

Financial stability and depositor protection: strengthening the framework

Response by Citizens Advice to HM Treasury

April 2008

Citizens Advice welcomes the opportunity to respond to HM Treasury's consultation on financial stability and protecting consumer deposits in the event of a major financial institution becoming insolvent.

Citizens Advice is the national umbrella body for Citizens Advice Bureaux in England, Wales and Northern Ireland. The Citizens Advice Bureaux (CAB) network is the largest independent network of free advice centres in Europe, providing advice from over 3,200 outlets throughout Wales, England and Northern Ireland. We provide advice from a range of outlets, including GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups.

The service aims:

- To provide the advice people need for the problems they face; and
- To improve the policies and practices that affect people's lives.

In 2006-2007 the CAB service dealt with 5.7 million enquiries in total. Of these, 1.7 million were about debt, 110,000 about financial services and 1.6 million about benefits and tax credits. As well as giving advice, some Citizens Advice Bureaux deliver financial education initiatives to their community. Over 80 bureaux are now undertaking financial skill training in their communities, particularly to people at risk of social or financial exclusion. We are also piloting a generic financial advice service in 24 bureaux.

CAB clients are often disadvantaged and many are on low incomes or benefits, or are disadvantaged in some way. For example, research by MORI for Citizens Advice found that CAB users tend to be in social grades DE and be unemployed, or living in social housing.¹

Because of our client group, we are limiting our response to this consultation to some of the issues in Chapter 5 which covers consumer confidence and compensation arrangements.

Compensation limit (questions 5.1 – 5.6)

Citizens Advice believes that there should be no upper limit to the amount protected for personal deposits in the event of a financial institution going into liquidation for the following reasons:

- Having no upper limit could encourage consumers to save more.
- The current protection available to consumers is complex and is not easily understood, as recent research on the current FSCS limits for the FSA shows. We believe that consumer confidence in the system for protecting deposits could improve if the limit on the amount protected was lifted.

¹ Financial Overcommitment, research study conducted for Citizens Advice by MORI, July 2003

- It would remove the need for complex and expensive additional data collection by FSCS, as proposed in this section of the consultation paper.
- We agree with the view expressed in the NCC's consultation response that the risk of bank failure should not be borne by its ordinary retail customers, as they will not be in control of or party to the bank's finances

The compensation process (speed of payments, claims and opening new accounts, vulnerable consumers- questions 5.7 – 5.10, 5.20 and 5.24 – 5.27; 5.30)

The situation envisaged by the proposals in these sections of the consultation paper is:

- At first signs of a financial institution experiencing problems, FSCS will ask it for details of deposits to enable them to issue compensation to deposit holders
- After the financial institution fails, FSCS will not require customers of the failed bank to make a formal claim, but will aim to make compensation payments deposit holders within a week. If this is not possible, they will aim to issue interim payments.
- The deposit holder will then open a new account with another bank. Where they do not have sufficient proof of their identity and address, the money laundering regulations will be satisfied with the assistance of the failed bank. According to the Banking Code, new accounts should be fully operational within 10 days of the bank approving an application.²

However, we believe that this scenario is completely unrealistic, for a number of reasons:

- Whilst many consumers will have another account into which to pay the compensation cheque, others may not and therefore could find it difficult to cash the cheque without incurring additional charges at a cheque cashing facility. We believe that people in this situation are likely to be on lower incomes, and therefore can ill-afford to lose any of the money in their savings or current account.
- Moreover, people without an additional existing account will need to open a new account quickly to receive their wages or benefits. We do not believe that the measures outlined in paragraphs 5.58 to 5.65 of the consultation paper will be adequate to ensure that people in this situation will be able to open a new account quickly enough. Depending on the size of the failed bank, other banks could be overwhelmed by new applications, and they could find it difficult to meet the commitment in the Banking Code to ensure that a new account is operational within 10 working days of the application being approved. HM Treasury should also note that there is no target time in the Banking Code for banks to approve applications for new accounts. If large numbers of people are without an

² Paragraph 7.4, The Banking Code (2008)

operational bank account for more than a week, this would not only have implications for their own personal and financial situations, but also for the cash flow of their mortgage lenders or landlords, their utility companies and other financial services. Any delay in opening new accounts therefore has the potential to adversely affect the UK economy.

- Whilst we welcome the acknowledgement in paragraphs 5.70 – 5.72 that contingency plans need to be put in place for recipients of state benefits and tax credits in the event of a bank failure, we are concerned that DWP and HMRC might not have the capacity to sort out alternative payment methods quickly enough for large numbers of benefit claimants. Even short delays in payment can be too long for people whose main or sole source of income is state benefits.
- The consultation paper does not propose any solution to the advice needs of consumers affected by the failure of a bank. We assume that the Treasury envisages that FSCS should take this role, however they may not be resourced to deal with the volume and type of problems that affected consumers might raise.

For these reasons, Citizens Advice believes a different approach is needed. We believe it would be more cost effective for an administrator to be appointed to the failed bank so that incoming and outgoing payments are not affected. This would allow the opportunity for the bank to be sold, and therefore affected consumers would not have to open new accounts. Alternatively, the administrator, together with FSCS, could manage a phased closure of the accounts to allow the customers to open new accounts without putting pressure on them or other financial institutions. The latter solution could take place over six months to a year, depending on the size of the failed bank. We consider that good quality information and advice would need to be available to allow consumers to help them open new accounts, and suggest that the new Money Guidance service proposed in the Thorensen Review of Generic Financial Advice would be best placed to provide this.

For this approach to be effective, there would have to be no upper limit on compensation, as we argued earlier in our response.