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Dear Chancellor

Financial stability and depositor protection

- BBA responses to the two July consultation documents -

The British Bankers' Association has today responded to the two banking reform consultation documents published by the tripartite authorities in July: *'Financial stability and depositor protection: further consultation'* and *'Financial stability and depositor protection: special resolution regime'.*

The BBA is the leading association for the UK banking and financial services sector, speaking for 223 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

Our response to the first July consultation document confirms our support in principle for the banking reform initiative being taken forward and in the process highlights the following points:

- The critical lesson to be learnt from Northern Rock is that the regulators must utilise their regulatory powers to the full and that on the rare occasion when regulation fails to work they should take action to deal with financial failure on a decisive and confident basis.

- The tripartite system is not fundamentally broken but instead needs to operate more efficiently. We see the essential ingredients as being: an approach that identifies emerging risks in a timely and robust way; a clear assignment of roles and responsibilities within the tripartite; improved communication between the authorities and the outside world; and a better process for crisis management.

- The FSA should continue as the sole UK financial regulator, but at the same time needs to act upon its internal report on the shortcomings in regulatory execution displayed in the case of Northern Rock and its recommendations for supervisory improvement.

- Conditions of market stress can be aided significantly through a more flexible use of the Bank of England's money market tools. Access to liquidity needs to be placed more on a 'business as usual' footing and away from the stigma attached to the connotations of 'lender of last resort' or 'emergency liquidity assistance' and in keeping with the way in which money market operations are conducted by other key central banks.

- There is a role for a special resolution regime (SRR) and bank-specific insolvency arrangements that would help resolve an ailing institution in the event that supervisory tools have not helped prevent a bank getting into financial difficulty. It should be a regulatory objective to avoid resorting to the SRR wherever possible. It needs to be recognised that utilising the SRR arrangements is a means of dealing with the consequences of financial failure, not avoiding failure.

- We support measures aimed at enhancing the terms of the Financial Services Compensation Scheme and the confidence in which consumers hold the scheme and the prospect of efficient and orderly payout in the event of bank insolvency. We have already supported the removal of coinsurance up to the £35,000 limit and advocate a move to payment on a gross basis (excluding overdrafts). The FSA is due to consult in October on whether there is a case for an increase in the limit to £50,000.

While there remain issues arising out of the proposals for reform to the deposit protection scheme, not least the issue of pre-funding, many of the concerns in this area are operational in nature. These relate to whether payout by the FSCS in 7 days is necessarily the right objective or whether we should be placing greater emphasis on providing protected depositors with greater assurance of continued access to their money, including perhaps through continued operation of an ailing bank's infrastructure. This raises intricate issues which are the subject of ongoing technical discussion between the FSA, FSCS and the BBA. We are working to a timetable envisaging the FSA publishing a consultation document on these operational issues in January 2009.

Our dialogue with members and other interested parties, including representatives of the legal profession, has identified that there remain highly significant questions over the operation of the proposed SRR. With this in mind we consider that the proposed fast track timetable for legislation carries unacceptable risks for banks and the UK economy generally. This is an aspect of the reform package that has concerned the banking industry and market practitioners from the outset.

Our concerns centre principally on the sweeping powers that the authorities would have to vary, suspend or restrict creditor rights in the case of partial transfers of the business of an failed bank or, more precisely, the potential adverse consequences that those powers could have on the cost and availability of funding. While the tripartite authorities have sought to build in safeguards addressing these reservations it remains unclear whether these will be sufficient to deal with the market and legal uncertainty that would arise from proceeding with primary legislation. This could have serious implications for the funding costs of UK banks and their regulatory capital. The partial transfer arrangements potentially involve the unpicking of master netting agreements and collateral arrangements. We believe that obtaining the powers sought could undermine the competitiveness of London as an international financial centre. The absence of a cost/benefit analysis of the impact of the SRR tools remains a concern.

The banking industry and other interested parties need to see the proposals for partial transfer under the SRR in their entirety including the provisions intended for secondary legislation and the planned code of practice. The information provided within the SRR consultation document and the draft clauses for the primary legislation so far provided have not served to allay these legitimate concerns and it is difficult to see how the potential impact of the partial transfer arrangements can be assessed

properly without sight of the secondary legislation and the accompanying code of practice, both of which are some way off completion. We also need to ensure that an appropriate balance is achieved between the operational flexibility that would accrue through proceeding through a code and the legal certainty that only legislative provision can provide. The legislation needs to incorporate key principles and other safeguards and an informed view of these can only be made once we have sight of the detailed supporting provisions.

We therefore see an imperative need for the Government to give further time for consideration of the partial transfer arrangements under the SRR and believe that these provisions should be stripped out of the primary legislation to be introduced into Parliament in October and placed on a different timetable. Failing this, we see no alternative other than the Government obtaining more time to work through these critical issues by seeking an extension to the temporary powers obtained under the Banking (Special Provisions) Act 2008.

Yours sincerely

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