

Banking reform – protecting depositors: a discussion paper

October 2007



HM TREASURY





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INTRODUCTION

1.1 Financial services play an important role in all advanced economies – matching savers to borrowers, helping to manage risk, providing firms and individuals with the means to make and receive payments, and allocating savings to productive investment.

1.2 The financial services sector in the UK, with London at its heart, makes an enormous contribution to the UK economy, and to the European and global economies. The sector continues to grow as a share of UK output and employment; it employs over one million in London and in other centres such as Edinburgh and Leeds, and generates 9.4 per cent of GDP. Supporting and promoting London, and the UK, as a centre for financial and business services remains a priority for the Government.

1.3 It is in everyone's interest to ensure financial stability. It allows the financial services sector to thrive, particularly given the inter-relationships between firms in the sector, and supports the growth of the wider economy more generally.

Global economic change and the financial services sector

1.4 Over the past ten years, international financial markets have changed dramatically: global financial flows have doubled to five trillion dollars, and a quarter of global assets are now internationally owned. In a globally inter-dependent financial system no country or company can insulate itself entirely from international risk. If a problem does happen, it needs to be dealt with quickly to maintain stability and confidence.

1.5 The way retail banks¹ do their business has also changed, and loans are now funded not just from the deposits in current and savings accounts of individuals, businesses and organisations but also from deposits taken from the wholesale and interbank markets. Banks are also increasingly pursuing an 'originate and distribute' model to lending with credit risk increasingly spread across the financial system including through securitisation. As a result, financial markets are now more complex and interconnected.

1.6 The way people do business with their banks has also changed, and banking is an essential service for individuals and businesses to participate in the modern economy. This has brought considerable consumer benefits and economic efficiencies, but has also increased consumers' reliance on the banking system in ways that mean aspects of the financial system have become essential to the orderly functioning of the economy.

1.7 With growing wealth and income, many households are learning more about the financial sector in order to manage their own finances. However there are limits to the research it is possible for them to undertake - so protection through regulation and insurance is important as a way of sustaining their confidence.

¹ For the purposes of this discussion paper, the term 'bank' shall mean all deposit taking institutions, including for example building societies.

The UK economic framework

1.8 The UK faces these changes with an economy whose fundamentals remain strong and stable. The Government's economic framework is built around:

- full operational independence for the Monetary Policy Committee (MPC) in setting interest rates to meet the Government's target;
- clear fiscal rules underpinning the Government's public spending framework; and
- the tripartite framework for co-operation on financial stability between the Bank of England, the Financial Services Authority (FSA) and HM Treasury. This defines the roles and responsibilities of each authority in maintaining financial stability, in responding to operational disruptions to the financial sector, and for financial crisis management.

1.9 These frameworks for monetary policy, fiscal policy and financial stability provide a coherent strategy for maintaining high and stable levels of growth and employment, and for minimising the adverse impact of external events.

1.10 Recently the financial system has come under pressure globally and in the UK. The UK has played a leading role in international discussions about responding to these challenges on a global scale, for example in groups such as the Financial Stability Forum and the Basel Committee.

1.11 As the international economy changes and challenges arise, the Government needs to be able to adapt quickly and respond. Recent events have shown that the frameworks in place for dealing with banks in distress, and in particular the arrangements for depositor protection, may not always be robust enough to give depositors the confidence that is a necessary underpinning of financial stability.

Policy objectives

1.12 The Government's overall objectives for the financial system are stability, competitiveness and consumer confidence. This discussion paper explores some key questions around the ways in which the current framework for dealing with banks in distress, and in particular depositor protection, might be improved to respond better to challenges. In particular, recent events have demonstrated the importance of depositor confidence if institutions are to weather periods of financial instability. Unless there are robust mechanisms to shore up depositor confidence, the risk of instability can be exacerbated.

1.13 Key issues for depositors include both the level of protection offered and the timeliness of repayment. In addition, the Government also believes that, given the integration of modern banking services in the wider economy, there may be a case for resolving the position of troubled banks in a manner that preserves continuity of access to certain key banking functions.

1.14 The responsibility to minimise risks and prevent problems happening in a particular institution lies, first and foremost, with the people who run and own that institution. The Government should not be in the business of using public money to protect executives who make the wrong call or bad decisions – or to protect shareholders from the consequences of those decisions.

1.15 However the authorities, acting not just individually at the national level, but increasingly together at the international level, do have a role in ensuring the regulatory system, while being principled and proportionate, reinforces firms' responsibilities. The Government believes that reforms to the framework for depositor protection and for resolution of banks in distress, could make a large contribution to ensuring financial stability in the future.

How to respond

1.16 The Government invites responses to the issues raised in this discussion document. A summary of questions is included at Annex B. The Government would welcome comments by 5 December, during which time the authorities will hold meetings with relevant stakeholders. If you, or your organisation, would be interested in joining these discussions, please inform the Treasury (contact details are provided in Chapter 4). This accelerated timetable reflects the urgency that the authorities attach to finding workable solutions to the challenging issues raised, and meeting the stated objectives.

1.17 Although changes to the current framework may have benefits, they will almost certainly give rise to costs, either direct or indirect. Before enacting any specific measure, the Government will want to be reasonably assured that the benefits of proposed changes exceed the costs. Informed by responses to this discussion paper, the Government therefore intends to publish a consultation paper early in the New Year setting out any options identified to achieve the objectives set out above, alongside a partial Regulatory Impact Assessment, before any definitive rule changes or changes to legislation are enacted.

1.18 The Government intends to begin the process of preparing any draft clauses as soon as possible after considering the responses from this discussion paper. This will overlap with the consultation. All responses received to the consultation will be considered carefully but consultees will be invited to give early indications of their likely viewpoints to aid that process.

1.19 In line with the requirements of the Financial Services and Market Act, the FSA intends to conduct a consultation on any changes to the Financial Services Compensation Scheme (FSCS) that may result from the issues raised in this paper, or which may be required to assure the overall coherence of the compensation scheme in light of any changes to depositor protection.

2

THE CURRENT FRAMEWORK

Financial disruption **2.1** In the event of financial disruption, a loss of consumer or market confidence in particular companies or institutions can follow. This may in turn threaten to lead to wider difficulties for those companies or to the stability of the broader financial system and markets.

2.2 Recent events have demonstrated both the importance of consumer confidence to ensuring financial stability, and that the current arrangements for dealing with banks in distress, and in particular depositor protection may not adequately uphold that confidence thus exacerbating financial instability.

CURRENT SYSTEMS FOR DEALING WITH BANKS IN DISTRESS

Depositor protection

Financial Services Compensation Scheme **2.3** The FSCS protects customers of financial services products. In the event that a firm is unable, or is likely to be unable, to meet claims against it, the scheme will compensate consumers, up to certain limits. The scheme covers eligible claims involving deposits, insurance and other claims arising from the activities carried out by an authorised financial services firm.

2.4 The FSCS covers customers of authorised financial services firms including banks and building societies. The FSA is responsible for setting the rules within which the FSCS operates, including on eligibility of claims and compensation limits. Since 2001 it has dealt with a wide variety of firm failures and has paid out more than £950 million to consumers. The FSCS is funded through levies on the financial services industry.

2.5 The FSCS's main function is consumer protection: it provides consumers with a measure of compensation in the event of a failure of an institution in the financial sector. The existence of compensation also helps to reduce the systemic risk that a single failure of a financial firm may trigger a wider loss of confidence. Annex A gives a further description of the FSCS. However, while it contributes to encouraging consumer confidence in the markets, the FSCS was not designed, on its own, to be able to deal with all potential failures of financial firms, nor to be a crisis management tool in the event of a large-scale failure.

2.6 As a first stage of reforms, on 1 October 2007 the FSA announced an increase in the limits on compensation payable under the FSCS so that compensation will be paid to eligible depositors on deposits up to £35,000 equal to 100 per cent of the loss incurred¹.

Resolution

2.7 Generally, financial firms are subject to normal corporate insolvency procedures, which have a narrow focus on the failing firm and the interests of creditors. In a normal administration, the administrator is able to suspend creditors' (including retail depositors') ability to exercise their contractual rights so that the amount of loss can be established and apportioned fairly among them. This means that firms and

¹ Before 1 October 2007, compensation was limited to the first £2,000 plus 90% of the deposit between £2,000 and £35,000. The maximum compensation payable in respect of a £35,000 deposit was therefore £31,700 (= £2,000 + 0.9 × (£35,000 - £2,000)).

individuals may not be able to use their accounts or access their money – possibly for a period of weeks or even months. Any outstanding debts may also be offset against the relevant creditor’s claim, in effect recovering those debts before repaying those creditors a proportion of their net claim on the bank. While any difference may be recoverable through the FSCS, this may cause disruption, not only to the customers of the bank, but also to the firms and consumers with whom the customers of the bank interact.

RECENT CHALLENGES

Financial stability 2.8 Arrangements for compensating depositors should enhance financial stability. That requires the compensation system to provide an appropriate amount of coverage and to provide the protection promised within an appropriate time frame.

Limitations of the current framework 2.9 Recent events suggest that the current framework for depositor protection may not uphold confidence adequately. In particular, concerns have been raised about whether timely protection would be available for consumers, and whether there was a lack of understanding of the scope and operation of the compensation arrangements.

PRINCIPLES GUIDING FURTHER REFORMS

Objectives 2.10 Chapter 3 explores whether there are further areas where the Government may wish to introduce reforms, in order to give depositors the confidence that is a necessary underpinning of financial stability. In order to maintain the consumer and market confidence that are essential to meet the Government’s central objective of maintaining financial stability, any reform must meet the following objectives:

- it must be well understood by retail depositors, with consumers confident that they are protected by an appropriate, credible and reliable guarantee that can operate in a timely fashion;
- it must maintain wider market confidence with full transparency about the framework (including its funding) that would operate in the case of a disruption to banking services; and
- it must preserve the critical banking services appropriate to retail, business and wholesale customers of a bank for such time as is necessary to effect an orderly transition to an alternative banking provider; while
- it must maintain the UK’s reputation as the pre-eminent location for financial services; and
- it must protect the taxpayer interest and ensure an appropriate sharing of costs between all parties.

Question 2.1: Do you agree that these are the right objectives? Are any of these objectives more important than others?

Question 2.2: What other issues should the Government consider when reviewing the framework for depositor protection?

Question 2.3: What other issues should the Government consider when considering how best to preserve any critical banking functions?

3

ISSUES TO REVIEW

3.1 Chapter 2 outlined the current arrangements for dealing with banks in distress and for depositor protection and made some observations surrounding the way they have performed recently under challenge. This chapter explores two key areas where the Government may wish to introduce reforms, in order to give depositors the confidence that is a necessary underpinning of financial stability:

- whether there are further reforms that are necessary to enable the FSCS to make a greater contribution to depositor confidence; and
- whether, in the event of a bank failing and when another solution cannot be arranged sufficiently quickly, there is a case for preserving some critical banking functions for a certain period.

3.2 Chapter 2 also set out the objectives the Government believes any reforms should meet. In particular, in assessing the case for any further reforms, the Government will balance the need to provide an appropriate level of consumer protection, and the need to have regard to the impact of any new regime on wider markets and the economy.

THE FINANCIAL SERVICES COMPENSATION SCHEME

Reforming the Financial Services Compensation Scheme

3.3 Chapter 2 set out the reform recently announced to the FSCS. This section explores some areas where the Government may want to introduce further reforms, to reinforce consumer confidence that the FSCS provides effective protection to depositors.

Limits on compensation payable

3.4 The limit on compensation is set per customer per firm and type of claim. This means that, by diversifying their deposits depositors can access deposit guarantees significantly in excess of the £35,000 limit. This limit compares favourably with arrangements for deposit protection in most other countries, and the new limit means the vast majority of deposits are fully covered by the FSCS.

Question 3.1: Should the level of coverage for deposits be increased from £35,000? If so, to what level and what are the benefits and costs of doing so? Should the bank deposit coverage limits be related to those for other sectors, for example investment business and insurance?

Timing of payouts

3.5 If compensation is to be effective, protected deposits must be paid out promptly. This requires information about the amounts due to depositors as well as access to the funds needed to pay those depositors. The FSCS currently processes most simple deposit taking claims within four weeks, with hardship cases taking top priority. However, complex cases or large cases could take longer. This links with the discussion of critical banking functions in the next section.

Question 3.2: Would it be desirable to put in place arrangements to better ensure that depositors are repaid in a more timely fashion? What issues would need to be considered in assessing any new arrangements?

Coverage of different products **3.6** The FSCS provides compensation for different types of financial products, including bank deposits and insurance. The levels of compensation offered by the FSCS to depositors in banks are different to those offered for other types of investment. As consumers have a choice between different types of investment, the Government recognises that different compensation arrangements may distort consumer behaviour.

Question 3.3: What are the issues the Government should consider in relation to other parts of the FSCS?

Funding arrangements **3.7** The compensation scheme is currently funded entirely from a levy on the financial services industry. The FSA is currently reviewing the funding of the FSCS and expects to publish final proposals shortly. The FSA has consulted on changes to the funding of the compensation scheme based on affordability of levies to the industry as well as a principle of overall responsibility of the financial services industry for losses. The FSA's proposed new arrangements will see explicit cross-subsidy introduced for the first time, requiring different classes of firms to contribute to losses incurred in different sectors in the event that any one class (or sector) has reached the maximum it can afford to pay in any one year. This will provide enhanced levels of consumer protection and help maintain financial stability in the UK. The proposals increase the overall annual financial capacity of the compensation scheme up to a maximum of £4.04 billion.

3.8 Historically the Government has rejected the introduction of a pre-funded FSCS and this approach has generally been supported in consultation. This approach differs from the approach taken in the United States where the Federal Deposit Insurance Corporation is a pre-funded insurance-type scheme. The main reason why pre-funding has not been used in the UK are that a pre-funded scheme would tie up a considerable amount of resources which would otherwise be used productively in the UK financial system while the introduction of a pre-funded scheme now would mean that levy payers had to finance both the existing post-funded scheme and a new pre-funded scheme during the transitional period. The introduction of a pure pre-funded scheme would also require changes to Financial Services and Markets Act 2000.

Question 3.4: What issues should the Government take into account in any further review of the funding mechanisms for the FSCS?

Continuity of services **3.9** The current framework for compensation allows the FSCS to secure the continuity of insurance cover provided by policies issued by insurance companies which are unable, or likely to be unable, to meet claims against them in a range of ways. But there is no corresponding provision enabling the FSCS to secure the continuity of banking services for customers of banks in a similar position. Enabling the FSCS to support an orderly transfer of customers' accounts to another bank may be important in preserving critical banking functions.

Question 3.5: Should the role of the FSCS be extended to promote access to banking services for depositors with failed banks?

Consumer awareness **3.10** Consumers need to understand the precise nature of the guarantee underlying their bank deposits, and the risk they face in holding non guaranteed deposits. This will allow them to make informed decisions about spreading their money across different products and different institutions to minimise risk.

Question 3.6: What are the best ways to help consumers understand how banking deposit guarantees affect them?

CRITICAL BANKING FUNCTIONS

3.11 This section explores whether in the event of a bank being in distress, in order to protect consumers and help maintain consumer confidence, there is a need to preserve some critical banking functions for a certain period, for example to ensure an orderly transfer of services.

3.12 Box 3.1 below sets out the Government's initial view of some banking functions that could be considered critical, and seeks views from stakeholders on these. There are a range of mechanisms that could be employed to preserve any critical banking functions, and the following section goes on to outline the approach taken in some other countries. For now, the Government is particularly interested in identifying the right outcomes such mechanisms should be designed to achieve.

Box 3.1: Possible critical banking services

The introduction of banking services such as direct debit and automated payments has brought considerable consumer benefits and economic efficiencies. At the same time, these payment systems have become integrated into the wider economy, increasing consumers' reliance on the banking system, in ways that mean aspects of the financial system have become essential to the orderly functioning of the economy.

The main banking product which customers use to access their money is current accounts: 88 per cent of the adult population in the UK has a current account. Direct debits and credits are widely used to pay bills and receive salaries, and ATMs and debit cards are widely used to access money held in current accounts. The use of these functions is expected to further increase over the next ten years.

The Government considers that access to current accounts may be a critical function. However, there is not necessarily a clear dividing line between current accounts, saving accounts and other products (for example offset mortgages). Many instant access savings accounts provide payment functions such as payments cards, cheque books and direct debit facilities. It could therefore be argued that access to a wider range of accounts should be preserved.

It may also be desirable to provide continuity of access by institutions to payment systems that are linked to bank accounts. This would enable, for example, banks to operate ATMs and direct debits, individuals to withdraw money, receive salaries and pay bills, and companies to transfer salaries and settle invoices. If a bank enters into administration or other insolvency proceedings, it may be suspended from payment systems of which it is a member.

Question 3.7: Do you agree with the concept of critical banking functions? If so, what banking services might be properly regarded as so critical to the modern economy that they should continue to be provided in the event of a bank failure?

Question 3.8: For what period of time should any critical banking functions be maintained and how this might vary in different circumstances?

Delivering critical banking functions

3.13 As set out in Chapter 2, there is currently no special insolvency regime for banks that is designed to facilitate speedy and efficient resolution, nor the preservation of critical banking functions. Therefore normal corporate insolvency procedures would apply.

3.14 Ensuring continuity of critical banking functions could involve those functions being continued by another provider, detached and transferred to one or more other

providers, or continued by the original provider but immunised in some way from any disruption. For some large banks, however, there may be difficulties in identifying which are critical banking activities and which are not, and in separating out these two types of activity.

3.15 A number of countries have put in place special provisions for dealing with failing banks (see Box 3.2). While some of these approaches are untested, especially for large banks, the Government is keen to learn from the experience of other countries.

Box 3.2: Approaches to resolving banks in some other countries

Some countries, notably the United States, resolve banks under a statutory insolvency regime that is distinct from that applying to companies in general. Common features of these regimes include:

- special resolution measures may be taken in relation to banks whose failure could have systemic consequences and threaten financial stability or the economy more broadly;
- wide powers are allocated to the special administrator who is appointed to carry out the resolution of such banks;
- those appointed as special administrator vary from country to country and include the deposit insurer, the banking regulator, or insolvency practitioners; and
- special administrators are generally appointed by and answerable to the banking regulator and financial or legislative authorities, rather than the bankruptcy courts.

Bridge banks were used on ten separate occasions in the United States between 1987 and 1994, with most of these instances involving multiple related bank failures. Some 32 bridge banks were created in total, into which the Federal Deposit Insurance Corporation placed 114 individual banks.

Using a bridge bank involves either the transfer of the assets and liabilities of the existing legal entity to a new legal entity or the transfer of ownership of the existing legal entity to new owners. The new (bridge) bank would then continue to provide the critical banking functions while either a recapitalisation or a permanent transfer of business to new owners is organised.

In Canada, bank resolution arrangements draw on aspects of general insolvency law, supplemented by the provision of extensive powers for the bank supervisor and deposit insurance fund. This represents a middle path between the US and UK approaches.

Some European countries (including Italy and Switzerland) have made special arrangements for dealing with troubled banks. These arrangements do not go as far as the regimes described above, but some make provisions for:

- financial authorities to appoint special or provisional administrators and have some discretion over the initiation of measures, including the ability to apply them to banks before they are technically insolvent; and
- special administrators to have fairly wide powers, although the balance between their objectives, including that of maintaining financial stability, is not precisely defined.

3.16 The approach taken to banking failures in the UK contrasts with the approach taken in the UK for the water and railway industries, and energy infrastructure companies, where special administration schemes are in place; as well as with the approach towards banking failures taken in many other countries. Box 3.3 briefly

provides further details on special administration regimes, and arrangements in place in the UK to maintain access to other services.

Box 3.3: Maintaining access to critical services in the UK

The UK has special administration regimes for the energy, water and railway industries. These ensure that essential services to consumers remain secure and uninterrupted in the event of a company providing those services becoming insolvent.

For example, the Energy Act 2004 created a special administration regime for companies owning or operating gas or electricity networks. Rather than risk consumers' supplies being cut off due to the actual or threatened insolvency of an energy network company, the key objective of energy administration is to ensure an efficient and economic continuity of supply through either the rescue of the energy network company as a going concern or by transferring its business to another company (or companies).

Other arrangements apply to some other sectors. For example there are two schemes that exist to protect holidaymakers if their travel company goes out of business - ABTA and ATOL. These schemes apply to package holidays and to some flight-only arrangements:

- ABTA provides a discretionary scheme of financial protection so that consumers already on holiday will be able to continue as originally planned, and consumers who have not yet started their holiday will get their money back or, where possible, ABTA will make arrangements for them to continue with the planned trip; and
- for consumers who book a package holiday that includes a flight, their money must be protected under the ATOL scheme operated by the Civil Aviation Authority (CAA). All licensed firms are required to lodge bonds with the CAA so that if they go out of business, the CAA can give refunds to people who cannot travel and arrange for people abroad to finish their holidays and fly home. In addition, a Government-backed fund called the Air Travel Trust steps in if any ATOL bond isn't enough to look after all consumers affected by the failure.

3.17 The banking sector is different to the other sectors covered by special administration regimes and consequently any regime applying to banks may work in a different way to existing special administration regimes. For example, if on top of the cover already provided by the FSCS, continued routine use of current accounts was considered to be a critical banking function that needed to be maintained in the event of an insolvency, this could require a change in insolvency law to modify the order of priority applying to repayment of creditors of an insolvent bank. In addition, unlike the companies covered by these special administration schemes, banks are not monopolies, and therefore the Government will consider whether mechanisms other than a special administration regime may be a more appropriate way of delivering any critical banking functions.

3.18 The Government would need to consider, for example, the fact that a special administration regime for banks poses complex issues, not least how the ongoing operation of a bank could be funded in the event that the special administrator is required to keep some, or all, of the bank in operation during the special administration process. Decisions would need to be made on which liabilities have to be paid, and how the necessary liquidity to meet those liabilities would be assured. This would include issues of creditor priority.

Question 3.9: What issues should the Government consider in assessing possible arrangements, in addition to the FSCS already available, to deliver continuity of any critical banking functions in the event of a banking failure?

Question 3.10: What, if any, lessons can the Government learn from other sectors and other economies? For example, from special administration regimes and pre-funded insurance type schemes such as the Federal Deposit Insurance Corporation in the United States?

THE NEEDS OF DIFFERENT CUSTOMERS

3.19 In assessing any reforms, the Government will want to consider the position not only of retail depositors, but also corporate customers and unsecured creditors. It may not be appropriate to extend the same levels of deposit protection to all customers. However all businesses and institutional customers (including Government) may need access to payment systems and other banking services in order to prevent ripple effects. For example, if a large employer could not process salaries on time due to its bank failing, the effects could be spread among customers of many banks.

Question 3.11: How do the needs of different groups of customers differ? How should the Government take this into account in drawing up the new framework?

4

HOW TO RESPOND

4.1 The Government invites responses to the issues raised in this discussion document. The Government would welcome responses by 5 December, during which time the Government and other authorities will engage in intensive discussions with relevant stakeholders. This accelerated timetable reflects the urgency the authorities attach to finding workable solutions to the challenging issues raised, and meeting the stated objectives.

Next steps 4.2 Informed by responses to this discussion paper, the Government intends to:

- discuss specific questions in more depth with stakeholders, throughout the autumn. Please let the Treasury know if you would be interested in joining these discussions. Contact details are provided below;
- publish a consultation paper early in the New Year setting out any options identified to achieve the objectives highlighted in this discussion paper;
- begin the process of preparing any draft clauses as soon as possible after the end of the period in 4.1; and
- subject to finding workable solutions to the challenging issues raised, introduce legislation in the first half of 2008.

4.3 The Treasury will work closely with other authorities during this process, in particular the FSA and Bank of England. Responses to this discussion paper will be shared among the relevant authorities.

4.4 Please ensure that responses to this document reach us by the closing date. We cannot guarantee to consider your response if it arrives after that date.

Responses should be sent to:

Banking Reform discussion responses
Banking Reform Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Telephone: 020 7270 5000

Email: banking.reform@hm-treasury.gov.uk

4.5 This paper is available on the Treasury's public website at www.hm-treasury.gov.uk. For hard copies, please use the contact details above.

4.6 When responding, please state whether you are responding on behalf of an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

Confidentiality

4.7 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise in writing.

4.8 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regime. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

4.9 In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response.

4.10 Subject to the previous two paragraphs, if you wish part (but not all) of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and another confidential version for use by HM Treasury.

4.11 A summary of responses will be published at www.hm-treasury.gov.uk.

4.12 Any FOIA queries should be directed at:

Correspondence and Enquiry Unit
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HM Treasury
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London, SW1A 2HQ

Telephone: +44 (0)20 7270 4558

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Email: public.enquiries@hm-treasury.x.gsi.gov.uk

Code of practice for written consultation

4.13 The consultation process on any changes to current framework for dealing with banks in distress, and in particular depositor protection, includes this discussion paper as well as the consultation paper being published early in the New Year. This process is being conducted in line with the Code of Practice for written consultation (a full version can be found at www.cabinetoffice.gov.uk/regulation/code.htm) which sets down the following criteria:

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy. HM Treasury welcomes comments on this discussion document by 5 December. The Government will conduct a formal consultation for 12 weeks early in the

New Year on the policy proposals that are developed as a result of this discussion document;

- Be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses;
- Ensure the consultation is clear, concise and widely accessible;
- Give feedback regarding the responses received and how the consultation process influenced the policy;
- Monitor the department's effectiveness at consultation, including through the use of a designated consultation coordinator; and
- Ensure your consultation follows better regulation best practice, including carrying out an Impact Assessment if appropriate. The Government will complete an Impact Assessment alongside the consultation document published early in the New Year.

4.14 If you feel that this consultation does not fulfil these criteria, please contact:

Sowdamini Kadambari
HM Treasury
1 Horse Guards Road
London
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Telephone: 020 7270 4867

Email: Sowdamini.Kadambari@hm-treasury.gov.uk

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THE FINANCIAL SERVICES COMPENSATION SCHEME

A.1 The Financial Services Compensation Scheme (FSCS) was set up under the Financial Services & Markets Act 2000 (FSMA) as the UK's compensation fund of last resort for customers of financial services firms.

A.2 The Financial Services Authority (FSA), and not HM Treasury, sets the detailed framework within which the FSCS operates. In spite of the primary role of the FSA in determining the rules governing it, the FSCS was established as a not-for-profit, independent body, with board members acting independently of the FSA.

Eligibility and compensation limits

A.3 The FSA is responsible for setting the eligibility and compensation limits that apply to the FSCS. The scheme covers business conducted by firms authorised by the FSA. European firms (authorised by their home state regulator) that operate in the UK may also be covered. Individuals and small businesses are eligible to make claims to the FSCS¹ and the service is free to such customers. The actual level of compensation received will depend on the basis of the consumer's claim. FSCS can only pay compensation for financial loss.

A.4 The FSCS provides protection for customers of authorised firms and covers the following areas:

Areas covered by FSCS	Compensation limits
Deposits	100% of eligible deposits up to £35,000, as of 1 October 2007
Insurance policies	Long-term insurance: unlimited. 100% of the first £2,000 plus 90% of the remainder of the claim General insurance: unlimited Compulsory insurance (e.g. third party motor): 100% of the claim Non-compulsory insurance (e.g. home and general): 100% of the first £2,000 plus 90% of the remainder of the claim
Insurance broking (for business on or after 14 January 2005)	Unlimited. 100% of the first £2,000 plus 90% of the remainder of the claim. Compulsory insurance is protected in full
Investment business	£48,000 per person. 100% of the first £30,000 and 90% of the next £20,000
Mortgage advice and arranging (for business on or after 31 October 2004)	£48,000 per person. 100% of the first £30,000 and 90% of the next £20,000

¹ For the purpose of the compensation scheme, a small business is one with a group turnover of less than £1 million. A £1 million limit also applies, in the case of charities, to their annual income, and, in the case of trustees, to the net assets of the trust.

B

LIST OF QUESTIONS FOR CONSULTATION

- Question 2.1: Do you agree that these are the right objectives? Are any of these objectives more important than others?
- Question 2.2: What other issues should the Government consider when reviewing the framework for depositor protection?
- Question 2.3: What other issues should the Government consider when considering how best to preserve any critical banking functions?
- Question 3.1: Should the level of coverage for deposits be increased from £35,000? If so, to what level and what are the benefits and costs of doing so? Should the bank deposit limits be related to those for other sectors, e.g. investment business and insurance?
- Question 3.2: Would it be desirable to put in place arrangements to better ensure that depositors are repaid in a more timely fashion? What issues would need to be considered in assessing any new arrangements?
- Question 3.3: What are the issues the Government should consider in relation to other parts of the FSCS?
- Question 3.4: What issues should the Government take into account in any further review of the funding mechanisms for the FSCS?
- Question 3.5: Should the role of the FSCS be extended to promote access to banking services for depositors with failed banks?
- Question 3.6: The Government would be interested in views on the best way to help consumers understand how banking deposit guarantees affect them?
- Question 3.7: Do you agree with the concept of critical banking functions? If so, what banking services might be properly regarded as so critical to the modern economy that they should continue to be provided in the event of a bank failure?
- Question 3.8: For what period of time should any critical banking functions be maintained and how this might vary in different circumstances?
- Question 3.9: What issues should the Government consider in assessing possible arrangements, in addition to the FSCS already available, to deliver continuity of any critical banking functions in the event of a banking failure?
- Question 3.10: What, if any, lessons can the Government learn from other sectors and other economies? For example, from special administration regimes and pre-funded insurance type schemes such as the Federal Deposit Insurance Corporation in the United States?
- Question 3.11: How do the needs of different groups of customers differ? How should the Government take this into account in drawing up the new framework?

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