See DP Rule 14.

<sup>6</sup> See DP Rule 12. Unavailability is defined for these purposes in the PRA Rules as including a situation in which the PRA has determined that the bank appears to be unable, for reasons that are directly related to its financial circumstances, to repay the deposit and has no current prospect of being able to do so.

### 3. Details of the breaches

The annex to the PRA Final Notice presents a detailed timeline of failings – starting in relation to HBEU from 2015, and HBUK in 2018 following its establishment – in connection with the Firms’ implementation of the DP Rules.

These failures included:

- the Firms not marking eligible deposits in a way that would allow for their immediate identification as eligible or potentially eligible;
- the Firms’ failure to produce finalised SCV effectiveness reports on an annual basis;
- inaccurate attestations made on behalf of both Firms in 2018 that their respective SCV systems met the PRA’s SCV requirements (in the case of HBEU, this attestation was materially incorrect);
- the Firms’ failure to assign clear ownership for the processes required under the DP Rules; and
- the Firms’ failure to ensure that a senior manager, under the Senior Managers and Certification Regime (“SMCR”), was allocated responsibility for these processes and the integrity of the information required under the DP Rules.

As suggested by this brief summary, the failures were most acute at HBEU, apparently due in part to a lack of subject matter expertise after a number of individuals with knowledge of the DP Rules moved from HBEU to HBUK when HBUK was established in 2018. HBEU’s SCV systems incorrectly classified 99% of eligible deposits by value as ineligible for FSCS protection. This, the PRA flags, raised the possibility of severe disruption in the event HBEU needed to be resolved, and may have also resulted in the wrongly categorised deposits incorrectly being deemed to have been bailed-in on resolution.

The PRA found that governance shortcomings were an important contributor to the breaches by HBEU, with the Final Notice providing three notable examples of this:

- practical management of the SCV attestation process in HBEU was largely left to a single individual from the Regulatory Compliance Advisory team, who noted it had fallen to them to try and complete the process despite it not being their responsibility;
- an internal working group established in 2019 to investigate whether client deposit accounts were being correctly reported in HBEU’s SCV File was governed informally, minutes were not formally taken, and members of the group later gave conflicting accounts of its objectives and who was accountable for the group’s work; and

- testing of how the HBEU SCV File was created was incorrectly described as completed (and the file correctly produced) following “*an impression that HSBC’s IT team seemed to understand the issues and the regulation*”.<sup>7</sup>

The PRA also found that HBEU further failed to disclose information to the PRA of which it would have reasonably expected notice. There was a delay of approximately 15 months between HBEU becoming aware it had information which reasonably suggested it may have been mismarking a significant volume of deposits from FSCS protection and its 23 April 2021 notification to the PRA, during which time HBEU had undertaken multiple strands of internal investigation. The PRA suggests that HBEU only realised the need for the internal investigation following a PRA request for information regarding one of HBEU’s clients.

These failings meant that the Firms breached PRA Fundamental Rules 2 and 6, as well as DP Rules 11, 12 and 14. HBEU was also found to have breached DP Rule 50,<sup>8</sup> and Fundamental Rules 7 and 8. Significantly, this is the first PRA enforcement action in relation to Fundamental Rule 8, which states that firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption to critical services.

#### PRA Fundamental Rules

**PRA FR2:** A firm must conduct its business with due skill, care and diligence

**PRA FR6:** A firm must organise and control its affairs responsibly and effectively

**PRA FR7:** A firm must deal with its regulators in an open and cooperative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice

**PRA FR8:** A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services

### 4. Lessons to be learned

The PRA’s strong response reflects the severity of the situation HBEU found itself in: HBEU’s failure to generate reliable SCV data, exclusions views or SCV effectiveness reports undermined its readiness for resolution and indeed, undermined the wider financial system: “*The breach by HBEU of the DP Rules for such an extended period of time very much increased the potential risk to*

<sup>7</sup> See paragraph 8.20 of the Final Notice.

<sup>8</sup> As set out in the pre-December 2016 version of the DP Rules.

the UK financial system by undermining FSCS protection”.<sup>9</sup>

HBEU’s delay in disclosing information to the PRA was not well received, and the PRA expects to be promptly notified of any material issues relating to the accuracy and status of a firm’s depositors. While the PRA recognises that a firm will want to investigate issues once they have been identified, this does not mean that information which should be disclosed to the PRA can be withheld for lengthy periods until those investigations are completed. The PRA puts this point strongly in the Final Notice: “For PRA Supervision’s purposes, understanding how an error has occurred is ancillary to knowing that an error had potentially occurred.”<sup>10</sup>

The PRA further emphasises that:

- the Firms’ failure to ensure that a senior manager had been allocated ownership of the SCV process and associated reporting was considered a serious failing in the Firm’s implementation of SMCR;
- when attestations are provided regarding a firm’s compliance with regulatory requirements, verification must have taken place to ensure their

accuracy and it is a serious issue when they are later revealed to be inaccurate; and

- firms should ensure that relevant expertise for critical areas such as depositor protection is not lost following internal re-organisations or restructurings.

This case provides a timely opportunity for all banks with FSCS-eligible deposits:

- to reassess the views they have taken in the past on the interpretation and operation of the DP Rules, particularly where these views could affect the eligibility of deposits; and
- to ensure that the governance arrangements they have in place for compliance with the DP Rules are clear, and that they are devoting adequate resources to discharging their obligations under these rules.

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<sup>9</sup> See paragraph 4.4.4 of Annex B of the Final Notice.

<sup>10</sup> See paragraph 2.6 of Annex B of the Final Notice.