
FINANCIAL STABILITY &
DEPOSITOR PROTECTION:
FURTHER CONSULTATION

RESPONSE FROM
LLOYDS TSB GROUP PLC

SEPTEMBER 2008

FINANCIAL STABILITY AND DEPOSITOR PROTECTION: FURTHER CONSULTATION RESPONSE FROM LLOYDS TSB

Executive Summary

- Lloyds TSB strongly supports the objectives of the Tripartite Authorities' consultations around Financial Stability and Depositor Protection but we are concerned that they are currently tilted in favour of depositors. We would recommend that the current objective of strengthening the stability and resilience of the financial system should be expanded to include a reference to the competitiveness of the financial services sector.
- A key challenge will be to ensure that the combined effects of domestic and international measures do not have the unintended consequence of causing instability. We see a high risk that the net effect of measures to strengthen prudential oversight and increase capital requirements will combine to increase the cost of capital and reduce the capacity for lending at a time when this will have significant downstream consequences.
- It is critically important that the FSA has people who can fully understand and interpret relevant risk factors, including prudential risk, and the skills needed to develop productive relationships with the supervised organisation. We welcome the FSA's supervisory enhancement programme. We also support the concept of 'heightened supervision' where it can be delivered without arousing market suspicion that a firm is in difficulty.
- Lloyds TSB strongly supports a more joined-up approach between the Tripartite Authorities and supports information sharing powers as long as information requests remain proportionate and sharing does not, by default, move confidential information into the public domain.

Liquidity Assistance

- We encourage the Bank of England to extend the Special Liquidity Scheme beyond October 2008 and convert it to a rolling scheme.

Payment Systems

- We support the proposal to consolidate payment systems oversight within the Bank of England. We encourage a payment systems recognition approach which reflects the potential for smaller systems to consolidate and become more systemically important.
- We do not believe new powers are necessary to facilitate the Bank's information gathering and ongoing oversight of payment systems as the current oversight approach and the reporting against performance to the BIS Core Principles are working well.

Reducing the Impact of a Failing Bank

- We support measures which ensure the Authorities have the powers they need to deal effectively with failing banks. We are, however, concerned that elements of the proposed Special Resolution Regime, particularly those linked to the Partial Transfer tool, will create a destabilising legal uncertainty. Aspects of the proposed regime require considerable further development to ensure that they are effective and balance the interests of different groups of stakeholders.

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- We agree that the decision to trigger the SRR should be a regulatory judgement by the FSA and that the operation of the SRR and its resolution tools should be the responsibility of the Bank of England. We would emphasise the need for a close collaboration both before and after the trigger point.
 - We do not believe that the FSCS should be used to finance the cost of the resolution fund.

Effective Compensation Arrangements for Depositors

- We welcome the Authorities' further thoughts on developing more effective compensation arrangements for depositors and are contributing to joint work between the industry, FSA and FSCS to examine options for faster compensation payouts. We will respond to the FSA's consultations planned for October 2008 and January 2009.
- We do not consider that a higher compensation limit is needed as the current level of £35,000 already covers the vast majority of individual deposits and savings accounts. Nor do we believe that increasing the limit will have a lasting material effect on consumer confidence. However, it is right that a range of compensation options should be considered and we look forward to the FSA consultation.
- We share the desire to ensure that depositors can access some funds swiftly and the Authorities' aim of speeding up compensation payments should a bank fail. We will contribute to the E&Y study on achieving a faster payout and provide an assessment of the various models under consideration. Whatever the solution, it is likely to be imperfect and cause some inconvenience to customers.
- We agree the FSA should be the principal channel for information gathering, whether for the FSCS or the Bank of England. We will contribute to the FSA's consultation on how the information held by banks is reviewed for accuracy and usefulness. However, we consider the approach most likely to deliver a swift and robust result for customers of the failed bank will be for the Authorities to continue to use the existing infrastructure of the failed bank to facilitate speedy payments.
- We support the principle of gross payments (excluding overdrafts). We believe that this will assist consumer confidence in the event of a bank failure and help to achieve swifter compensation payments.
- Ensuring that the customers of a failed bank can put new banking arrangements in place swiftly will be key to ensuring a return to confidence. We welcome the Authorities' commitment to work with stakeholders to remove unnecessary regulatory constraints on processing new account applications.
- We welcome the commitment to review how consumers can be better informed about the current compensation scheme. We envisage a collaborative approach involving industry, the FSA, government departments and others. Within this a key challenge will be to inform depositors without inspiring panic or encouraging unusual behaviour.
- We welcome Government's commitment to ensuring that the FSCS has access to immediate liquidity through borrowing from the National Loans Fund. Our strong view is that pre-funding of the FSCS is not only inappropriate against the backdrop of current market conditions, but will continue to be inappropriate in the foreseeable future.

Strengthening the Bank of England and Tripartite Co-ordination

- We support the formalisation of the Bank of England's role in financial stability and the proposal to bring forward changes to the financial stability governance and accountability structures. We also support the clarification of responsibilities within the Memorandum of Understanding between HMT, the FSA and the Bank of England.

Impact Assessment

- We consider the impact assessment published with the further consultation to be a significant understatement of the costs for banks of the proposed measures.

FINANCIAL STABILITY AND DEPOSITOR PROTECTION: FURTHER CONSULTATION RESPONSE FROM LLOYDS TSB

Chapter 1: Introduction and Overview

Lloyds TSB strongly supports the unchanged objectives of the Tripartite Authorities' consultations around Financial Stability and Depositor Protection to strengthen the stability and resilience of the financial system, to reduce the likelihood of individual banks facing difficulties and the impact if, nonetheless, a bank should get into difficulty including the provision of effective compensation arrangements in which consumers can have confidence. We recognise that these objectives will only be achieved within a complementary regulatory infrastructure. We therefore also support plans to strengthen the Bank of England and to ensure that action between domestic and international authorities is appropriately co-ordinated.

A successful and dynamic UK economy depends on the confidence and ability of individual citizens and businesses to access the different types of finance they need to realize their goals and to generate prosperity for all. They will best be able to do so where there is a healthy and competitive financial services sector which can innovate to meet different customer needs. We therefore consider that the current objective of strengthening the stability and resilience of the financial system should be expanded to include the competitiveness of the financial services sector and that the Authorities should consider whether the objectives set out for the Special Resolution Regime also need to be amended to reflect a wider range of stakeholder interests.

CHAPTER 2: STABILITY AND RESILIENCE OF THE FINANCIAL SYSTEM

Chapter 2 is helpful in summarising the wide range of actions in train to respond to instability in financial services markets. A key challenge for the authorities will be to ensure that the combined effects of these domestic and international measures do not have the perverse and unintended consequence of causing further instability. We see a high risk that the net effect of measures to strengthen prudential oversight and increase capital requirements will combine to increase the cost of capital and reduce the capacity for lending at a time when this will have significant downstream consequences. We would therefore urge the Authorities to review, with industry, the cumulative impact of these initiatives in the light of the current needs of consumers and the wider economy.

CHAPTER 3: REDUCING THE LIKELIHOOD OF BANK FAILURE

The Importance of Regulation

Supervisory Enhancement

Lloyds TSB supports the key elements of the FSA's supervisory enhancement programme set out in March 2008 which will improve the FSA's engagement with firms and promote a more appropriate ratio of supervisory staff to institutions and a more rigorous approach to the supervisory processes to which they are subjected. In addition, continuity of supervision of a firm by the same people is critical to their understanding of the business of that firm. We also support the concept of 'heightened supervision' where a bank is judged to face increased risk, posing a greater threat to financial stability. However, this should be delivered in such a way as not to arouse suspicion that a firm is in difficulty, which might expedite its demise.

There should also be clarity around the criteria to be used by the FSA in deciding when to 'pull' the trigger.

Whatever the intensity of the supervision, key to ensuring its effectiveness in reducing the likelihood in banking failures is that it is conducted by properly skilled and experienced people. It is therefore critically important that the FSA recruits and trains people with the know-how and insight needed fully to understand and interpret relevant risk factors, including prudential risk, and the skills needed to develop productive relationships with the supervised organisation. In addition to formal training programmes and effective guidance, we would strongly recommend, that all Authorities – not just the FSA - invest in a programme of people development/exchange geared to developing sectoral understanding. One option may be to adopt, for all supervisory staff, the 'week in business' approach used in some Government departments to encourage staff to develop their insight and understanding of the daily challenges faced by different organisations.

Obtaining and sharing information

Lloyds TSB strongly supports a more joined-up approach between the Tripartite Authorities and therefore supports information sharing powers as long as this does not, by default, move commercially confidential information into the public domain.

We therefore support measures geared to ensuring that the FSA can collect and share, with the Bank of England and the Treasury, information relevant to delivering financial stability. Channelling all information requests through the FSA would help to reduce the potential for duplication between the Authorities and will ensure that the administrative burdens involved in responding to such requests are managed. It is not clear, however, whether other Authorities would continue to be able to initiate information requests *without* the need to do so through the FSA.

Complying with any information request involves an administrative cost. It will therefore be important to ensure that all requests are proportionate and provide for a realistic response timescale which is not reduced by the need to be directed through the FSA.

Additional supervisory information

We look forward to contributing our views to the forthcoming FSA consultation on the provision of additional information to demonstrate that threshold conditions are being met on an ongoing and forward looking basis. We do not believe that significant new information requirements are necessary given that the existing information gathering tools are largely sufficient, if used appropriately. We will therefore wish to be assured that FSA information requests are themselves risk-based, proportionate and concerned with material matters only.

An effective supervisory relationship, informed by effective monitoring and forecasting of market conditions, is key to minimising the need for short notice information requests.

Market Abuse

Lloyds TSB agrees with the damaging effects of market abuse and supports legislative measures to provide additional powers to tackle it.

Liquidity Support Arrangements

Against the backdrop of global economic uncertainty, the UK's economic well-being will depend to a significant extent on the willingness and ability of core financial institutions to continue lending whether to individuals, as they manage their daily finances or buy homes, or to businesses as they invest to start up or grow by innovating or developing new markets.

The Special Liquidity Scheme, introduced in April and due to conclude in October 2008, has helped to support this activity, but the pressures on liquidity remain. It will be important to ensure that measures to encourage liquidity remain appropriate. We would strongly encourage the Bank of England to extend the Special Liquidity Scheme and convert it to a rolling scheme, whereby as new mortgages were written they could be warehoused by the lenders and then entered into the scheme at say three or six monthly breaks. This would continue to ensure there was a suitable flow of funding, which would then be directed to mortgage lending, whilst we wait a longer-term easing in the wholesale funding markets.

Where the Authorities are providing short term liquidity to an institution that is fundamentally sound but has a short term difficulty, the Authorities should be prepared to provide liquidity support on an unsecured basis. Where there are longer term issues, the Authorities should be seeking a longer term solution rather than merely providing liquidity support in the short term.

In relation to the specific proposals within the further consultation document:

- We support the intention to provide the Bank of England with statutory immunity from liabilities in damages arising from acts or omissions in carrying out its responsibilities in relation to financial stability and other central bank functions although (consultation paragraph 3.17) although that immunity should not extend to cover mistakes made in the Bank's running of a bridge bank under the Special Resolution Scheme leading to poor performance and loss of value;
- We support the proposal, following consultation, to introduce secondary legislation to amend the Settlement Finality Regulations 1999 to ensure that collateral provided to the central bank may be realised more effectively (consultation paragraph 3.18);
- We support the proposal for legislation to ensure that floating charges may be granted by building societies in relation to the provision of liquidity support by central banks (consultation paragraph 3.21)

Liquidity disclosure

While we agree that amendment of the current arrangements is necessary in some form to enable the Bank of England to fulfil its role in supporting banks facing temporary liquidity problems, a difficult balance must be struck in managing liquidity disclosure. We recognise that in some cases disclosure of liquidity assistance can damage the positive impact of liquidity assistance by disproportionately undermining market confidence. However, disclosure arrangements must continue to offer appropriate transparency to creditors and investors. We will respond to the more detailed proposals set out in the FSA's CP 08/13 on changes to the Disclosure and Transparency Rules.

Potential contractual barriers to effective action

The consultation document seeks views on whether Government should legislate to provide that restrictions on borrowing are nullified to the extent that they would prevent financial assistance by the Authorities for the purposes of financial stability or are otherwise triggered by steps taken by the Authorities. It is difficult to judge whether legislation would be appropriate without a clearer sense of what contractual provisions it is intended to cover and in what way, but we would not be supportive of provisions which would prevent banks from providing securities to counterparties for their obligations as this could deprive the Authorities of potential collateral and thus potentially form a barrier to financial assistance. We would also be concerned to see provisions which would affect UK insolvency law to give the Authorities a preference.

Oversight of Payment Systems

We welcome the Tripartite's further thinking on the oversight of payment systems. We support the proposal to consolidate payment systems oversight within the Bank of England and would support legislation in formalising this role although we do not believe it is necessary. Ensuring that any new powers are appropriate and proportionate will demand a sound understanding of the whole payments process from start to finish and constructive engagement of key stakeholders. We stand ready to assist with the development of high quality legislation.

Question 3.2 Are the recognition criteria as set out the right criteria and will they provide sufficient flexibility as payment systems evolve over time?

We would support the criteria set out at paragraph 3.44 of the consultation document but it will also be important to consider whether the system in question is of systemic importance¹. That consideration needs to reflect the potential for 'smaller' systems to consolidate and become more systemically important.

Question 3.3 Is there a preferred method for recognising payment systems?

Some of the major payment schemes are already designated (or in the process of application for designation) under the Settlement Finality Directive. It may be appropriate to use this model and process to avoid duplication of effort and increased administrative burdens both within the Bank of England and within different banks.

Question 3.4 Do you agree that the indicative list in paragraph 3.48 includes all the relevant payment systems which are of systemic or system-wide importance?

The list contains all those we would expect to see at present but, as set out above, needs to reflect the potential for 'smaller' systems to consolidate and become more systemically important.

Question 3.5 Are the powers, as set out above, necessary and appropriately graduated?

We do not believe these new powers are necessary as the current oversight approach and the reporting against performance to the BIS Core Principles are working well. There is a strong relationship between the Bank, the schemes and the members which has a track record of delivering improvement. However, we recognise that if there is to be legislation it must include defined powers.

We believe that the powers should focus on behaviours and be aimed at members (owners/users) of payment schemes rather than scheme managers, as to focus on the latter would be less effective.

We are confident that, with appropriate oversight of payment systems, it should never become appropriate to close a payment system but we can envisage a situation where a member may need to be suspended (the schemes already have powers to do this themselves in cases of settlement default but only after the event). We can also envisage a scenario where a scheme might be temporarily suspended if there was, say, a fraud attack on the central infrastructure of a number of members.

¹ . For example, although CHAPS volumes are low, it is of clear systemic importance. By contrast PayPal is higher volume but of lower systemic significance.

As explained above, it is critical to avoid unintended consequences and to engage in debate over specifics. We suggest that scenarios would be helpful to indicate the types of situations under which each power could be exercised. This would expose any unnecessary or disproportionate powers and assist the understanding of all players

CHAPTER 4: REDUCING THE IMPACT OF A FAILING BANK

Chapter 4 of the consultation document outlines proposals for the Special Resolution Regime suggested in the earlier consultation document. In our response to that earlier consultation we questioned the need for a special regime and, in particular, whether an SRR would have the undesired consequence of driving ailing banks more swiftly towards failure and result in increased contagion. That given, we agree with the need to put in place measures which will ensure the Authorities have the powers they need to deal effectively with failing banks. We have prepared a separate response to the Authorities' consultation on the regime. Within that response we highlight our concern that some of the proposals, particularly those linked to the SRR Partial Transfer tool, will have far-reaching implications for the stability of the sector by creating legal uncertainty and thereby encouraging healthy banks to withdraw lines of credit more swiftly and rein back lending. We consider that aspects of the proposed regime require considerable further development to ensure that they are effective and balance the interests of different groups of stakeholder.

Overview of SRR Model

Question 4.1 The Authorities would welcome views on the most appropriate ways to deal with other relevant entities in investment banking groups with the aim of helping to maintain financial stability

To protect financial stability it will be important for the Authorities to ensure that the right supervisory practices and performance thresholds are in place for all entities including those in investment banking groups. Where such an entity is seen to be approaching difficulties, we believe that heightened supervisory arrangements should kick in, as they would for a retail bank. Where heightened supervision fails to deliver a return to compliance with core threshold conditions and the likelihood that that compliance will be sustained we believe that an adapted SRR may be appropriate although we would not envisage the need to include the Partial Transfer tool.

Question 4.2 Do you agree with the roles for the Authorities for the triggering and operation of the special resolution regime?

We agree that the decision to trigger the SRR should be a regulatory judgement by the FSA in consultation with other Authorities. In our view this fits best with the FSA's role as the lead financial services regulator. However, the FSA's ability to make an appropriate judgement at the right time will be dependent on the long term effectiveness of the supervisory relationship it develops with the failing bank and the ability of FSA people accurately to assess information related to that organisation in the context of prevailing market conditions. It is therefore vital that the FSA should press ahead with its supervisory enhancement programme including improvements in staff training and development approaches.

We also agree that the operation of the SRR and the resolution tools within it should be the responsibility of the Bank of England, but we would emphasise the need for a close collaboration – both before and after the trigger – with the FSA's supervisory team.

We agree that the Chancellor of the Exchequer should authorise the use of funds for which the Chancellor is responsible or which have implications for the public finances and that the Chancellor should have overall responsibility for ensuring compliance with the UK's international obligations although we would expect that the Bank will be closely involved in any dialogue with the European Commission. We also agree that any decision involving a period of temporary public ownership of an institution should be for the Chancellor having consulted both the FSA and the Bank of England.

Practical considerations in developing an SRR

Question 4.3 Respondents' views are sought on the practical considerations involved in developing an SRR.

Our detailed reflections on the proposed Special Resolution Regime are set out in our response to that consultation. That response identifies a number of practical concerns in particular linked to:

- the impact of regime tools on UK insolvency practice and creditor status/preference;
- confidentiality and the risk of contagion;
- Meeting the costs of operating the regime.

In addition, because the SRR includes tools for the whole or partial transfer, the legislation will need to address the relationship between this provision and the merger control rules. There must be a case arising from the proposals for a new public interest consideration under section 58 of the Enterprise Act, expressed in terms of prudential supervision or confidence in the financial system. This would enable decisions to be made by the Secretary of State on the basis of a fuller consideration of relevant issues, including those set out in the special resolution objectives.

We appreciate that there might be a gap for transactions governed by the European Merger Control Regulations, which has no exemption for rescues and no explicit scope for balancing wider interests. In the context of broader concerns about financial stability that may be perceived to be a gap about which HMG can do nothing. It does not however seem to us to be a reason not to make sensible provision under applicable UK rules.

Funding the SRR

Question 4.4 What would be the best way to calculate the hypothetical net cost of depositor compensation payments, including the estimation of the recovery rate?

We do not believe that the FSCS should be used to finance the cost of the resolution fund.

Chapter 5: Effective Compensation Arrangements for Depositors

We welcome the Authorities' further thoughts on developing more effective compensation arrangements for depositors. We are contributing, through the BBA and to joint work between the industry, FSA and FSCS to examine options for faster compensation payouts and will respond to the FSA's consultations planned for October 2008 and January 2009. Lloyds TSB has indicated its willingness to be a sample bank for the purposes of the Ernst & Young study.

Compensation Limit

Our response to the January consultation document, made clear our view that a higher compensation limit was not needed as the current level of £35,000 already covers the vast majority of individual deposits and savings accounts. Nor do we believe that increasing the limit will have a lasting material effect on consumer confidence. However, it is right that a range of compensation options – including the status quo – should be considered and we look forward to the FSA consultation on changes to both compensation limits and changes to other factors used in the Financial Services Compensation Scheme (FSCS) compensation calculation.

We note that that consultation is expected to propose an increase in the compensation limit for protected deposits to £50,000 on a per person per bank basis. As the scheme already covers some 97% of depositors, we believe that, rather than focusing on increases to the level of compensation, consumer confidence would be more greatly enhanced by actions which reassure customers of a failed bank that they will be able to access the funds they need to live with minimal disruption. However, it should be recognised that the highly concentrated nature of the UK banking market means that the failure of any of the UK's banking groups is likely to cause considerable disruption to the customers of the failed bank and will be an unavoidable short-term inconvenience.

We will look to see a robust and objective impact assessment which demonstrates the value of this change in increasing consumer confidence and sector stability.

Coverage of balances above the compensation limit

We recognise that there will be occasions when, for some individuals, the impact of a bank failure is significantly heightened, for example when they have temporarily high balances linked to key life events such as selling/buying a home or the proceeds of probate. The FSA is already working with the sector to investigate ways in which these balances, and those held in solicitors' client accounts, might be protected and we are contributing to this debate

Faster compensation payment

New Process

We strongly share the desire to ensure that depositors can access some funds within a short timeframe and the Authorities' aim of speeding up compensation payments should a bank fail. However, whilst we believe that improvements can and should be made to the existing process, the target of 7 days for (at least) partial payments to depositors remains challenging for the reasons set out in our original consultation response.

We look forward to contributing fully to the E&Y study on achieving a faster payout and providing our assessment of the various models that are under consideration. But whatever the solution, it is likely to be imperfect and cause some inconvenience to customers.

Early access to information

We note Government's intention to legislate to enable the FSA to collect the information that the FSCS requires from firms prior to default and to ensure that there are no barriers to the Bank of England sharing information with the FSCS once SRR arrangements are invoked. We agree it is appropriate for the FSA to be the principal channel for information gathering, whether for the FSCS or the Bank of England. We will contribute to the FSA's consultation on how the information held by banks is reviewed for accuracy and usefulness. We will want

to be assured that the approaches adopted are proportionate and minimise administrative burdens on banks as far as possible.

Information Holding Requirements

We will contribute to the forthcoming FSA consultation on new rules requiring banks to have readily available information including balance on the accounts held by depositors eligible for compensation from the FSCS. We are keen to see an approach which will genuinely speed accurate compensation payments and minimise the potential for fraudulent compensation claims but which balances the considerable costs which can be involved in systems changes. We believe that, on further consideration, the approach most likely to deliver a swift and robust result for customers of the failed bank will be for the Authorities to continue to use the existing infrastructure of the failed bank to facilitate speedy payments.

Eligibility

The further consultation makes clear that it is not intended to reduce exclusions from eligibility conditions for depositors to qualify for FSCS compensation payments. We welcome this decision, but are concerned to see that, despite it, the consultation document includes a proposal for an FSA consultation on depositor eligibility criteria. If, as the consultation document suggests, the intention is to consult on measures to ensure that the FSCS can immediately identify those individual customers who are eligible for compensation when an institution fails this should be made clear in the consultation titling.

Gross payments

Question 5.1 The Authorities would welcome further views on the best way of introducing gross payouts when there are mutual debts

Lloyds TSB supports the principle of gross payments (excluding overdrafts). We believe that this will assist consumer confidence in the event of a bank failure and help to achieve swifter compensation payments.

Streamlined claims process

We look forward to contributing to the FSA consultation on new rules for this area.

Opening new accounts

Ensuring that the customers of a failed bank can put new banking arrangements in place swiftly will be key to ensuring a return to confidence but, as the further consultation recognises, there are significant practical problems associated with opening a very large number of new accounts which offer the full range of banking services in a short space of time.

Current arrangements for account opening allow instant account opening in branch, when the customer is present, provided a customer has the correct ID&V. Current accounts can also be opened instantly by phone, subject to customers passing electronic ID&V checks. It would, therefore, be possible to arrange for accounts to be opened reasonably swiftly, depending on volumes (likely to be very high in event of a major bank collapse), for receipt of payments of salaries, wages, benefits or FSCS compensation. It would take longer, however, to provide other account functionality, e.g. provision of debit cards and changing of direct debit details, which are dependent on third party initiators such as utility companies and mobile phone operators.

We welcome the Authorities' commitment, set out in the consultation document, to work with a range of stakeholders to remove unnecessary regulatory constraints on our ability to process new account applications while minimising the risk of fraud.

Consumer Awareness

The further consultation notes (paragraph 5.5) that the way in which existing deposit protection arrangements operate is not well understood. We would agree. Even where customers understand that they are protected, we do not believe that this will be sufficient to sustain their confidence and to prevent a run on a bank which is reported to be in difficulty. Most customers will be concerned not only about the absolute value of their account holdings, but also – and often more overtly – about their ability to be able to continue to access the funds they need to fund their daily lives ie to buy food, pay key bills, provide for their families. Against this backdrop, we welcome the commitment to review how consumers can be better informed about the current compensation scheme. We would caution against any temptation simply to require banks to add more information to the already significant list of information items required when customers open accounts or take any significant account action (eg taking out a loan). We would also encourage a careful consideration of how best different information channels might be used. We would envisage a collaborative approach involving industry, the FSA, government departments and others. Within this a key challenge will be to inform depositors without inspiring panic or encouraging unusual behaviour. Any awareness raising campaign should also extend to clarifying how deposits held with EEA banks are covered.

FSCS Funding and Liquidity

Question 5.2 The Authorities would welcome further views on a possible move to pre-funding and on the proposed legal framework for pre-funding and FSCS borrowing from the National Loans Fund

Borrowing from the public sector

We welcome Government's commitment to ensuring that the FSCS has access to immediate liquidity through borrowing from the National Loans Fund.

Pre-funding & Risk-based levies

We welcome the decision not to introduce pre-funding of the FSCS now and the recognition that, should a pre-funding approach be introduced in the future, contributions would need to be capped with the FSCS supported by public sector funds. However, our strong view is that pre-funding of the FSCS is not only inappropriate against the backdrop of current market conditions, but will continue to be inappropriate in the foreseeable future.

We note that the FSA will consider further the question of risk-based levies. We recognise the concerns related to the confidentiality of the levy for different banks, but in principle support the concept of a risk-based approach in which riskier institutions pay a higher premium to reflect their relatively higher likelihood of failure. It is possible that existing methods for assessing firm risk, for instance capital requirements, could be used rather than developing a separate system for calculating the risk-weighting. Linking the levy to an existing measure would also address concerns around confidentiality of calculating the levy for different banks. That said, we do not believe that a risk-based premium would be a sufficient justification for the introduction of a pre-funded scheme.

Banknotes and cheques in Scotland and Northern Ireland

We note Government's intention to legislate to strengthen underpinning banknote issuance by commercial banks in Scotland and Northern Ireland and can support the proposed features of the legislative framework. We also support the proposal to bring the law in Scotland relating to the treatment of cheques into line with that in the rest of the UK by abolishing the 'funds attached' rule.

CHAPTER 6: STRENGTHENING THE BANK OF ENGLAND AND TRIPARTITE CO-ORDINATION

Lloyds TSB welcomes the intention to improve the policy instruments available to the Bank of England in support of its financial stability responsibility. In relation to specific measures:

- **Liquidity:** Our comments on liquidity proposals are set out above in our response to chapter 3 of the Further Consultation.
- **Oversight of payment system:** We support the proposal to consolidate payment systems oversight within the Bank of England.
- **Information gathering:** We support measures geared to ensuring that the FSA can collect and share, with the Bank of England and the Treasury, information relevant to delivering financial stability. Complying with any information request involves an administrative cost. It will therefore be important to ensure that all requests are proportionate and provide for a realistic response timescale which is not reduced by the need to be directed through the FSA.
- **Prudential policy:** We strongly support the proposal that the FSA and Bank of England will continue to consult each other on proposals for prudential regulation. A key challenge for the authorities will be to ensure that the combined effects of domestic and international measures do not combine to increase the cost of capital and reduce the capacity for lending at a time when this will have significant downstream consequences. As we comment in Chapter [3] we therefore urge the Authorities to review the cumulative impact of prudential initiatives in the light of the current needs of consumers and the wider economy
- **Implementing and overseeing the special resolution regime for banks:** We agree that the operation of the SRR and the resolution tools within it should be the responsibility of the Bank of England, but we would emphasise the need for a close collaboration – both before and after the trigger – with the FSA's supervisory team.

Governance and Accountability

We support the formalisation of the Bank of England's role in financial stability and the proposal to bring forward changes to the financial stability governance and accountability structures. In ensuring that these changes deliver maximum benefits, we would suggest:

- that the overall effectiveness of the system and of the proposed Financial Stability Committee is regularly tested through formal scenario analysis and contingency planning;
- that membership of the Financial Stability Committee and of the Court is examined to ensure an appropriate mix of skills and expertise.

Improving co-ordination across the UK authorities

We would support the clarification of responsibilities within the Memorandum of understanding between HMT, the FSA and the Bank of England.

Annex A: Impact Assessment

We have reviewed the impact assessment published with the consultation document. The document makes a number of recommendations which have significant implications for the development of banking information systems and administrative procedures. Although many of these are subject to further consultation it is clear that they will involve initial costs far in excess of the £1.3 - £3m suggested for Year 1 and have the potential to involve significant ongoing costs for both systems maintenance and ad hoc information gathering. At the same time the proposals include the potential for non-administrative costs for example linked to possible pre-funding of the FSCS and increased liabilities on survivor banks where a bank fails. It is difficult to predict likely costs before we have seen more fully worked through proposals but, for example, the systems changes required to move us towards a Single Customer View have been estimated to cost up to £60 million for Lloyds TSB.