

23 April 2008

Dear Sirs,

Consultation paper: *Financial stability and depositor protection: strengthening the framework*

We welcome much that is proposed in this paper, and in particular proposals to introduce a special resolution regime and preserve critical banking functions in the event of a banking failure. An effective system of depositor protection is extremely important for older people, who often have limited opportunity to replace lost assets.

We intend to comment when the FSA consults on its review of the Financial Services Compensation Scheme (FSCS), but in the meantime we have some comments on specific questions in the current consultation.

Definition of a 'single bank'

We are disappointed that the FSA does not intend to review the definition of a 'single bank' (paragraph 5.5), which is extremely unclear. While we can understand the principle of applying to the limit to all accounts with a 'single bank', in practice consumers seeking to diversify their risk might not appreciate that a single bank might encompass several banking brands. It is essential that consumers are given the information they need in order to reduce their exposure. The definition of 'single bank' should be changed so that there is a separate compensation limit for each separate banking 'brand'. Failing this, banks with more than one brand should be required to tell consumers who are opening an account, and at regular periods after that, if other brands belong to the same 'single bank'.

### Balances above the compensation limit

We are pleased that the paper recognises that consumers who are far from wealthy may have balances above the compensation limit at certain periods in their lives. The paper puts forward three proposed solutions.

*Q5.4 Which of the solutions to cover balances above the compensation limit is the most practical, desirable and/or proportionate, and why?*

It is our strongly-held belief that it is not reasonable to rely on individuals to spread their risk among several banking institutions – not least, because of the difficulty of defining a ‘single bank’. It is particularly difficult for older people, who may not have access to information on the internet and who may be opening a high-value account at a stressful time – such as when moving house or entering a care home, or following a bereavement. It also places a heavy burden on friends or family who have legal authority to act for someone with limited capacity to take financial decisions.

We would also have reservations about relying on private deposit insurance alone, although it might have a role to play if it could be provided at reasonable cost, perhaps bundled with another product or offered as part of another transaction, e.g. through conveyancers on selling a property.

We would certainly like to see the option of extending the limit for particular transactions explored further - even if private insurance is available, the risk is that those who would be most vulnerable to loss would be the least likely to buy it, for example older people reliant on a redundancy payment or pension lump sum. The FSA’s work on financial capability has shown that the area where older people are least capable is that of choosing financial products.

*Q5.5 What types of large balance should be subject to additional protection?*

We support the idea of increased protection for certain accounts, but reject the idea that this should only be available for non-interest bearing accounts as the consumer would be paying a heavy cost for the increased protection. Nor should the protection only be limited to short-term accounts – as stated above, older people often have good reason to keep larger amounts in for long periods (for example, to pay for care home fees, or if they are not in a position to accept investment risk).

The FSA should take account of the marketing messages put out by the financial services industry. Banks and building societies tend to offer better rates for larger amounts, and for fixed-rate accounts in particular (which are often attractive to older people) the best rates may require a deposit above the maximum compensation.

We would like to see the FSA exploring the feasibility of special accounts where the bank pays for some form of deposit insurance for amounts above the maximum compensation. We accept that the cost of the insurance would be reflected in the interest rate, but this would give the bank a strong incentive to buy a keenly-priced policy, and would also mean that the insurer contracts with the party (the bank) that is best placed to give information relating to the risk. It would also mean that those banks who would have to pay above-the-odds would be more likely to limit the maximum investment.

### Speeding up FSCS payments

We welcome proposals to speed up payments, streamlined claims processes and particularly the one-week target. However, we have concerns around the logistics of sending out individual cheques that would then have to be banked. Customers without internet access or with limited mobility may face many barriers in finding a replacement account within a reasonable time, Vulnerable consumers would also be at risk of fraud. Is there no way of setting up 'interim' accounts, with funds paid in by automatic transfer, without the customer having to make a choice immediately?

### Gross payments

We support moves to gross payment, rather than netting off accounts in credit against loans with the same bank. A customer's ability to borrow may have declined since the loan was first granted, and they could face severe hardship if liquid assets are lost – even if their overall wealth is not reduced.

### Pre-funding

We are pleased that the issue of pre-funding the scheme has been raised and believe that a certain amount of pre-funding should be considered. It would greatly increase consumer confidence. A risk-based levy would also increase the incentives for banks to manage their risk effectively.

### Consumer awareness

All customers should be told about the limit, both at outset and regularly, but in order for this to be meaningful the FSCS rules may need to be simplified. For example, in a recent BBC Money Box programme on the FSCS the interviewee could not – because of the complexity of the 'single bank' rule – give a definitive answer to a question about whether two well-known banks which belong to the same banking group would count as a single bank. Banks should be required to warn consumers who are trying to open an account for more than the compensation limit and – unless the 'single bank' definition is changed – people who are depositing large amounts that are approaching the compensation limit.

### Protecting vulnerable consumers

The DWP and HMRC should consider providing emergency access to cash for people in need – perhaps using the model of the contingency plans being developed against the possibility of pandemic flu. We doubt whether pre-paid cards will be workable until they are more widely used and understood.

Yours sincerely,