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Banking Reform Consultation Responses
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15 September 2008

Dear Sir/Madam

Tripartite Authorities July 2008 Consultation: Financial Stability and Depositor Protection

This is the Financial Services Consumer Panel response to the Tripartite Authorities July 2008 Consultation on Financial Stability and Depositor Protection. Since there are fewer direct questions in this particular consultation, and most of these are of a technical nature, we believe it will be more helpful to concentrate our response on those areas where we feel we are most able to contribute to the debate. As with our response to the January consultation this is essentially those areas where we feel the outcomes will have direct and significant impact on consumers. Our detailed comments are contained in an annex to this letter.

The best of all compensation schemes is one that does not have to be used. Perfect bank regulation would of course be the best way to achieve this, although it is hard to bring about in the real world. However the Panel's view is that the second-best contribution would come from offering unlimited compensation to all depositors without restriction on amount. Because depositors would not fear losing their money if an institution came under pressure, they would have no incentive to withdraw it. Any necessary measures to shore up the institution would not take place under pressure of an actual or threatened run on the bank, and could thus be more considered and orderly.

We do not accept the argument that full protection is not needed as 96% - or with a new £50K compensation limit 98% - of depositors are protected and therefore there is no need to go further. This is true by number of deposits but in fact only around two-thirds of the total amount deposited is safeguarded, which might result in many depositors still rushing to withdraw their money at the first sign of a problem.

We do not accept either the argument from moral hazard. Most customers cannot be expected to have a sophisticated view of whether the institution in which they are investing is sound or not. Indeed, as Northern Rock showed, in practice no retail bank can be allowed to go under without full compensation of depositors, and the pretence implicit in a limit to the contrary is a hollow one.

If a limit is to remain, it should apply to each brand, not to each authorised institution. Account facilities are often marketed by brand and are therefore chosen by brand. Brand-linked compensation arrangements are more appropriate and might in addition go at least some way in helping consumers through the confusing maze of compensation arrangements and limits. In the event of brand merger, provided that adequate arrangements are in place for communicating the consequences of such events, consumers should be well-placed to take a sensible decision about whether to move some of their money.

The issue of consumer communications is key and we expect the forthcoming FSA consultation paper to put clear, concrete proposals forward for an overall consumer strategy that covers both the launch of the new compensation arrangements and the continuing provision of information on an individual basis, from initial marketing to pre and post contractual requirements. These proposals must take account not only the varying levels of understanding of financial issues amongst consumers, but also the different commercial arrangements that are in place between institutions promoting account facilities, such as that between The Post Office and Bank of Ireland. It is essential that consumers are made aware of the institution that will be holding their money and any compensation arrangements, before any payment is made.

The Panel's detailed comments on these and other issues, including transactional amounts; continuity of service to customers; and the Special Resolution Regime; are contained in the attached annex.

Yours sincerely

A handwritten signature in black ink that reads "David L. Lipsey" followed by a long, horizontal flourish.

David Lipsey
Chairman