



23rd April 2008

Dear Sirs,

Financial stability and depositor protection: strengthening the framework

AFB response to the tripartite consultation document - January 2008

Introduction

The Association of Foreign Banks (AFB) welcomes the opportunity to respond to the consultation paper (CP) '*Financial stability and depositor protection: strengthening the framework*' (CM 7308) published in January 2008 jointly by HM Treasury, the Bank of England and the Financial Services Authority (the tripartite authorities).

AFB represents over 170 foreign banks doing business in London and 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 the industry, government, regulatory bodies and other peer group associations to ensure the attainment of good international practice. These foreign banks engage in a wide range of banking and investment business activity in the UK in mainly the wholesale but also the 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.

Lack of clarity about the implications of the proposals for foreign banks

In considering how to respond to the CP, 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 - the reason why so many foreign banks choose to maintain offices in the UK. Nowhere, however, does the CP expressly indicate how the proposals might affect foreign banks operating in the UK and little account seems to have been taken of the potential implications of the proposals for London's position.

In the footnote on page 6 in the *'Introduction and Overview'* the paper expressly states:

'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 world country banks, or to entities within a UK banking group other than a UK incorporated bank.'

Notwithstanding this statement it seems clear to us that many of the proposals could potentially affect the UK operations of foreign banks, but it is not possible to identify how and where. In preparing this relatively short and concise response it is AFB's intention to comment on concerns about Chapter 4 *'Reducing the impact of a failing bank'* and Chapter 5 *'Consumer confidence and compensation arrangements.'*

Insofar as the CP sets out proposals for a UK solution to a perceived UK problem then we anticipate that the foreign banking community will accept that that the UK incorporated bank subsidiaries of foreign banks should be subject to a like regime as their UK counterparts. That does not mean, however, that the foreign banking community is necessarily supportive of all of the proposals as they currently stand. Where we do not expressly comment on proposals or respond to specific questions it should be assumed that we support the comments contained in the detailed response that has already been submitted by the British Bankers Association (BBA) to the Chancellor of the Exchequer. In particular we share with BBA and would want to emphasise the following concerns:

- we are not convinced that sufficient weight has been placed on the benefit of improving the FSA's execution of its existing regulatory powers and the proposed escalation of regulatory intervention on the basis of heightened supervision ;
- we have serious concerns about the proposals for a special resolution regime (SRR) and bank-specific insolvency arrangements not only for the reasons expressed by BBA but also because the CP fails to explain whether, and if so how far, these proposals might affect foreign banking operations in the UK. Not only might these arrangements potentially damage the competitiveness of the UK financial markets and the financial standing of banks that operate within them, as expressed by BBA but also, in the absence of any indication as to what impact the proposals might have for foreign banks, they could be introduced in a manner

that might act as a deterrent to foreign banks wanting to set up or to continue operations in the UK;

- while we share the concerns more widely expressed by BBA concerning the proposals for depositor protection afforded under the Financial Services Compensation Scheme (FSCS) we are also very concerned by the effect of the proposal to 'simplify' and widen eligibility to all depositors except for the 3 specific exceptions mentioned in paragraph 5.37, and the subsequent impact for those banks engaged in wholesale banking activities (please see our later comments);
- we understand that an aggressive legislative timetable is to be followed and we fear that there may be serious unintended consequences that could adversely affect the attractiveness of London as a major global financial centre. We therefore share BBA's view that it is essential that the tripartite authorities adopt a more realistic timeframe for the more intricate measures falling within the consultation especially those that they may relate to non-UK banking institutions.

Chapter 4: Reducing the impact of a failing bank

The CP is silent as to whether the proposals contained in this chapter will apply to foreign banks. Foreign banks can be taken to refer to a wide range of entities but, in practice, they are operating in the UK by a variety of means including:

- through a UK locally incorporated subsidiary;
- operating from another EEA state and marketing their services into the UK through their EEA passport (when accepting deposits from UK retail depositors they may or may not offer 'top up' FSCS deposit protection in addition to the EEA member state's own deposit protection scheme);
- maintaining one or more UK branches of the foreign bank especially for the purpose of taking deposits. Again, where the branch is a branch of an EEA bank no UK authorisation is required. In the case of a branch of a third country bank UK authorisation will be required.

For the purpose of this response we are referring to foreign banks as those operating through operations listed in the 2nd and 3rd bullet points above.

As discussed earlier this chapter fails to give any indication as to whether the proposals are meant to apply to foreign banks. If they are, it is absolutely vital that the tripartite authorities indicate what their intentions are in this area and have a full consultation with the sector before any legislation or other changes are drafted. There would seem to be a major difference of approach required for a foreign bank with a home state supervisor operating in the UK in one of the ways outlined above and a UK incorporated bank.

We are concerned that it might be suggested that because the tripartite authorities cannot anticipate all circumstances when they might need all such powers as are discussed in this chapter, then they should have the powers reserved in any event just in case they are required. For a major international financial centre such as London we consider this may be an inappropriate and potentially damaging approach that might well adversely affect the attractiveness of London to foreign banks.

Consultation questions 4.1-4.3

Given the views expressed above we cannot respond adequately to these questions because there is no clarity as to how the SRR and insolvency proposals might be applied, if at all, to foreign banks with a UK presence. For the reasons indicated above we consider that it is vital that the tripartite authorities clarify their intentions in this regard at an early date and have a full consultation with the foreign bank sector.

Chapter 5: Consumer confidence and compensation arrangements

In considering this chapter and the implications for the foreign banking community it should be born in mind that while some foreign banks do seek retail deposits in the UK the majority establish offices in the UK to access the international wholesale financial markets. Accordingly at present those banks either have no involvement with the FSCS or it is very limited in relation to their private banking/client activities. In the context of the proposals set out in Chapter 5 we consider it a very worrying development to suggest that eligibility should be widely extended beyond what, until now, has been the UK retail depositor. The levels now and possibly being considered for future deposit limits are of little significance in the wholesale markets.

It seems to us wholly inappropriate to extend deposit protection into the business and wholesale arena and it could have unintended consequences of a major nature affecting foreign banks operating in the wholesale markets. This proposal would affect them not only as potential contributors through any FSCS scheme but in establishing procedures and incurring information technology costs in order to meet UK requirements which have little or no benefit for them. We strongly urge that deposit protection should not extend beyond the retail sector however that should ultimately be defined.

Consultation Question 5.15

The CP proposes to widen significantly the current definition of eligible claimant' to incorporate a much wider range of claimants for whom the scheme was not originally designed to protect. We see no grounds for expanding the scope of eligibility and for the reasons expressed above have serious concerns for the financial and costs consequences for the foreign banks engaged in wholesale banking activities in the UK should eligibility be so widened.

Summary

As previously indicated where we have not expressly commented on proposals or responded on specific questions it should be assumed that we support the comments of the BBA in their response. Our principal concerns relate to the impact of the proposals in chapters 4 and 5 for the foreign banking community. At a time when the perceived advantages which have led to London in recent times being regarded as the leading international financial centre are seen to be in decline, any unattractive measures affecting foreign banks would be most unwelcome and potentially damaging to London's position.

Yours sincerely