



23 April 2008

**Financial Stability and Depositor Protection: Strengthening the Framework**  
**– Response of Barclays Bank PLC**

Barclays is grateful for the opportunity to respond to the consultation paper issued by the Tripartite Authorities and to participate in the important debate about the future regulation of the banking sector in the UK.

We have responded to your specific questions in an Annex to this letter, but would like to highlight a number of more general points.

As John Varley confirmed in his recent letter to the Chancellor, Barclays fully supports the authorities' objectives and the broad thrust of the consultation paper's recommendations. We agree that action is needed on measures to make the financial system more robust – such as strengthening and clarifying responsibilities within the tripartite arrangements; reforming the money market tools at the disposal of the Bank of England; and giving the Bank of England the legal responsibility for financial stability.

However, the highly complex issues relating to the proposed special resolution regime must be fully thought through. We think it would be helpful if the Government were to publish, and consult on, draft Bill clauses covering the SRR proposals over the summer.

We are also aware that the Financial Stability Forum's recent report to the G7 Finance Ministers contains recommendations which are relevant to many of the proposals in the consultation paper. The Treasury will need to carefully consider the potential impact of these international initiatives and it would be helpful if the Authorities could outline their position on the recommendations.

Current market conditions are difficult and whilst it is important to ensure we have systems to manage a failing bank, we must also look to what proactive preventative steps can be taken. The Bank of England's new collateral swaps arrangement is both innovative and substantive. We expect it to make

a significant contribution to alleviating the pressures in the UK money markets. Barclays is fully committed to making the new facility a success and will be an active participant.

The Bank of England's (BoE's) standby facility could be further improved by minimising the stigma attached to its use. We would recommend structural separation of day to day operational funding facilities and emergency liquidity funding, with a renaming of the operational facility. The Bank and industry both have a role to play in increasing the media and investment communities' understanding of how, why and when banks use the operational facility. This could include publishing historical trend data to demonstrate that use of the operational facility during the credit crunch has had no different pattern than prior to it. We would also recommend that the Bank formalises an extension of eligible collateral during times of stress – this would provide the certainty required for banks to create adequate contingency plans.

The Authorities have engaged well with the industry over the past few months and we have appreciated the opportunity to attend workshops and meetings on these proposals. We hope to be able to continue this level of engagement as the proposals develop further.

If you have any questions about our response, please do not hesitate to contact me directly.

Yours sincerely

## **Barclays Response to Financial Stability and Depositor Protection: Strengthening the Framework**

### **Chapter 1 – Introduction and overview**

#### **1.1 Please provide detail if you think that any of the proposals in this document: are necessary and proportionate; raise significant concerns; or could be improved?**

Barclays broadly supports the thrust of the proposals in this consultation document, subject to the detailed comments below. We do have a number of high level concerns arising from:

- The accelerated timetable for consultation and action which leave too little time for detailed consideration of highly complex issues that cut to the heart of the UK's attractiveness as a financial centre. This is especially true of the reliance that creditors can place on the protection afforded them under English law. Recent issues surrounding the taxation of capital gain and non-domicile individuals have highlighted the need for prior consultation on complex financial services issues.
- The apparent lack of differentiation in the document between types of institutions and the tools that might be appropriate to them. We can see no circumstances under which it would be appropriate to proceed to the immediate liquidation of a bank that was intimately involved in the UK payments system on account of the disruption of the daily lives of citizens and the deep damage that would be done to the economy. While we appreciate that the authorities would find it difficult to agree with this publicly, to proceed to build an infrastructure to cope with the insolvent liquidation of such an institution and the compensation of its depositors in the timeframes envisaged by the consultation paper would be a significant misuse of capital.
- While Barclays sees the need to complete the range of tools at the disposal of the authorities with an SRR, and in particular for the authorities to have a mechanism to circumscribe directors' and shareholders' rights, we are concerned that this may be attracting a disproportionate share of the authorities' attention. This regime will only ever be activated in exceptional circumstances. It is of at least equal importance that the day to day operations of the FSA and Bank of England and the operation of the tripartite agreement receive as much attention as the regime for when these operations have – for whatever reason – failed. We note that the FSA has made an assessment of how it might operate more effectively. We would urge the Bank of England to do the same, and with equal transparency.

#### **1.2 To what extent are the proposals in this document mutually reinforcing?**

The consultation document suggests that elements of the SRR are separate, when there are close relationships between them. We draw out what we see as some of the linkages below.

#### **1.3 The proposals in this consultation document, unless specified, are intended to be implemented for banks, building societies and other deposit-taking firms. Please provide details where this is not appropriate.**

We agree with this approach.

## **Chapter 2 – Stability and resilience on the financial system**

### **2.1 Do you agree with the actions being taken by the Authorities in the UK to improve stress testing by banks?**

We support the proportionate use of stress and scenario testing and note that as a result of Basel II it is embedded in the manner in which management runs the bank. It is right that senior managers are required to think through areas of vulnerability and avenues for contagion and how they would respond to crises and market developments.

However, there are limits of practicability. A potential response to the turmoil we have seen might be to increase the number, severity and detail of liquidity and other stress tests that banks are required to undertake. However, the recent market turmoil highlights just how specific liquidity risk is. The next crisis will almost certainly be different from previous crises and not necessarily the one that was anticipated. Even if firms did correctly anticipate the broad stress scenario, it is likely that crucial channels through which the crisis was propagated would have been missed. There is a real danger that running a large number of detailed liquidity and other stress scenarios and hard coding them into contingency funding plans could lull firms and authorities into a sense of false security and leave them unprepared for and inflexible in the face of alternative scenarios.

Liquidity stress testing in particular is a valuable tool because it helps firms identify the areas in which they may be vulnerable and how these might be correlated. Instead of trying to predict precise causes of liquidity stress, firms and the authorities should put more emphasis on understanding:

- The term structure, composition and behaviour of liabilities;
- Concentrations in the asset and liability profile;
- The strength of relationships with funding counterparties in good times and bad;
- The size, nature and behaviour of contractual and reputational commitments and contingent liabilities; and
- The true liquidity value of assets taking into account the correlation of those assets to the stress in question.

Under this approach to stress testing the focus is on assessing how a firm would cope in the event that particular funding sources cease to be available, particular types of commitments were drawn down or particular contingent liabilities were to crystallise rather than on the specific events in a stress scenario.

### **2.2 Have the Authorities correctly identified the issues on which international work on stress testing and risk management should focus?**

We welcome the emphasis on international co-ordination. We reiterate the points made above with respect to the limits of stress testing as a tool. It is not a panacea.

### **2.3 Have the Authorities correctly identified the issues on which the work on liquidity regulation should focus?**

We agree that the work on liquidity regulation should focus on:

- The balance between quantitative and qualitative requirements;
- The quality and robustness of banks' stress testing;
- The use of liquidity insurance;
- The documentation of banks' policies;
- The quality and effectiveness of contingency plans; and
- The nature and frequency of the management information available.

We note that FSA has had rules in place since January 2005 on stress testing, documentation and contingency planning in respect of liquidity risk.

We welcome the recognition by the authorities that routine liquidity provision by central banks has significant implications for the regulation of liquidity and we welcome the review of the Bank of England's money market operations. When reviewing the arrangements for providing central bank liquidity, the authorities need to be careful not to put the UK banking sector at a competitive disadvantage relative to our US and EU competitors.

We also welcome the commitment to work towards greater consistency in international approaches to the quantitative regulation of liquidity. However, we believe that until an international consensus is established on quantitative requirements, the focus of the UK authorities should be on stress testing, liquidity policies and contingency planning. The UK should not strike out alone in developing a quantitative approach to liquidity regulation.

**2.4 Do you agree with the actions being taken by the Authorities to encourage full and consistent valuation and disclosure by banks?**

We believe that the authorities should encourage market-based approaches to this issue and the work of auditors and standard setters in this area. It is unlikely that a perfect solution to the valuation issue will be found and over-simplifications are likely to be dangerous. It will also be important for the authorities to recognise that valuation and provisioning may, in current circumstances where markets are thin or non-existent, lead to an overstatement of "losses" where an institution is not in the position of having to sell the instruments in question. Over-hasty disclosure on the basis of such distressed valuations may not be as cathartic or as helpful as some commentators seem to believe.

**2.5 Have the Authorities correctly identified the issues on which international work on accounting and valuation of structured products should focus?**

See answer to 2.4 above.

**2.6 Have the Authorities correctly identified the issues on which international work on credit rating agencies should focus?**

**2.7 Do you agree with the Authorities' proposals to improve the information content of credit ratings?**

**2.8 Do you agree with the Authorities that the preferred approach to restoring confidence in ratings of structured products is through market action and, where appropriate, changes to the IOSCO Code of Conduct on Credit Rating Agencies?**

We agree that the focus of the authorities should be on the IOSCO Code of Conduct and working with the CRAs and market participants to address the issues that have been raised, taking into account the global context of this marketplace. While we are supportive of efforts to improve the information content of ratings, the main focus should be on establishing a clear understanding and disclosure of methodologies on the one hand and the limitations of ratings (and the precise nature of what is being rated) on the other.

While it is undoubtedly right that at the level of principle, investors should do their own due diligence over the securities they acquire, there will be clear limitations on the extent to which it will be rational and cost effective for all investors to acquire this capacity. Ratings are likely to continue to play a key role for many investors, and it is entirely rational that this should be so, provided that investors understand what a rating means.

The recent report by the Financial Stability Forum contains many important recommendations for international action on these topics. We believe that it is right for these issues to be considered at an international level and it is vital that the Government and industry ensure any steps taken strengthen the UK as the leading international financial centre.

## **2.9 Have the Authorities correctly identified the issues on which international work on banks' exposures to off-balance sheet vehicles should focus?**

The authorities are right to focus on the implications of the reputational risks relating to off-balance sheet vehicles for capital charges, liquidity requirements and consolidation decisions.

However, this focus needs to be balanced by an appreciation of the benefits that securitisations have brought banks, investors and customers. Securitisation has allowed banks to diversify risks and funding sources. Allowing investors to access different asset classes has driven down the cost of borrowing. This has in turn facilitated the democratisation of credit that has allowed banks to make progress on providing affordable products to a broad consumer base.

## **Chapter 3 – Reducing the likelihood of a bank failing**

### **3.1 To what extent does the FSA's range of existing powers reduce the likelihood of failure of a bank, and under what circumstances would they not be effective?**

FSA has extensive powers that should reduce the likelihood of bank failure. It is, however, key that these are fully used in a timely manner. It is also unclear the extent to which the FSA has been willing to explore the limits of its ability to act. The recommendations of the FSA's internal audit review and the programme of actions that it has taken as a result should largely address this. It is not clear that the FSA needs additional powers for normal business conditions, although we agree that the authorities do need some additional tools to deal with a failing bank. Especially with regards to the interests of shareholders and the powers of incumbent directors.

**3.2 Are the FSA's existing powers, and in particular the application of them, clear, and how could they be further clarified?**

See 3.1 above. FSA should focus on using its existing powers and tools.

**3.3 To what extent are the annual and one-off costs of the new information requirement on banks proportionate? Can they be quantified?**

It is difficult to answer the question fully in the absence of any specific detail about the information likely to be required. However, we strongly question the need for these powers. FSA has sufficient powers to require information under the FSMA. We also question whether the approach outlined is proportionate, given that the FSA will under most circumstances be working with firms that will be actively seeking to co-operate in the common cause of resolving a crisis. FSA already has sufficient powers to deal with recalcitrant institutions.

Banks will seek to provide the FSA with the information that it seeks on a best endeavours basis. Unless the FSA is able to specify in advance the sort of information it will require, firms cannot undertake that they will be able to provide this within the indicative 12 hour deadline specified and any information that can be produced on an ad hoc basis within that timescale cannot be to the same standard of reliability as that produced for normal regulatory returns that are extensively checked. This will also hold true where the FSA is using standard management information – although data accuracy and cost issues will be less in such circumstances.

Similarly, unless the data that will be required are specified in advance, then it will not be possible to make systems changes that will make production of that data easier and faster, and the data themselves more reliable. The cost of altering information systems can be considerable as information may not be easy to extract from information systems that were designed to meet other objectives.

We note in this context, the very considerable effort and investment that went into producing factbooks for use in a crisis. We are not aware that these factbooks have been used during the recent turmoil.

**3.4 How effective would the new information requirement be in identifying and addressing a sudden deterioration in a bank's financial soundness?**

See answer to 3.3 above.

Under Principle 11 a firm is already required to make the FSA aware of such a deterioration without the need for such a requirement.

**3.5 Are there circumstances in which it would not be appropriate for the FSA to collect and share the information that the Bank of England or H M Treasury require?**

We cannot currently envisage such circumstances, although we trust that the authorities would approach issues on their merits with an eye to the common good of financial stability rather than the agenda of any particular institution. Clearly, given the likely sensitivity of such information, it is

important that this information does not get into the public domain or be inappropriately shared with another financial institution.

**3.6 Do you agree with the proposal for a new and flexible regime for payment systems oversight and, if so, how should its scope be defined?**

We do not see a rationale for dividing responsibility for the payment systems between the FSA and the Bank of England. The Bank of England should have sole responsibility for oversight of payment systems. Payments systems are complex operations with links, interactions and dependencies between them. It would be unrealistic to expect the Bank of England to be able effectively to discharge its financial stability mandate if it were not at the same time responsible for the oversight of payment systems as a whole. The governance of payment systems has been reviewed recently following the creation of the Payments Council.

We would also recommend that any new regime recognises the Industry's own arrangements for ensuring continuity and stability, for example, the Liquidity Funding and Collateral Agreement (LFCA) that supports BACS and the Cheque Credit Clearing Co. schemes.

**3.7 Which elements of such a payments systems regime should be effected through statutory powers?**

The Bank of England's responsibility for oversight of payments systems should be established in statute, together with accountability for that regime. The detail of the statutory regime will require further detailed consultation. We would recommend that the Bank and Treasury consider international best practice, for example the American Federal Reserve Bank model.

However, to date we have not seen any evidence that the absence of a statutory base has caused any problems either for overseer or payment schemes. Those who run payment schemes appreciate the quality of the contacts with the Bank of England and the openness of their dialogue. The Bank of England's annual oversight reports have scored the main UK payment schemes well against internationally accepted criteria – in particular, the core principles for systemically important payment systems. Where schemes have been judged not to meet any particular criterion, they have a good track record in responding positively; subsequent oversight reports have indicated that steps have been taken to ensure that the criterion has been met. Most importantly, the overall resilience and integrity of the payment schemes and their supporting infrastructure have been excellent. The Bank of England has also played a role in ensuring that schemes meet the criteria for designation under the Settlement Finality Directive.

**3.8 To what extent is the current provision to register charges at Companies House relevant to banks? Do you agree that it is appropriate to amend it?**

The current provision to register charges at Companies House is relevant to banks. The proposed exemption for banks in receipt of Emergency Liquidity Assistance would be an effective solution to the problem of premature disclosure of Bank of England Emergency Liquidity Assistance.

**3.9 Should any exemption for banks only apply to receipt of ELA, or should there be a more general exemption for all types of lending?**

Any reduction in the availability and reliability of information relating to credit risk must be kept to the very minimum in the interests of maximising the effectiveness of risk management.

**3.10 Would extending the 21 day period be a viable, alternative proposition?**

No.

**3.11 What would be the effect of removing the 'weekly return' reporting requirement? What other statutory reporting requirements disclose ELA?**

The reduction in transparency about the operations of the Bank may have unwelcome signalling effects at a time when the authorities are encouraging greater transparency on regulated institutions. However, we agree with the need to keep ELA confidential. We would therefore encourage the authorities to consider the information that should be in the public domain about the activities of the central bank and the frequency of publication.

**3.12 Do you agree that the Bank of England should be provided with statutory immunity for any acts or omissions which relate to its role in providing financial stability and central banking functions?**

Yes.

**3.13 Do you agree that it is appropriate for the Bank of England to be able to rely upon its security in all such circumstances?**

Yes. As a matter of principle all banks should be able to rely upon their security in all circumstances. If there is doubt on this point, there will be reduced appetite to lend, further damage to confidence and resilience that will undermine the intention of the authorities to enhance financial stability.

**3.14 Do you agree that funds provided by the Bank of England should be exempted from calculation of building societies' wholesale funding?**

Yes. In general terms, funds provided by the Bank of England should be provided on terms that are no less favourable than those granted to other deposit-takers such as banks.

**3.15 What risks are there to building societies granting floating charges over their assets to the Bank of England?**

The authorities require powers over building societies which are parallel to and consistent with their powers over banks. Building societies should be able to avail themselves of the same rights as banks.

## **Chapter 4 – Reducing the impact of a failing bank**

### **4.1 Do you agree there should be a special resolution regime for banks?**

We see a need for a set of tools that the authorities are able to deploy to deal with failing institutions, and for a mechanism that will allow them to set aside the interests of shareholders before existing equity is exhausted.

While we understand that the authorities will not wish publicly to distinguish between institutions, we believe that it is clear that not all tools can be applied to all types of institution. However, the failure to segment the ‘banking’ population means that the authorities envisage a range of possibilities – and consequent requirements upon firms – that are unrealistic and disproportionate. Institutions that are integral to payment systems and key capital market operations will have to be either nationalised, be subject to sale or to a bridge bank type arrangement. The insolvent failure of such an institution would have disastrous economic impacts extending far beyond the financial system. Other “high impact” institutions that take significant quantities of retail deposits that consumers may need to access quickly will need to be subject to sale or bridge bank arrangements. The insolvent failure of such institutions would have significant political and social impacts. Only minor or tertiary institutions are likely to be susceptible to administration/insolvency and the immediate activation of the FSCS.

Consequent to the above, the proposals in the consultation paper for a very large compensation capacity that can be activated within seven days are overdone, although we accept that depositors in minor or tertiary institutions deserve as rapid a payout as possible.

Where the SRR is applied, it should be applied to the entirety of a bank’s business. Once a bank is in SRR, it may then be possible to sell or otherwise dispose of elements of the business as part of the resolution process. Banks are organic wholes and cannot as a rule be easily subdivided.

### **4.2 Do you agree that the trigger for a bank entering a special resolution regime should be based on a regulatory judgement exercised by the FSA in close consultation with the Bank of England and H M Treasury?**

Yes. The FSA will need to develop a series of triggers that will be the cue for an institution to be placed under heightened supervision. During this period which is designed to nurse the failing institution back to health, the authorities should also be selecting and preparing to use the appropriate SRR tool, so that if the SRR is activated, the authorities are able to act decisively and in a manner that will prevent spillovers to the wider financial sector.

The FSA will need to publish a frame work with details of the types of triggers it will use to determine whether the SRR could be activated and how the FSA will assess these triggers. These triggers should be closely related to the current Threshold Conditions. Triggers should cover liquidity, solvency, management capacity and reliability and the reliability of the bank’s systems and infrastructure. These triggers would not automatically lead to the application of the SRR, but would require the FSA to make a judgement as to whether the SRR should be invoked. This would be a decision for the FSA alone – although clearly there should be close consultation and preparation with the other tripartite authorities.

The existence of such triggers would, to the extent that they were specific, protect the authorities against shareholder complaints that their interests had been unfairly treated. They would also allow shareholders and other market participants to exert a degree of market discipline as thresholds were approached.

**4.3 Do you agree that the trigger should be linked to regulatory guidance material?**

It would be helpful if the FSA could be as transparent as possible about the way in which they intend to employ the triggers. Guidance developed over time would help inform the market.

**4.4 Do you agree with the special resolution regime process as outlined?**

There is insufficient detail to be able to answer this question fully. At a minimum what is required is for the Tripartite Authorities to spell out unambiguously who will have responsibility for what and at which point in a crisis. There needs to be further consultation on a fuller set of proposals. We agree with a mechanism that allows the interests of shareholders to be set aside. We are not yet persuaded that the SRR should potentially set aside or disturb the property rights of other creditors and counterparties. A key element in the success of London as a financial centre is the financial confidence English law has inspired in counterparties about the protection for and certainty of their property rights. Were counterparties to lose confidence in the protection afforded them by English law, potentially very serious consequences could ensue.

**4.5 Do you agree that the potential abridgement of property rights in the special resolution regime can, in principle, be justified with a suitable public interest test?**

In some circumstances abridgement of shareholder property rights may be appropriate as part of the SRR. However, the consultation paper does not make the case for this, and much more clarity is required around these powers and how they would be used in order to have an informed debate on this issue.

**4.6 What safeguards and appeal processes would be needed to support a public interest test for the special resolution regime?**

The clarity of triggers should go some way to achieving this. In addition appropriate guidance as to how the regime would be operated should be provided. Any application to the courts should not be able to prevent application of the SRR.

**4.7 Do you agree that the Authorities should have the power to direct a sale of a bank possibly against the wishes of the directors or shareholders?**

Yes. However, we believe that in order to minimise the possibility of unintended consequences for counterparties, creditors and customers, this power should apply to the entirety of the institution. This will ensure equal treatment.

If an institution has businesses that could be readily sold to recapitalise the bank, this restructuring should occur only after the bank is under its new ownership and the divestment can be properly and prudently managed. To attempt a restructuring in the heat of a crisis may lead counterparties and

creditors to question the viability of the bank and may crystallise the failure that the authorities are seeking to avoid.

However, as a general rule we see major practical obstacles to splitting a business and effecting a partial transfer. The disparate businesses of a bank may often operate out of the same legal entity, and operations that are apparently separate can and do share premises, systems and personnel.

**4.8 Is judicial review the correct mechanism for challenging a decision to institute the directed transfer?**

Yes. The possibility of judicial review cannot be avoided, but the limited scope of the grounds for review should ensure that certainty and decisiveness with which the authorities need to act should not be significantly adversely affected, especially if the objective triggers for intervention have been met.

**4.9 Is the Financial Services Tribunal the right forum for resolution of transactional issues such as valuation or distribution of proceeds among stakeholders?**

The FST would need to be given a remit with respect to the Bank of England and the Treasury that it does not currently have. Provided that this is done, it could be an appropriate forum

**4.10 Do you agree that, in tightly defined circumstances, the Authorities should be able to take control of a failing bank through effecting a transfer of some or all of its assets and liabilities to a bridge bank? Do you agree that some flexibility in the description of these circumstances is also desirable?**

Yes, but only where a sale of the institution has not proved possible. For the reasons given above, we believe that the whole institution should be transferred, with restructuring taking place subsequently in a considered manner after appropriate due diligence.

While a bridge bank should be a temporary arrangement, it is not clear why the authorities have sought to limit the arrangement to twelve months (albeit with the possibility of extension).

Nor are we convinced that the other limitations that the consultation paper envisages will always be appropriate. The paper envisages that the new management would have a business plan that would run the bank conservatively. That may well be appropriate to preserve value, but it is possible to envisage circumstances where the preservation of value may require investment and other entrepreneurial actions. This may particularly be the case with “healthy” parts of the business that are being prepared for sale. Management’s mandate should not prevent these actions.

**4.11 Do you agree with the removal of shareholders’ and directors’ rights and temporary suspension of creditors’ rights under this bridge bank proposal?**

We broadly agree with the removal of shareholders’ and directors’ rights. However, we do not see merit in the disruption of counterparties’ and creditors’ rights. Any removal of directors’ rights would also need to be accompanied by a suspension of their liabilities for actions taken under the SRR.

**4.12 Is judicial review the correct mechanism for challenging a decision to transfer to a bridge bank?**

See 4.8 above.

**4.13 Is the Financial Services Tribunal the right forum for resolution of transactional issues such as a valuation or distribution of proceeds among stakeholders?**

See 4.9 above.

**4.14 Should a new bank insolvency procedure be introduced for banks and building societies as an option for the Authorities instead of normal insolvency procedures?**

The consultation paper does not make a case for a bank-specific insolvency regime, or explain why the current regime could not work for banks with a number of adjustments specifically for deposit-taking institutions (for example by requiring FSA consent before a deposit-taker could be placed in insolvency). Barclays believes that a fuller consultation is required here, and that the existence of the SRR will mean that only minor, low impact banks or tertiary institutions are likely to face an insolvency procedure.

**4.15 Do you think that there ought to be provision in the bank insolvency procedure for continued trading of some of the bank's business in the interests of depositors or other creditors? If so, how do you think this might work?**

If a bank is in such a position that it is in actual insolvency procedures it is rarely going to be appropriate for it to continue trading. If, for any reason, it is felt necessary that a bank should continue to trade, then one of the other tools in the SRR should be applied.

**4.16 Should the objectives of a bank liquidator be limited to assisting a rapid FSCS payout to eligible depositors and then winding up the affairs of a failed bank? Should the proceedings have any other statutory objectives?**

We also do not believe that the primary objective of the procedure should be to facilitate FSCS payments, but to preserve and maximise the value of the assets of the failed institution in the interests of the creditors as a whole. It is right that the liquidator should assist the FSCS with the provision of relevant information, but as a general proposition wholesale and uninsured creditors (which may include charities and good causes as well as for profit companies) are as worthy of the liquidator's protection as insured creditors. Insured creditors have the FSCS to look after their interests. The consultation paper conveys the impression that the UK authorities are primarily focused on retail depositors and minimising the authorities' involvement. Counterparties and wholesale depositors are crucial to the health of UK banks and to London as a financial centre. It is of fundamental importance that the UK does not inadvertently convey the impression that it is disinterested in creditors' rights.

An objective to operate in a manner that promotes confidence in and the integrity and stability of the financial system may also be helpful.

**4.17 Should a bank insolvency procedure be subject to the overall supervision of the Authorities?**

The liquidator should liaise closely with the authorities. The institution being liquidated should in any case remain under the supervision of the FSA until all deposits have been repaid and/or the liquidation is complete.

**4.18 Should a bank insolvency procedure be a stand-alone regime in which the bank liquidator has the combined powers of an administrator and liquidator? Are any other powers required?**

See 4.14 above.

**4.19 Should the FSCS cover any additional costs that a new bank insolvency procedure may incur?**

No. We do not see what role the FSCS has to play in the liquidation of the failed institution. Its role is and should continue to be limited to the compensation of insured deposits. The costs of the liquidation should be met in the normal way – that is paid out of the insolvent estate.

**4.20 Should further consideration be given to the introduction of depositor preference?**

The consultation paper correctly identifies the adverse consequences for banks and other creditors in terms of increased wholesale funding costs. The SRR tools should give the authorities the instruments that they need to secure the interests of depositors.

**4.21 Do you agree that commencement into insolvency should be controlled by the Authorities, for example, through requiring 14 days prior notice be given to the FSA? Should normal insolvency proceedings be retained alongside the bank insolvency procedure?**

See 4.14 above.

**4.22 What should the governance arrangements for SRR be?**

The consultation paper does not identify who will be responsible for running the SRR. It does not seem appropriate that the FSA run it. The FSA are rather responsible for banking supervision, including heightened supervision, and the triggers for activating the SRR. They will also be maintaining the continued supervision of the institution in SRR. We see no merit in creating an FDIC-type institution to do this given the low probability of the SRR being used in any one year, or to give this role to the FSCS which is and should continue to be a specialist compensation fund. The Bank of England should therefore run and be accountable for the SRR.

**4.23 Do you consider that introducing the office of the restructuring officer as part of the SRR would be a helpful and necessary development?**

We are puzzled by why this position is thought necessary. If the SRR is engaged, one of the first actions should be to appoint new executive management for the failed institution with responsibility to bring it back to health or to dispose of it in an orderly manner. We struggle to see what the restructuring

officer would do that new management was not doing, and there would appear to be the possibility of real confusion of roles and responsibilities. That said, provided that there is a clear role and rationale for the appointment, we have no fundamental objection to the creation of this position.

**4.24 Do you have any comments on the specific implications for shareholders, creditors or directors from the appointment of the restructuring officer over and above those already raised by the other resolution tools?**

See 4.23 above. If a restructuring officer has power to compel directors of a failed institution to take actions that they would otherwise not take, then it would be unfair to make those directors bear responsibility for these actions, and inappropriate for the restructuring officer not to be appointed to the board of directors.

**4.25 Should the Government have the power to take temporary ownership of a failing bank, in order to facilitate a more orderly resolution? Under what circumstances would it be appropriate for this power to be exercised?**

Yes. We foresee that such a power may be needed when it is vital that markets are assured that the full credit of the UK Government and taxpayer is engaged in supporting a bank. This may be needed when difficulties start a process of contagion that threatens otherwise healthy institutions and/or threatens the credit of the UK, especially if there is insufficient time to apply other tools in the SRR. As recent events have shown, time is of the essence and decisiveness is key.

**4.26 Do you agree that the special resolution regime should be extended to building societies but not other mutuals?**

**4.27 Do you agree with the proposals for a new accelerated directed transfer procedure for building societies, similar to that proposed for banks?**

**4.28 Do you believe a form of temporary public sector control through a bridge bank should be provided for building societies?**

**4.29 Do you agree that a building society insolvency procedure should exist for building societies alongside a similar model for banks?**

**4.30 Do you agree that the Treasury should make an Order under the 2007 Act to ensure that, on the winding up or dissolution of a building society, any assets available to satisfy the society's liabilities are applied equally to creditors and members?**

The authorities require powers over building societies which are parallel to and consistent with their powers over banks.

**4.31 Should the industry contribute to the costs of an SRR?**

No. The costs should be recovered from the assets of the failed bank as would be the case with other procedures. The SRR allows the authorities to take control of the institution while it retains positive value. This should allow the costs to be recovered.

**4.32 Would mechanisms other than the FSCS be appropriate for addressing such cost issues? How might such mechanisms work?**

There is no role for the FSCS in the SRR, other than the compensation of depositors in the event that the bank is placed into insolvency. FSCS has neither the skills nor the resources to be anything other than a specialist compensation provider. The FSCS also has compensation responsibilities in the investment and insurance sectors and it is important that the FSCS is not overly focused on the banking sector at these sectors expense. We reiterate that the costs of the SRR should be recovered from the failed bank.

**4.33 Are there any other mechanisms available to secure access to payment systems for agency banks in the event of a settlement bank failure?**

The proposed mechanism for maintaining access to payment systems in the event of a settlement bank failure is unworkable. It would be extremely costly and inefficient to put in place back-up settlement arrangements. The process of switching settlement banks is complex, costly and time-consuming. Moreover, it would be difficult, if not impossible to test these back-up arrangements effectively. Without such regular testing, it is quite likely that the back-up settlement bank arrangements would not work properly when needed.

A more practical and secure mechanism for maintaining access to settlement bank services would be to use the SRR tools of directed sale, bridge bank or nationalisation.

**4.34 Are there contingency measures that banks could adopt to ensure that their organisation and structure are compatible with the tools proposed in the special resolution regime?**

No. The minute likelihood of the failure of a settlement bank means that additional measures, beyond existing good business practice and regulatory requirements in relation to contingency planning and outsourced suppliers of services, would not satisfy a cost-benefit analysis.

**4.35 Do you agree that the Government should take a power to enable it to make secondary legislation in relation to financial collateral arrangements, and with the proposed definitional scope? If not, why, and what would you suggest?**

The consultation paper does not make it clear what the Government envisages in this case. Financial collateral is a highly complex issue that involves international standards and where we are not aware of particular issues under English law that require immediate attention. This is another area where a much fuller consultation is required if unintended consequences are to be avoided.

**4.36 Do you have any suggestions as to future revisions to the financial collateral regime that should be considered?**

See 4.35 above. UK arrangements should continue to reflect international standards and the requirements of relevant EU Directives, and inspire the utmost confidence in the protection afforded by English law.

## **Chapter 5 – Consumer confidence and compensation arrangements**

### **5.1 How would a higher compensation limit affect consumer confidence?**

Given that a £35k limit covers some 96% of deposits and savings accounts, we believe that the positive effect of a higher compensation limit would be very minor, and that the cost of procuring that effect would be disproportionate to the contingent liability that the UK banking system would be required to bear.

Some commentators have blamed the UK's deposit protection arrangements for the run on Northern Rock. However, we do not believe that these were a key factor in starting the run, as is demonstrated by the consumer awareness data in the consultation document that shows that even after Northern Rock, only 1% of consumers were able to identify the correct level of coverage for deposits.

### **5.2 How would a higher compensation limit affect the responsibility consumers have for their financial choices?**

Practical experience in the US savings and loans crisis of the 1980s suggests that where consumers are very aware of their levels of protection, they are capable of behaving in a way that seeks highest return on deposits without thinking about risk. The savings and loans crisis cost the US taxpayer many billions. We therefore think it prudent to assume that significantly increased limits would lead to consumers taking less responsibility for their financial choices.

### **5.3 How would a higher compensation limit for deposits affect consumer perception of other financial products?**

There may be some effect at the margin if levels of compensation are greatly different, but in general there is no evidence that consumers regard the broad asset classes of deposits, insurance and investments as substitutable. Bank deposits have historically been subject to lower levels of compensation than investment products and insurance without undue adverse impact on the banking sector. There is no reason to suppose that an increase in the level of deposit coverage will have an adverse effect on other financial products.

We would also observe that institutions do not market products on the basis of the arrangements that will apply in the event of the bankruptcy of the firm.

### **5.4 Which of the solutions to cover balances above the compensation limit is the most practical, desirable and/or proportionate, and why?**

Our preferred option is for a market solution, although we acknowledge that there is currently no market for this product in the UK. Whilst the development of a private deposit insurance market merits serious consideration we do not see mandating deposit-taking institutions to offer such insurance as an appropriate use of legislation and would be concerned that a statutory requirement may in fact reduce depositors' confidence in other mechanisms for depositor protection.

**5.5 What types of large balance should be subject to additional protection, and in what circumstances?**

It could be argued that certain circumstances are more deserving of additional protection as the large balance has arisen as an integral part of a transaction for which the depositor has no alternative, such as house purchases. However, this risks an extension of the coverage of the compensation limit beyond its original purpose and the risks attached to a higher limit as discussed above in response to question 5.2.

**5.6 Are there other circumstances, apart from client accounts, where consumers have little influence on where accounts are opened? What are your views on how the issue of client accounts might be addressed in relation to compensation payouts?**

There are numerous circumstances where an individual may not have direct control over where funds in which they have an interest are deposited. These include trust accounts and accounts held by a qualified guardian.

**5.7 What are your views on a one-week target for FSCS payment?**

We agree that depositors should receive compensation payments as rapidly as possible. However, we do not believe that a one week target is achievable. The balance sheets of major banks will take about this length of time just to settle.

For accounts that are used to make everyday purchases, a one week delay is both too short (balances potentially fluctuate as payments clear and payments are potentially returned), and too long (the monies are needed for essentials).

Even if it were possible to make a one week payment, it would not be possible for the banking system to absorb all the customers of a major bank, in terms of account opening, provision of debit cards, transfer of direct debits and standing orders etc. Banks maintain a certain amount of spare capacity to accommodate new customers and those transferring from other banks, but this would be quickly exhausted. The system and normal banking services would grind to a halt under the strain of trying to reallocate all these customers, crystallising the systemic risk that the authorities were looking to avoid.

This reinforces the point made above that the authorities should not use the compensation tool to deal with a bank that has significant volumes of payments business. Instead, one of the other SRR tools should be used to allow the infrastructure of the failing bank to be used and to allow consumers continuous access to their funds. This would also avoid the expense of developing infrastructure that would never be used.

**5.8 How feasible would be it for banks to provide instant access to the funds provided by FSCS cheques as soon as they are deposited?**

It might be possible to treat FSCS cheques as cleared funds, provided that these can be properly identified. The use of cheques does present significant fraud risk, and alternatives should be considered.

**5.9 Are there other means to ensure consumers have access to funds within one week, including alternative payment methods to cheques?**

See answers to 5.7 and 5.8 above. The answer is to use the infrastructure of the failing bank.

**5.10 How effective would interim payments be in mitigating consumer detriment when a full payout is not possible within a week?**

Interim payments present the same issues as full payments. Again, using the failing bank's infrastructure would appear to present the cleanest solution.

However, interim payments may potentially have a role to play to mitigate hardship and encouraging confidence and are used in Japan.

**5.11 How quickly could banks make the changes to have the necessary information readily available on account balances of FSCS-eligible depositors, and what would be the cost to them?**

Our understanding is that banks are in very different places in developing a single customer view. Barclays is still developing its systems, although this work is progressing well. Our experience is that it has been very time-consuming (several years) and expensive (tens of millions). We understand that we are among the market leaders in this regard. It is clear that some banks have yet to begin this process.

It is also worth stressing that while systems will register a customer's interest in accounts with the bank (including joint accounts), no system is going to be able to pick up an individual's further interest in accounts where the depositor is not named. These could include trust accounts, solicitors' accounts and the like.

**5.12 Should banks follow a common data standard or format, and, if so, what would this entail?**

Given that a number of banks are already developing their systems, the specification of common formats would be too late and potentially disadvantage those that have already invested. The retrofitting of systems to standard definitions and labelling would be disproportionately costly and complex to implement.

More importantly, the rationale for a single customer view must always rely on other elements of the business case, and to be useful to the business, the system will need to be tailored to the circumstances of the individual firm.

**5.13 What information should be included in a single customer view and what would be the implications for firms or different information requirements?**

As the FSCS needs to know who has a right to be compensated and in what amount, it would make sense to limit information to names, account numbers/sort codes, cleared and ledger balances, interest rates, maturity dates and possibly recent transactions. It would be important to keep it simple.

**5.14 How would banks place a 'flag' on accounts that are not eligible for FSCS payments?**

Flagging known accounts would be simple – e.g. directors. However, certain ineligible accounts would be impossible to know in advance – e.g. those involved in money laundering (which if we were aware of we would be taking action against in conjunction with the relevant authorities). Other accounts might depend on the circumstances at the time, or vary through time, e.g. businesses that met the criteria defining a small business in the Deposit Guarantee Schemes Directive. The simpler the eligibility criteria, the more feasible flagging would be.

**5.15 Are there other classes of depositor that should be ineligible for FSCS compensation payments and, if so, why?**

The consultation paper envisages a significant extension of the scope of compensation to cover entities far removed from the original objectives of depositor protection, that should be able to protect themselves. Many of these parties are easily identifiable.

**5.16 To what extent would gross payments help maintain depositor confidence and speed up payment?**

Maturity should be respected. We appreciate that to offset a current account deposit against a term loan or mortgage could create consumer detriment. We believe that applying gross payments would avoid this unfairness and, at the margin, might help both maintain confidence and simplify the system. However, in keeping with our position that the maturity of commitments should be respected, where a depositor has both a positive balance on one account and an overdraft on another, we believe that the two should be netted as the overdraft is not a term facility.

**5.17 To what extent are gross payments justified by maintaining depositors' access to liquidity as well as by accelerating payments by the FSCS?**

See 5.16 above.

**5.18 What are your views on the link between FSCS gross payment and set-off?**

See 5.16 above.

**5.19 Are any other measures necessary to better align FSCS rules and the provisions of the proposed bank insolvency procedure?**

No comment offered.

**5.20 What are your views on the removal of the formal claims process? What risks would be involved in the FSCS automatically sending out cheques and how can they be mitigated?**

The use of cheques does present significant fraud risk, and alternatives should be considered. To the extent that the infrastructure of the failing institution is preserved under new ownership and management, this issue is much reduced in significance.

We would observe that this proposal is very reliant on the quality of data at the failing bank, and it may not be possible to do this in all cases, especially where there may have been management fraud or poor management. Would the authorities require the FSCS to pay out on the strength of the books and records of an institution failing under circumstances similar to BCCI?

A claims-free process could probably only be used for active accounts. Data quality issues also arise in the case of accounts that have been dormant for some time. In these cases it is highly likely that the personal details will be out of date.

We understand the attractiveness of this proposal to the authorities in terms of streamlining the process. However, if compensation is used mainly for very minor or tertiary banks, then we believe that the need for the immediate disbursement of funds is much reduced, and a more orderly claims process can take place. This would also have the merit of allowing the authorities to obtain sufficient details about claimants to use more secure forms of payment such as electronic transfers.

### **5.21 What are your views on the introduction of an element of pre-funding into the FSCS?**

The structure of banking and the distribution of deposits between banks in the UK means that pre-funding is not appropriate, not as a matter of principle but because it would be an ineffective and a disproportionate response.

Firstly, we do not believe that the authorities can credibly maintain that they will allow the failure of a systemically significant UK deposit taker, or of a deposit taker that has a significant retail deposit base. In the first case the damage to the UK economy and its international standing would be catastrophic. Damage to London as financial centre would be incalculable. In the second the damage to public confidence in the financial system would be such that there could be significant second round systemic effects as well as a strong political reaction. If banks of this nature were to fail, the authorities should use different tools within the SRR.

Secondly, the corollary of this is that compensation should be the tool generally applied to very minor or tertiary banks, which by their nature will have relatively low levels of eligible deposits (especially if the Government does not extend the scope of eligible depositors as proposed). A post-funded scheme would be appropriate for such circumstances.

Thirdly, given the manner in which UK deposits are concentrated in relatively few hands, the fund would have to be very large in order to be able to cover the failure of even a medium-sized bank. A fund of the size envisaged in the consultation paper, while representing a very significant contribution of capital, would barely cover half the retail deposits at Northern Rock. We could expect the press to draw attention to this, considerably reducing the positive effect on public confidence that any fund might have.

Fourthly, the existence of a fund of the size envisaged would have relatively little impact on levies if the authorities were ever to allow a major bank or building society to fail. Concern about funding compensation payments should be addressed by a line of credit from the Bank of England, if necessary with a guarantee from the Government.

Finally, this is an unproductive use of capital. Drawdowns would be rare. We believe that trying to create a UK version of the FDIC takes insufficient account of the different circumstances in the US, particularly the fact that the FDIC is backed by the US Government.

We strongly believe that a post-funded model continues to be most appropriate to the nature of the banking industry and the regulatory framework in the UK.

**5.22 What steps would need to be taken to ensure that pre-funding would be compatible with other elements of the FSCS funding arrangements?**

We see no role for pre-funding.

**5.23 What are your views on whether the FSCS should be permitted to borrow from the Government or the Bank of England?**

We believe that this would be appropriate to give the FSCS operational flexibility and speed of response.

**5.24 How soon could streamlined procedures for opening accounts be introduced so that the one-week target for a new account can be met?**

This is simply unrealistic, except perhaps in the case of the failure of a minor bank and possibly for savings accounts.

The process of opening potentially millions of current accounts are legion and could bring normal banking operations to a halt. Even if accounts could be opened (and this would place enormous strain on branch staff and on customers of the failed bank that would have to queue to do this), making the accounts operational through the transfer of standing orders and direct debits and the provision of debit and other cards would take considerably longer. Some of the steps to be taken would be in the hands of employers (for salaries) and direct debit originators that might also be overwhelmed. For payments that went in error to the failed bank, there would be significant issues in getting these back from a liquidator that might be looking to maximise the value of the insolvent estate.

This is why we have been so insistent that, for banks that are involved in significant volumes of payments, it is not appropriate to use the tools of liquidation and compensation. Instead, the authorities should look to put the failing institution into safe hands and to operate the existing infrastructure under new management, thereby ensuring continuity of customer service.

**5.25 Are there additional risks which need to be considered with this faster account opening method?**

There are significant risks to the operation of normal banking services; there are also significant risks to the effective operation of monitoring and anti-money laundering processes. There is also a risk that the confusion created could lead to a secondary crisis of confidence in the banking system.

**5.26 How else could the account opening process be sped up?**

We note the suggestion that money laundering precautions could be deemed satisfied by relying on the procedures of the failed bank. This may not always be practical, especially where a bank may have unreliable or disrupted systems and controls, or where a bank may have been complicit in criminal or unethical activity.

The EU review of bank account portability shows that the UK account-switching process is market-leading and that portable bank account numbers are not a way forward.

**5.27 What else would be needed to enable banks to provide instant access to funds following the deposit of a FSCS compensation payment?**

Banks may need to be able to access additional liquidity.

**5.28 What notification requirements on compensation should apply to banks, and how can they be made less burdensome? Would these have an effect on market stability or depositor confidence?**

Clearly, consumers will need to be informed through a range of media. The consumer awareness data in the consultation paper suggests, however, that there are real limits to what is possible in terms of depositor awareness and confidence. It is necessary to avoid conveying an impression of a banking system in permanent crisis on the one hand or encouraging morally hazardous consumer behaviour on the other.

We believe that the focus for banks should be on existing channels, including websites, leaflets and statements. Where a bank operates more than one deposit-taking brand an annual illustration of what that means for the consumer and entitlement to compensation should be provided.

We do not see merit in alerting customers as they pass the compensation limit. There is the potential to create undue alarm. The messages about compensation need to be conveyed in a calm manner, as consumer education. The caveat surrounding all awareness raising activity is that it should increase confidence in the system.

**5.29 How should disclosure requirements be imposed?**

An agreement between the banks and the authorities may be preferable to rules that are difficult to change, especially if there is a need to adapt to changing circumstances.

**5.30 What would be the best way for DWP and HMRC to make payments in the event that consumers did not have access to their bank accounts?**

Please see comments above about the need to operate through the existing infrastructure of banks involved in the payment systems.

**5.31 What are your views on the proposed changes to increase FSCS management flexibility?**

We do not see a need for the proposed changes.

**5.32 Are there other possible changes which could increase management flexibility for the FSCS or enable it to process a large volume of claims quickly in the most cost-effective way?**

We do not see the FSCS as ever constituting a realistic vehicle for the winding-up of a significant bank or building society.

**5.33 What are your views on the use of risk-based levies or on the introduction of behavioural factors into the calculation of the levies?**

Risk-based premia could make sense if pre-funding is applied. We reiterate our opposition to pre-funding as ineffective in the UK context.

In the context of our preferred post-funding option, risk premia and variations introduce unnecessary complexity at a time when speedy collection is required and time is of the essence.

**Chapter 6 – Strengthening the Bank of England****6.1 What are the benefits of formalising in statute the Bank of England’s role in the area of financial stability, and giving its Court responsibility for overseeing its performance in this area?**

We support the formalisation of the Bank of England’s responsibility for financial stability.

**6.2 To what extent would the proposals improve the ability of the Court of the Bank of England to oversee the Bank of England’s performance including its enhanced role in the area of financial stability?**

We support the proposals to improve the structure of the Court of the Bank of England. The Court should be smaller and there should be a review of its membership criteria to ensure an adequate balance of relevant professional experience.

**Chapter 7 – Effective coordination****7.1 To what extent will the proposals enable an improved handling of a financial crisis?**

We believe that the structure of the tripartite system is broadly right, but that much greater clarity is needed on the roles and responsibilities of each authority. The tripartite authorities must not underestimate the importance of clear communication with both the industry and the general public. In times of stress the authorities must be able to speak with one voice and respond publicly to changing events swiftly.

**7.2 To what extent would the proposals strengthen the operation of the IMF and FSF?**

The global nature of financial markets makes it vital that issues are considered at a global level. The proposals contained within the consultation paper seem sensible.

We have read the FSF's recent report to the G7 Finance Minister's with interest and are keen to engage with the authorities on its detail. The Treasury will need to carefully consider the potential impact of these international initiatives and it would be helpful if the Authorities could outline their position on the recommendations.

**7.3 To what extent would the proposal for the IMF and FSF to work together to develop an early warning system be helpful in improving risk identification and financial sector resilience at the international level? How would this best be implemented?**

We support moves to increase cooperation between the IMF and FSF to develop an early warning system to compliment existing national systems.

**7.4 To what extent will these proposals aid authorities in managing international financial crises?**

The international nature of many financial institutions will complicate the management of a significant failure. It is vital the Government retains a strong voice within the international fora which will develop further policy in this area. There is little detail regarding how the Authorities would manage the failure of an international institution. This should be considered as part of a further more detailed consultation process.