

Financial Stability and Depositor Protection: Strengthening the Framework

CBI Response

Executive Summary

The consultation paper sets out proposals for extensive changes for the UK banking system against a very aggressive legislative timetable. The CBI believes that time should be taken to consider the proposals very carefully. In our view it is more important to get the reforms right than meet an arbitrary time table. Legislative haste brings with it the probability of undesirable effects on what is a highly dynamic part of the UK economy.

To give one particular example, the proposed special resolution regime represents large scale changes of rights to the holders of the entire capital base of banks, both shares and loan capital, and should not be undertaken lightly. The CBI's members, both banking and investors, have voiced significant concern on these proposals. With the Banking (Special Provisions) Act 2007 in place these complex issues can be fully and properly considered.

Having said this, there are some areas that can quite easily be dealt with fairly quickly e.g.

- Detailed consideration of the speeding-up of compensation arrangements.
- Any action needed to bring about improvement in the operation of the tripartite arrangements and the Bank of England powers in support of the market

CBI members believe that changes can be made to the current compensation scheme to speed up payments but feel that there is no need for a change to a pre-funded regime. It would take a substantial amount of time to build up to any significant sum (the US system, in operation since 1933, has at its disposal at present only sufficient funds to deal with Northern Rock's retail depositors), and that its funding would be a significant burden on the industry. We further feel that there is no need for extension of the current compensation arrangements to business depositors, as this would neither be of sufficient advantage to many companies holding deposits over £35,000.

Primary responsibility for prudent banking falls on management and the costs of failure should be borne by shareholders. However this does not excuse the regulator from properly discharging its function. In the case of Northern Rock there is widespread agreement that both management and the regulator failed. The CBI believes there needs to be more skills and competence at middle management in the FSA to deal with ongoing firm monitoring and surveillance. Northern Rock also highlighted that to the extent that the Authorities felt constrained by EU directives, clarification is needed so that if necessary, action can be taken in the future.

The credit crunch and failure of Northern Rock have damaged the UK's financial reputation over the short term. If we take the time to get the answers right, the UK has the capacity to emerge strengthened by this experience, and it is absolutely vital to the UK economy that this is achieved. The CBI is keen to work with all concerned to ensure that this is the outcome.

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?*

Please refer to our opening comments. In our view some of the proposals are necessary. The proposal for a Special Resolution Regime raises significant concerns.

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

Some of the proposals do not appear to be mutually reinforcing. The special resolution regime proposals could affect both investors' perception and the market value of their bank investments as well as their attitudes to responding to the need for additional capital. Any move to a pre-funded compensation system would weaken the financial position of banks whilst taking a long while to reach any significant figures.

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 of the financial system

Recent events, the international response and strengthening risk management by banks

Stress testing

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

Yes. A key component of banking management is to stress test capital and liquidity against a range of scenarios. We agree with regulators applying this standard on a proportionate basis according to type, matter and liquidity. It is important to reform and improve this process, both internal and external.

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

Yes. Risk management at the group level is key to ensuring that banks' management and their regulators can make informed decisions. Stress testing will be the most relevant tool because this goes to the core of capital and liquidity.

Liquidity risk

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

Liquidity risk analysis and contingency planning have been regulatory requirements since 2005. We note that the FSA discussion paper (07/7) emphasises improved dialogue between the regulator and the individual firms. We strongly support this.

We agree that the primary responsibility for maintaining adequate liquidity should lie with banks' senior management. They have to ensure that they understand their liquidity risks through having sufficiently robust stress testing procedures and access to additional liquidity as necessary, either through maintaining sufficiently liquid short term funds or through contingency funding plans or liquidity insurance.

The role of the FSA should be to ensure that banks' testing and contingency plans are sufficient to assess and fund ongoing needs. The FSA also needs to make its views known at the most senior level if it has material disagreement with the detail.

We agree that consistency in approach in relation to liquidity requirements should be sought with other regulators through international cooperation. However, in our view liquidity regulation or supervision alone is not sufficient: the key to prevention of market failures lies in the appropriate combination of liquidity and solvency requirements and avenues for central bank intervention.

Improving the operation of the securitisation markets

Accounting and valuation of structured products

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

As noted, there is on-going work at a domestic and international level reviewing accounting principles and standards including measurement (valuation) and recognition of financial instruments. The aim is to reduce complexity and move to more principles based standards. In our view it is important that the Authorities are actively involved in this process so that there is no clash of regulatory goals. We note that the ASB and IASB are currently consulting (separately) on proposed changes to standards on measurement and valuation of financial instruments (IAS 32 and 39).

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

We encourage the Authorities to contribute to the current work being undertaken by the IASB and ASB on measurement and valuation of financial instruments.

Credit rating agencies

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

Credit Ratings Agencies operate globally and the Authorities should work on an international level to examine the role of the CRAs and to support the work of organisations such as IOSCO. The best solutions to identified deficiencies are likely to come from the industry rather than through regulatory action.

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

The CBI agrees that credit rating agencies should issue broader indicators for structured products which better articulate their risks and characteristics.

Increasing the measures issued by rating agencies beyond credit risk, in particular, to cover liquidity would be a significant increase in scope. It is unclear whether investors have an appetite for additional indicators or whether they could be reliably provided.

We agree that rating agencies are subject to extreme reputational damage (and litigation) if they favour an issuer, and accordingly there is a disincentive to overrate

built into the business model. There does however need to be consideration of the incentives posed by this charging structure.

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 market action and appropriate changes to the IOSCO Code of Conduct is the way forward.

Transparency of banks and exposure to off-balance sheet vehicles

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

Asset backed securitisations have brought significant benefits such as risk diversification and reduction in business costs, and this needs to be borne in mind. It is important not to prejudge the effect of recent changes to IFRS and the Capital Requirements Directive which require substantially increased disclosure of off-balance sheet activities.

Chapter 3: Reducing the likelihood of a bank failing

Regulatory interventions

The FSA's existing powers

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?*

The FSA's own internal audit report on Northern Rock recognises that it was not a lack of powers but a lack of expertise and supervisory engagement which were the major deficiencies in the supervision of Northern Rock.

The FSA has sufficient powers to enable it to intervene to reduce the likelihood of a failure of a bank but needs to address the identified deficiencies in exercising those powers. A significant issue is making sure that the FSA has the right skills to fully exercise its extensive powers. The FSA needs to be more in touch with market sentiments on particular business practices and economic conditions, such as liquidity.

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

The existing rules are considered clear and appropriate. The FSA should focus on ensuring that it applies these powers effectively.

FSA supervisory information requirements

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

We leave the industry to comment on costs as we do not conduct a banking business but note that members have queried this proposal in light of the considerable amounts of information the FSA already collects from the industry and the existing powers in s165 FSMA to require information. Accordingly, in our view any additional requirements need to be necessary, proportionate and robustly costed.

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

Absent some catastrophic event, banks like any other business enterprises rarely fail at short notice. There is a build up to an insolvency event. In our view the supervisory arrangements should be organised in such a way to enable action to be taken before failure. A prior understanding of a bank's operations and market conditions should reduce the need for the provision of complex information at very short notice.

Information sharing by the FSA

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 agree that there should be no impediments to the sharing of information between the Authorities where necessary to address problems of financial instability.

Oversight of payment systems

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?*

The complex and integrated nature of wholesale and retail payment systems and in particular their future development is such that statutory oversight should not be split between the Bank of England and FSA. As a core component of financial stability, ensuring the stability of payment systems would appear to be a more appropriate role for the Bank of England, splitting this role with the FSA risks causing confusion.

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

We leave this specialist area for the industry to comment on.

Liquidity assistance and disclosure

Disclosure of liquidity assistance

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?*

Notwithstanding the reason for registration of charges is creditor protection, i.e. creditors are able to check on a public register the extent to which assets are charged, there may be a case for exemption of assets in order to assist the Bank Of England in providing covert assistance, but the detriment to other creditors of removing this requirement needs to be properly assessed. In our view the real issue is how support can be given to institutions without a calamitous loss of confidence and overriding established and well recognised rules.

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?*

See comment above

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

See answer 3.8 above.

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

As stated above in our view the real issue is how give emergency assistance without this resulting in a calamitous loss of confidence which was the case with Northern Rock, rather than looking at ways to override established rules. We are not convinced that removing a specific reporting requirement will ensure secrecy and anonymity.

Protection for the Bank of England

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, this appears appropriate.

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. However the effects of this need to be carefully worked out in the context both of money market operations (e.g. repos) and creditors in bank insolvency.

Access by building societies to liquidity assistance

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

Yes. We see no reason why building societies should be treated differently to banks in regard to liquidity assistance and disclosure.

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

We leave this specialist area for the industry to comment on.

Chapter 4: Reducing the impact of a failing bank

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

Sudden, disorderly bank failures produce severe consequences for not only depositors and other creditors but also for the wider banking system and economy. It is axiomatic that these need to be avoided. The CBI consequently is supportive of efforts to explore a suitable regime which will deal with failing banks. In our view such a scheme needs to have well defined goals, well defined and transparent triggers, well defined tools and widespread support and in order to deliver these, time needs to be taken to properly develop such a scheme. Although schemes existing in other economies can provide useful guidance, we do not believe that they can provide a complete answer: any scheme to be effective and provide confidence needs to be reflective of the wider context in which it sits.

The paper proposes that legislation will be introduced to create a special resolution regime but unfortunately does not provide sufficient detail of the proposed scheme to enable any critical assessment of the mechanisms or the tools to be made. Stakeholders are being asked whether they approve of a scheme which has the potential to override long established and well understood mechanisms dealing with failing business enterprises but very little detail is given. There is no indication if the SRR will be applied to retail or wholesale operations or both.

The lack of detail is coupled with an aggressive legislative timetable. The CBI believes that time should be taken to properly work through the proposals. In our view it is more important to get the reforms right than meet an arbitrary time table. Legislative haste brings with it the probability of undesirable effects on what is a highly dynamic part of the UK economy, representing directly and indirectly up to 20% of GDP.

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 HM Treasury?*

We do not agree that the FSA should determine when the SRR should be invoked. The paper proposes that the decision will be taken by the FSA after consultation with the Bank of England and HM Treasury. There is no indication if there will be a mandatory obligation on the FSA to consult or if there needs to be a unanimous decision by the Authorities to activate the SRR.

We note that in the **Banking (Special Provisions) Act 2008**, power is vested in HM Treasury with no role for the FSA.

We further note under the US scheme, although the Federal Deposit Insurance Corporation (FDIC) has power to appoint itself as the receiver this decision is subject to judicial review albeit rarely successfully exercised. The trigger criteria also are transparent to the market providing a clear roadmap to intervention. In our view this is

an important aspect which contributes to the apparent overall market confidence in the US scheme.

Accordingly, in our view what is needed is clear definition not only of the trigger points leading to action but where authority rests. In our view overly prescriptive and mechanical tests with little margin for judgement should be avoided.

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

Yes, regulatory guidance material should be provided in order that any trigger mechanism is fully transparent along with detailed guidance on all aspects of the scheme.

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

Unfortunately there is insufficient detail of the SRR provided to make a proper evaluation.

Notwithstanding the lack of detail, the structure proposed in the paper follows the closely the scheme operating in the United States with powers to direct a transfer of the whole business to a private sector participant, power to establish a 'bridge bank', a special officer to carry out the resolution and a fast track insolvency procedure to pay out depositors. These structures are integral to the US scheme and accordingly appear to be necessary for that type of scheme.

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?*

Wider public interest is the justification generally given for extraordinary government action which affects private rights.

The real issue is how to adequately compensate the loss of those rights. We note that the **Banking (Special Provisions) Act 2008** extinguishes those rights and sets very stringent conditions for compensation and appeal of compensation decisions. We note further these have been criticised by Northern Rock shareholders. Accordingly, consideration needs to be given to whether these principles are the right ones.

We note that the US scheme also affects shareholders' private rights, but as we understand, the majority of large commercial banks in the US are wholly owned subsidiaries of holding companies and therefore the issue of shareholder rights is viewed somewhat differently. The holding companies are subject to general corporate insolvency regime. This is not the situation in the UK.

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

See comments above in 4.5

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?*

The power to make a directed or accelerated transfer is a fundamental element of the US scheme. In fact we note that HM Treasury has these powers now under the **Banking (Special Provisions) Act 2008** which provides that HMT may by order transfer securities and property, rights and liabilities of a UK deposit taker to the public or private sector if it is desirable to do so:

(i) to maintain financial stability and/or

(ii) protect the public interest is public financial assistance has been given which includes a HMT guarantee.

The Act provides that arrangements for compensation/consideration must be made and the amount to be determined by an independent valuer appointed by HMT whose decision is subject to limited judicial review in a HMT nominated Tribunal.

As we said above in 4.5, a key issue is compensation to those whose rights are extinguished.

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

Judicial review is the review mechanism for decisions of a public body and any decision of a public body is prima facie subject to judicial review unless that is expressly excluded by legislation.

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

No we do not agree this is the right forum. The role of the Tribunal is to review FSA decisions on breaches of rules under the FSMA. In our view there should be judicial supervision.

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 that some flexibility in the description of these circumstances is also desirable?*

The power to transfer assets to a bridge bank is a fundamental element of the US scheme and we note that HM Treasury has these powers now under the **Banking (Special Provisions) Act 2008**.

The ability to transfer assets and liabilities to a bridge bank is one of the tools which would be available under the proposed SRR. In our view it would be more productive to set out in detail the circumstances when it is envisaged that a bridge bank would be established and the criteria for determining what assets would be transferred and what is planned for those which are not transferred. All we are able to determine from the paper is that it is proposed that 'higher quality' assets would be transferred and 'lower-quality' would remain, but there is no indication of what may fall into these categories.

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 have stated our views on the proposal to remove well established rights.

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

See our answer to 4.8

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

See our answer to 4.9

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?*

We are not convinced that the case has been made for banks. Insolvency is a complex area of the law which has recently undergone major changes with the introduction of the Enterprise Act 2002, which came into force in 2003. Further thought is necessary as to the possible disruption of property rights for creditors other than depositors. As we understand one of the arguments in favour of a special regime is to make faster payments through the FSCS. Until we see the details of what is proposed for the FSCS it is difficult to know if a new regime is necessary.

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?*

As we understand it, under the US system a bridge bank is able to trade to a limited extent for the benefit of customers, e.g. most notably to make low risk loans to existing customers.

We assume what is intended in a UK scheme is that the bank liquidator/restructuring officer would operate as a type of receiver/manager with power to trade. In corporate insolvency the powers of the receiver/manager are set by the court on application by the creditors. We assume here those powers would be statutory as the contemplated bank insolvency regime will be ex judicial.

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?*

See answer to 4.14

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

In our view insolvency should remain a judicial process. We do not agree that overall supervision should be by the Authorities. In our view insolvency should remain supervised by a court which is impartial and has no interest in the outcome.

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 our answer to 4.14

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

See our answer to 4.14.

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

The CBI does not support preferential rights of depositors at the expense of other creditors.

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

See answers to 4.14 and 4.17.

Governance and operation of the special resolution regime

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

In our view the burden is on those proposing an SRR to propose the governance arrangements. The CBI is willing to consider any proposals put forward and make comment. Our members do not believe it is for them to make those proposals.

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?*

The power to appoint a special officer whatever the name is a fundamental element of the US scheme and it seems to us would be necessary in a proposed SRR scheme.

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?*

Our comments on the SRR and its effects on shareholder and creditor rights answer this question.

Temporary public ownership

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?*

We note that HM Treasury has these powers now under the **Banking (Special Provisions) Act 2008**. It is our understanding that the purpose of the SRR scheme and enhanced depositor protection is to do away with the need for Government to take temporary ownership. However, we can imagine that in a worst case scenario such as a very large bank failing there may be a need for temporary government ownership.

Resolution of building societies and other mutuals

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

We see no reason why building societies should be treated differently, but leave it to the industry to make more detailed comments.

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

We leave this for industry comment, but in theory can see no reason for not including building societies.

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

See answer to 4.27

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

See answer to 4.27.

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?*

We leave this specialist area for the industry to comment on.

Requirements on banks

Funding the special resolution regime

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

No. As we understand, under the US scheme costs are paid from the proceeds of winding up or transfer and we assume (as there is no detail given in the paper) that the same principle would apply. Insolvency costs for other failing business enterprises are borne by shareholders and we envisage the same principle would apply.

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

See answer to 4.31

Contingency planning & agency banks

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?*

We leave this specialist area for the industry to comment on.

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?*

We leave this specialist area for the industry to comment on.

Financial collateral arrangements

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 document does not provide a clear explanation of how existing legislation does not provide adequate protection to the holders of collateral. Further details and consultation would be required as to what changes to legislation are envisaged and how they would increase market confidence in the use of collateral.

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

No. We leave further comment to the industry.

Chapter 5: Consumer confidence and compensation arrangements

Compensation limit and coverage

Compensation limit and calculations

5.1 How would a higher compensation limit affect consumer confidence?

Increasing consumer awareness of the FSCS and the extent of coverage will surely give consumers some degree of comfort. A lack of consumer awareness and confidence in the FSCS was undoubtedly an important contributing factor in the bank run on the Northern Rock. Increasing consumer confidence should therefore be seen as important. However, the CBI considers that prudential supervision and enhancing consumer confidence in financial institutions themselves rather than the compensation scheme for failed institutions should be the main priority for the Authorities.

Following the abolition of the co-insurance element of the FSCS, approximately 95% of retail deposits are now fully protected. Increasing the compensation limit would be likely to have only a minimal impact on consumer confidence. Analysis within the consultation document shows that the UK compensation limit compares favourably with the EU average.

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

We repeat in part our answer to 5.1: the CBI considers that prudential supervision and enhancing consumer confidence in financial institutions themselves rather than the compensation scheme for failed institutions should be the main priority for the Authorities.

There is an argument that increasing the compensation limit above £35,000 risks damaging competing savings products and creating moral hazard by encouraging investors to take higher risks, safe in the knowledge that their deposits are protected.

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

Increasing the protection level for deposits will decrease the attractiveness of alternative savings products which could result in a distortion to the attractiveness of different asset classes. However, some research in this area of consumer attitudes would be useful.

Coverage of balances above the compensation limit

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

Three proposals are made: relying on customers to spread balances between banks, private deposit insurance and or unlimited compensation in special circumstances. None of these proposals are fully worked up so it is difficult to make any detailed comment.

Although spreading balances among a number of banks would be effective to mitigate risk, the reasonableness and practicality for consumers must be queried. There may be an appetite for private deposit insurance, this would likely be a niche market and may undermine consumer awareness and confidence in the existing compensation scheme. The application of an increased FSCS limit for certain higher balances risks increasing confusion. We note that under the US scheme extent and nature of coverage is clearly set out in consumer information and this seems to us a useful approach.

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

Real estate or other asset transactions can result in consumers holding deposit balances over the compensation limit for a short period. If consumers are aware of the compensation limits they are better able to minimise risks. Because these transactions are infrequent but are of high personal impact, it is questionable whether they warrant the additional administrative burden that would be required of the FSCS. We see this as an area for further work with consumers and professionals who operate client trust accounts.

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 is a good case for the FSA to undertake further work on the nature of accounts held and the how they are operated. The requirements of professional regulation also need to be taken into account, for example solicitors are required by professional regulations to deal with client monies in a particular way (Solicitors' Accounts Rules, Rule 14) and clients are entitled to rely on certain protections conferred by statute in relation (s.85 **Solicitors Act 1974**).

Faster compensation payment

New process

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

Ensuring that the FSCS can make payouts in a timely manner is important for two reasons; (1) it should help to instil confidence in consumers and therefore mitigate the risk of a run on a bank, and (2) in the event of a bank failure it should enable consumers to continue to access funds with minimal economic disruption. The CBI therefore supports the Authorities aim to ensure faster compensation payments.

The proposal for a one-week target is very ambitious. In the event of a medium or large failure, it is likely that the number of payments will be very large. Could the FSCS realistically raise the finance and process the required number of cheques or automated cash transfers in such a time frame? Also, the opening of new accounts requires careful data input and know your customer (KYC) controls; banks would be unlikely to be able to open large numbers of new accounts at short notice. The requirement for banks to be able to provide accurate account details for all customers at extremely short notice would require significant investment in new systems and indeed may not even be practically possible. Rather than concentrate on an arbitrary time period at this stage, it is more important to get the details of an expedited compensation scheme right. As we understand the US scheme does not set a time related target but emphasises lessening the impact on consumers.

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

This would involve suspending the usual cheque clearing processes and we leave this to the industry to comment further.

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

Alternative payment methods should be considered and we leave further comment to the industry. For customers who have pre-existing accounts with other banks, automated BACS (or similar) transfers would be more efficient.

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

If the target of one week cannot be met for full payment we query whether interim payments can be made in that period. They could be a way to ensuring that customers have immediate access to funds whilst providing sufficient time to ensure the orderly transfer of account balances and other banking details, e.g. standing orders and direct

debits to alternative accounts. However, interim payments would not address the problem of customers who do not have existing alternative banking facilities.

Early access to information

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?

We understand this would involve changes to IT systems which may result in huge costs for the industry. Such large scale systems re-engineering would be likely to take time to implement. We leave further comment to the industry.

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

We leave this for industry comment in detail but note that before requiring any standardised format, account needs to be taken of cross border operations and the requirements in other countries where banks may operate.

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

Whilst the single customer view is a sensible approach, in practice, the provision of such information at short notice may not be practicable without significant changes to systems. Further consideration will be necessary to determine whether this is the most suitable approach.

Eligibility

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

We leave this specialist area for the industry to comment on.

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

The scheme operating in the US covers the *deposits* received by the financial institution in its normal course of business *rather than the depositors*. The issue is the loss of the deposit. Given that the loss of deposits is potentially a high impact

event for all classes of depositors, perhaps it is right that the emphasis should be on the deposits rather than the nature of the depositor.

Gross payments

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

Gross payments under the FSCS could improve the speed of payments and but would be a major boost in consumer confidence because loss of access to funds would be a catastrophic event for most people. However, this needs to be balanced (albeit sensitively) with the need to recoup assets.

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 answer above 5.16.

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

Although there is a case to be made for compensation on a net basis, the loss of savings and access to banking services in the event of a bank failure would be catastrophic for most people and accordingly there needs to be a fair balancing of competing interests. Because the failure is with the institution not the borrower's capacity to repay, it is highly likely that loans and mortgages would be picked up by other institutions. The ability to realise good quality assets minimises risk of loss and reduces the need to rely on set off. Gross payments would in our view be in the public interest as this would maintain depositor confidence.

The US FDIC scheme pays on a gross basis.

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

We reserve comment until we have seen detailed plans for both.

Streamlined claims process

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 most obvious risks are those of fraud or incorrect payment.

FCSC funding and liquidity

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

The CBI is opposed to the introduction of pre-funding of the FSCS. Care needs to be taken in making international comparisons; for example, the Federal Deposit Insurance Corporation (FDIC) covers in excess of 5,000 deposit taking institutions. In contrast, the UK industry is heavily concentrated. Although the consultation document does not specifically mention the possible size of a pre-funded pot, paragraph A. 231 points to a fund of £13bn at an annual opportunity cost to the industry of £300m. Funding to this level would have a significant impact on banks' liquidity which is particularly not to be welcomed in the present market conditions.

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?*

See answer to 5.21.

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

This would appear to be a practical means of funding within an ex-ante scheme.

Opening new accounts

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?*

We leave this specialist area for the industry to comment on.

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

We leave this specialist area for the industry to comment on.

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

We leave this specialist area for the industry to comment on.

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

FSCS payments could result in significant short-term cash withdrawals by consumers. Liquidity support may be needed in this period.

Consumer awareness

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?*

Consumer awareness is not a trivial issue because with an increase in awareness of the compensation scheme there is an increase in awareness that deposits are at risk. The CBI is supportive of Government and industry initiatives to improve consumer awareness. To be effective, informing consumers about financial products has to find the right balance between providing useful information and overloading them with ‘small print’. We note the US FDIC scheme carries detailed information aimed informing consumers of their rights. In our view these materials provide good models. Information is clearly presented with examples consumers can relate to.

5.29 *How should disclosure requirements be imposed?*

In our view all avenues should be used to ensure that depositors are informed. It is the type of information consumers would expect the FSA to include on its web site and material.

Other protection for consumers

Protecting vulnerable consumers

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?*

Before direct deposit into bank accounts, the Post Office was used. Consideration could be given to this channel as a backup. We leave further comment to the industry.

Other changes to compensation arrangements

Increasing FSCS management flexibility

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

These changes appear broadly sensible.

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?*

The FSCS should consider how it could work with the staff and infrastructure of a stricken institution to facilitate the processing of FSCS payments.

Risk based levies

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?*

The paper notes that risk based levies would mitigate excessively risky behaviour. It would be more effective to address ‘excessively risky’ behaviour in the supervision and monitoring of a bank’s on-going operations so as to minimise that risk. We are not confident that risk based levies would be an effective regulatory tool. Also the paper fails to give any indication of what criteria would be used to determine levels of risk. This concept needs to be better thought through.

Chapter 6: Strengthening the Bank of England

Bank of England's objectives

- 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?*

The CBI supports clarification of the Bank of England's role in the area of financial stability.

Governance of the Bank of England

- 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?*

The CBI supports these proposals.

Chapter 7: Effective coordination

Coordination in the UK

Tripartite arrangements & operational arrangements and the MoU

7.1 *To what extent will the proposals enable an improved handling of a financial crisis?*

The CBI agrees that major changes to the tripartite arrangement are not appropriate. However, clarification of roles within the arrangement would be beneficial. Furthermore, the Authorities should seek to ensure that they are more coordinated and can communicate clearly and effectively in a financial crisis. The benefits of implementing a COBR mechanism are less clear. Many have questioned the effectiveness of the COBR (for example in managing the response to Foot & Mouth disease). The tripartite Authorities, not politicians, should be responsible for responding to financial crises.

International arrangements

Financial stability forum, IMF & an early warning system for global financial risks

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

The CBI supports these proposals.

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?*

The CBI supports these proposals.

Managing cross-border crises

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

We see there is a need for international bodies such as the FSF, BIS and IMF to provide leadership in responding to financial crises.

A Impact Assessment

A.1 Do you have information that would improve the analysis of this impact assessment?

In a number of areas the impact assessment recognises the competitive effects of proposals but there no further analysis. The proposals for a bridge bank and accelerated transfers are major proposals to lessen the impact of a failed institution. It seems to us crucial that the legality of these proposals is tested beforehand and not after the fact through the European Court of Justice. We note that in the US which is a single jurisdiction, it was necessary to pass legislation which effectively exempts similar arrangements from competition law.

In addition, we are not convinced that sufficient consideration has been given to the costing of some proposals such as those which involve IT systems.

A.2 Do you believe that the impact on building societies of the tools within the special resolution regime is different to that on other banks?

We leave this area for specialist industry comment.

A.3 Do you agree that small businesses would not be affected by these proposals in a different way to other consumers?

Small business may potentially benefit if the compensation scheme is extended to business accounts.

Other

N/A Protection for holders of banknotes issued by Scottish and Northern Irish banks

Section 5.73 – 5.77 of the consultation document proposes changes to the arrangements for note issuance by banks in Scotland and Northern Ireland. The CBI does not support the extension of the deposit against the issuance of these notes with Bank of England to seven days per week as it will reduce liquidity and the deposit does not earn interest.