



Financial Services Compensation Scheme (FSCS) **Treatment of service charges for residential property**

Guidance Note

Financial Services Compensation Scheme (FSCS) – Treatment of Service charges for residential properties

Please note that the following guidance is given on the basis of the rules, information and understanding at the time of publication. It is without commitment and is not binding on either the part of the FSCS or Communities and Local Government in the event of any future claim. It also does not constitute financial or legal advice.

The full FSCS rules can be found on the FSCS website at http://www.fscs.org.uk/industry/about_us/limitations/

Q1: Section 42 of the Landlord and Tenant Act 1987 (the 1987 Act) requires service charges collected by landlords from their tenants (including leaseholders) to be held in one or more accounts, which are deemed to be held in trust. What protection do such contributions have under the FSCS?

A1: Whilst any claim would be dependent on the circumstances and evidence available at the time of the claim, the FSCS would generally expect to treat the tenants (not the landlord) as being individually entitled to the protection available for that proportion of the money in the account to which they are entitled by statutory trust. This would mean each tenant being eligible for a maximum of £50,000 compensation to cover the loss of their particular proportion of the deposited funds.

Q2: Will the introduction of new section 42A of the Landlord and Tenant Act 1987 have an effect?

A2: No.

Q3: Does the fact that the 1987 Act deems the service charges to be held in trust have any effect, even though there may be no formal trust document?

A3: The FSCS would usually expect to see an express trust deed and supporting documentation as evidence of particular monies being held on trust on behalf of other persons. However where the entitlement and trust relationship is imposed by statute as in this case, it is unlikely that the FSCS would require such trust documentation to be in place. In the situation where no trust document exists, the FSCS will not expect the documentation to be created specially to enable a claim to be made.

Q4: Where there is a trust of service charge monies who would make the claim should one be required, the landlord or the individual tenants, and what evidence would be required?

A4: This is likely to be a two stage process. The landlord would first be expected to provide relevant information about the monies that were held on behalf of tenants. Such information is likely to be concerned with details of the account, the individual tenants who contributed and the size of their individual contributions. The tenant's authority to disclose personal details is likely to be required. The FSCS would then seek to contact those individual tenants to determine their individual eligibility to make a claim for compensation.

Difficulties may arise if it is not possible to determine precisely how much is held on behalf of each tenant or there are doubts as to the precise ownership of the funds in the account. If this cannot be done it will be difficult if not impossible for a tenant to successfully pursue a claim for full compensation for the loss of his share of the balance of any funds held in a service charge account.

It is therefore important that accurate and up-to date records are maintained by landlords or any agent acting on their behalf.

Q5: So under the scheme, each individual tenant will (subject to establishing his eligibility) receive their proportion of the funds deposited. But this means that the landlord will then have to demand those service charges from each tenant again?

A5: It is considered that the correct approach is for the individual tenants to receive any compensation that is available under the scheme. This reflects the fact that it is those who have contributed towards any balances held in service charge accounts that the scheme aims to protect. Therefore in order for the FSCS to provide the correct level of protection where service charges are concerned it is important that it can establish and verify each individual tenant's proportion, particularly if any deposits are likely to exceed the compensation limit.

Q6: Is it not sensible in these circumstances for payments of compensation to be made direct to the landlord?

A6: Yes, and in practice, individual tenants may ask FSCS to direct payments of compensation to the landlord. It may be in the interest of tenants in a block to agree with their landlord for this to happen. Doing so may help avoid any delays in compensation payments being made, allowing the property to continue to be maintained without further demands having to be made for the relevant service charges.

Q7: What about the interest that accrues on the account?

A7: The FSCS usually protects interest accrued on a deposit in the same way that it protects the deposit itself. In providing relevant information about the monies that were held on behalf of tenants to the FSCS (see Q4) the landlord would need to establish and take account of any accrued interest.

Q8. But what if the individual tenants had other money in the same institution?

A8: The normal rules of the FSCS would apply. Therefore where an individual tenant entitled to make a claim in respect of service charge monies also has other deposits with the same institution, then only the same maximum level of compensation protection will be payable. For example: Where a tenant is has contributed £5,000 towards the service charge funds, but also has £50,000 with the same institution in a personal capacity, those amounts would be added together to determine the maximum that may be claimed by the individual.

Q9: What about where all the leases have been terminated and there are no other leaseholders?

A9: Because the 1987 Act provides that the deposits in this case belong to the landlord, and on the assumption that the money is no longer being held in trust; the landlord would be treated as an individual subject to the same eligibility requirements and limits as anyone else.

Q10: What about the 'large company exemption' where a landlord has a large portfolio of properties?

A10: Whether or not the landlord was a 'large company' would be irrelevant where the FSCS regarded the individual tenants as those 'entitled' to claim the deposits.

Q11: So where does the landlord or managing agent as a business stand?

A11: There are statutory limits as to the maximum size a company or partnership can be if it wishes to apply for compensation under the scheme. The current limits are set out below.

If a company has any two or more of the following, it cannot claim under the FSCS:

- a turnover of more than £6.5m
- a balance sheet total of more than £3.26m
- more than 50 employees

If a partnership has net assets of more than £1.4m (or its equivalent in any other currency at the relevant time), it cannot claim under the FSCS.

Q12: What should I, the landlord, or the managing agent do in the event of a failure by a bank in which service charges are being held?

A12: In the event of a failure of an FSA authorised bank or building society at which service charges are held the landlord or managing agent should:

- write to the tenants (and landlord where a managing agent is employed) and tell them that a claim to the FSCS may be possible. Ask whether they wish to make a claim for compensation to the FSCS (assuming they would qualify)
- tell the FSCS that it is a service charge client account in accordance with the Landlord and Tenant Act 1987 and provide details (once authorised to do so by the underlying tenants) of the identities of the claimants and the amounts, reminding those concerned that there is no guarantee as to the success or amount of any claim

The FSCS may contact the landlord, managing agent or individual tenants accordingly. It will be important to comply with any requirements of the FSCS to enable eligibility to be established and a claim to be successfully made.

Published by the Department for Communities and Local Government; April 2009.

© Crown Copyright 2009

ISBN: 978 1 4098 1316 3