

OVER 60 YEARS SERVING THE INTERNATIONAL BANKING COMMUNITY

Banking Reform Consultation Responses  
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15 September 2008

Dear Sirs,

**Financial Stability and Depositor Protection:  
- Further Consultation  
- Special Resolution Regime**

AFB response to the two tripartite consultation documents - July 2008

**Introduction**

The Association of Foreign Banks (AFB) welcomes the opportunity to respond to the consultation papers 'Financial stability and depositor protection: further consultation' (CM 7436) and Financial stability and depositor protection: special resolution regime (CM 7459) published in July 2008 jointly by HM Treasury, the Bank of England and the Financial Services Authority (the tripartite authorities).

AFB represents over 180 foreign banks from over 50 countries doing business in London and the rest of the UK through branches, subsidiaries and representative offices. AFB provides a forum for the sharing of information on industry issues for the mutual benefit of foreign banks operating in and out of the UK and makes representations to industry, government, regulatory bodies and other peer group associations to ensure the attainment of good international practice. The foreign banks concerned engage in a wide range of banking and investment business activity in the UK in both the wholesale and retail sectors and make a significant contribution to London's standing as a major global financial centre. Member banks range from the largest with several thousand staff to the smallest with ten or less staff.

**The implications of the proposals for foreign banks (and consequently for London)**

In considering how to respond to the consultation papers, AFB and its members have had to consider what might be the implications of the proposals for them as foreign banks operating in the UK and for London as a major global financial centre, which is the reason why so many foreign banks choose to maintain offices in the UK.

In our response to the earlier consultation paper (CP) (ref CM 7308), we commented that it was unclear how these proposals might affect foreign banks operating in the UK. To some extent that remains the case, although the footnote to page 6 of CM 7436 repeats what was said in the earlier CP, namely that:

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*'It should be noted that the proposals outlined in this document refer to UK incorporated banks. They are not necessarily applicable to UK branches of EEA or third country banks, or to entities within a UK banking group other than a UK incorporated bank.'*

It is equally apparent from the use of the words '*not necessarily applicable to UK branches of EEA or third country banks.....*' that at least some aspects of the proposals may affect UK branches of EEA and third country banks, as well as UK incorporated banks. This will be the case where, for example:

- (1) Non UK banks seek UK 'top up' compensation cover for retail depositors;
- (2) The special resolution regime impacts on group companies which are not UK entities or which are located outside the UK (paras 4.11 of CM 7436 and 5.39 of CM7459 refer)

### **Support of BBA responses and the perspective of AFB**

We have seen the two detailed responses prepared by the British Bankers Association (BBA) to these two consultative papers. Rather than submitting similarly detailed papers we wish to make it clear that we are fully supportive of their comments and have similar concerns where the proposals affect the foreign banking community which makes up the AFB's membership.

This should, perhaps, be wholly understandable given that a number of our members are also members of the BBA. What makes the AFB's point of view different, however, is that our entire membership is made up of foreign banks; all our members have their head offices or parents located outside the UK. For a variety of reasons, they have chosen to establish offices in the UK and their presence significantly contributes to London's status as the world's largest international financial centre.

The importance of London's position is emphasised in HM Treasury's latest paper in the series published this month on *cross-border challenges and responses* (Para 1.13). However, should circumstances change and the UK becomes more expensive, more demanding or more difficult a place to do business, they could choose to move their business to more attractive jurisdictions. The challenge for the UK authorities is therefore one of maintaining a respected, effective and proportionate regulatory regime which is actively supported by the banking community, but without creating an environment where foreign banks feel the need to reassess their commitment to continuing to do business in / from the UK.

### **Summary of AFB's position**

As we indicated in our earlier response, where it appeared that the first CP set out proposals for a UK solution to a perceived UK problem, we anticipate that the foreign banking community will broadly accept that UK incorporated subsidiaries of foreign banks should be subject to the same regime as their UK counterparts. It would be difficult to argue otherwise, but we strongly urge the tripartite authorities to take full notice of the concerns comprehensively articulated on behalf of the banking community, as described in detail in the BBA submissions.

#### *Special Resolution Regime*

While we accept that there is merit in establishing a special resolution regime (SRR) to provide the UK authorities with powers to deal with failing banks effectively, we note there is little or no comment regarding UK banking subsidiaries of foreign banks on whether and on what basis UK Authorities will liaise with foreign parent banks and/or home state regulators before these powers are invoked.

HM Treasury accepts there are some 230 foreign bank subsidiaries in the UK, and it should be appreciated that there could be a significant impact on such banking groups. In the global environment we would normally expect there to be considerable liaison and consultation in advance, since we regard resort to SRR powers as very much a last resort.

We share the BBA's views that there are highly significant questions over the operation of the proposed SRR, and agree that the proposed fast track timetable for legislation carries real risks of unintended consequences. In particular, we are concerned at the sweeping powers that UK authorities would have to vary or suspend creditor rights in the case of partial transfers of the business of a failed

bank. Whilst we accept that the authorities must be able to act swiftly and decisively, it remains unclear whether the proposed safeguards are sufficient to deal with the legal and market uncertainties that will arise from proceeding with primary legislation. In consequence, there could be serious implications for the funding costs of UK banks and their regulatory capital at the very time when banks are being encouraged to increase that capital.

Netting agreements are fundamental to risk management and we are also very aware of the concerns that partial transfer arrangements potentially involve unpicking master netting agreements. The use of such powers could undermine the attractiveness of London as an international financial centre.

Accordingly we fully support the BBA's call that the Government give further time for consideration of the partial transfer arrangements under the SRR, and for these provisions to be stripped out of the primary legislation, to be introduced into Parliament in October, and placed on a different timetable.

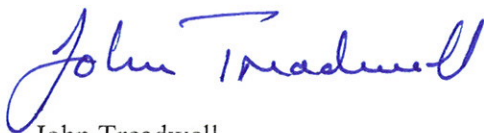
#### *Compensation*

Many of our members engage in wholesale banking business in London and the UK and have little or no direct interest in a compensation scheme designed to protect retail depositors. However, that is certainly not true of all, and for this reason we continue to follow developments in this regard and fully support the BBA's response and disagree with any proposal for the FSCS to contribute to resolution costs. That said, we take comfort that our concern, as expressed in our earlier submission - that eligibility for depositor protection might be greatly enlarged and affect banks engaged in wholesale activities - has been noted and that the intention is not to extend coverage significantly (see para 5.33 of CM7436).

We also note that the Government is not proposing to introduce pre-funding immediately but does intend to include in the forthcoming legislation powers to allow it to introduce pre-funding at a later date. We support the BBA view that these reserve powers should be regarded as helping to develop the infrastructure for a pre-fund and not the establishment of powers as a precursor to the exercise without further consultation.

We await with interest the intended FSA consultation paper on this and other issues affecting compensation.

Yours sincerely



John Treadwell  
Managing Director