

[banking.reform@hm-treasury.gov.uk](mailto:banking.reform@hm-treasury.gov.uk)

CONFIDENTIAL

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

Dear Sirs

**Combined response on Financial stability and depositor protection:  
further consultation and Special Resolution Regime  
- Alliance & Leicester plc. -**

Alliance & Leicester plc welcomes the opportunity to submit a combined response to the Treasury's further consultation on 'Financial stability and depositor protection' and to the consultation on the 'Special Resolution Regime'.

Alliance & Leicester is one of the UK's major financial service groups. Our business approach is based on delivering good value products both to our commercial and retail customers. You will also be aware that Alliance & Leicester is currently the subject of a take-over offer from Banco Santander. That offer has the recommendation of the Alliance & Leicester Board and is being voted on by Alliance & Leicester shareholders on 16 September 2008.

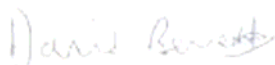
Alliance & Leicester supports a number of the Treasury proposals as set out in the further consultation document, such as an increase in the Financial Services Compensation Scheme (FSCS) limit, on a per person per bank basis.

Further we are in agreement with the British Bankers' Association (BBA) on most of their outstanding concerns, in particular, those regarding the structure of the Special Resolution Regime and the possibility of a future pre-funded FSCS.

Our response will therefore emphasise our support for the implementation of specific Treasury proposals and expand on our concerns on the Special Resolution Regime and a pre-funded FSCS. Appendix 1 sets out our response in detail.

Should you require any further information please do not hesitate to contact me via Gary Follis our Head of Public Affairs on 020 7908 3020.

Yours sincerely



**David Bennett**  
Group Chief Executive

**Appendix 1**

**CONFIDENTIAL**

**Financial Stability and Depositor Protection:**

Alliance & Leicester broadly supports most of the proposals as set out in the 'Further Consultation' document however some concerns do remain on the structure of the Special Resolution Regime and the potential for a future pre-funded Financial Services Compensation Scheme.

Our response will focus on three issues for particular consideration.

- 1) the Special Resolution Regime (SRR);
- 2) the funding of the Financial Services Compensation Scheme (FSCS);
- 3) limits for compensation under the FSCS;

**1) Special Resolution Regime**

While we can see a case for the development of the SRR and bank-specific insolvency arrangements, unless appropriately designed we believe that these could have the potential to damage the competitiveness of the UK financial markets and the financial standing of banks that operate within them.

We believe that heightened supervision should succeed in returning a bank or building society to a state of normality, with varying degrees of strategic refocusing, depending on need. Therefore SRR arrangements should only be undertaken when it becomes clear that there really is no viable alternative.

Alliance & Leicester in general agrees with the proposed high level conditions for triggering the SRR namely that a bank is failing, or is likely to fail to meet its Threshold Conditions as set out by the FSA, including conditions on capital and liquidity requirements; and that having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy the Threshold Conditions. However shareholders and creditors will require a high degree of certainty as to the point at which the SRR would be invoked and their property rights would be lost or diminished. Therefore further clarification on this process is necessary including clear minimum conditions which need to be met in order to justify the use of these powers.

With regards to creditor protection, the SRR consultation document states that the detail on how a balance might be struck between the creditor protection objective and other objectives of the regime will be set out in the 'code of practice'. Given the critical importance of creditors' rights in the SRR debate, we do not think this approach is satisfactory. The status of the proposed code would be non binding guidance. Such guidance would not reduce legal uncertainty and could not be relied upon in a court of law. The principles governing creditors' rights should be enshrined in the legislation itself.

With regards to netting and other financial collateral arrangements, Alliance & Leicester agrees with the BBA that the authorities should protect the types of financial contracts that are commonly entered into by counterparties in financial markets. Therefore the counterparties' rights to close out a netting agreement on initiation of the SRR should not be infringed and that if termination was not invoked the authorities would refrain from cherry-picking among contracts subject to a netting agreement.

Whilst clarification is needed on the sorts of contracts that would fall under non qualifying contracts, Alliance & Leicester agrees with the BBA that all legally enforceable master netting agreements should be protected. The fact that the treatment of non qualifying financial contracts (whether or not to cherry-pick) would be decided on a case by case basis would only add to the uncertainty.

With regard to group companies the consultation raises the possibility of the Treasury taking powers to create, alter or nullify contracts between companies in a group containing an ailing bank (Para 5.39). We consider this to be excessive. Such powers could destabilise other group companies and create further legal uncertainty. In addition, where group companies were incorporated outside the UK a raft of further issues would arise.

## **2) Funding of the Financial Services Compensation Scheme;**

Alliance & Leicester recognises that the Treasury currently propose not to introduce a pre-funded FSCS at this stage. However Alliance & Leicester remains of the opinion that a pre-funded Financial Services Compensation Scheme (FSCS) would be ineffective, potentially punitive and constitute a drag on bank liquidity. Therefore our preferred method of funding is for a post-funded FSCS.

### **Risk-based funding**

The consultation document states that the FSA will consider risk-based funding and consult on any changes to the criteria for calculating deposit contributions if appropriate in due course. Alliance & Leicester remains of the opinion that the use of risk-based levies or the introduction of behavioural factors into the calculation of levies is not an appropriate method to influence the risk appetite of banks. The current regulatory framework already provides more effective and faster means, for example capital and liquidity ratios, to compel riskier banks to modify their business model than would be provided by a risk-based approach to the FSCS.

Further, a risk based approach will add further unnecessary complexity to the regulatory process at a time when the FSA is already managing multiple roles and objectives – of which depositor protection is only one. To avoid possibly conflicting regulatory agendas, the assessment should be based on the existing regulatory process.

### **3) Limits for compensation under the Financial Services Compensation Scheme (FSCS)**

Alliance & Leicester supports the Treasury proposal to increase the FSCS limit from £35,000 to £50,000 on a per person per bank basis. Whilst this is only relevant when a deposit-taking institution fails, it can provide consumers with confidence that their deposits are safe when there is uncertainty in the financial markets.

An increase in the limit to £50,000 would increase the proportion of balances protected to 57%, going some way to reduce potential outflows in the event of a banking crisis and would place UK deposit protection in line with the best standards seen worldwide, namely the US, Canada and France. This should improve confidence in the system as a whole.

In addition, by providing cover on a per person per bank basis the Treasury ensures a level playing field for all banks which the FSCS covers. This avoids a situation whereby one bank with a large number of brands secures greater cover for their customers over another bank with fewer brands.

With regards to informing consumers as to how the banking deposit guarantees affect them. We believe that this is best achieved by using a number of different channels:

- Financial Institutions' product literature;
- Banking Code wording and guidance;
- BBA communications;
- Institutions' staff training; and
- General financial education also has a role to play.

There is a line to be struck, however, ensuring that consumers are informed, but also ensuring that this is done without inadvertently raising concerns about the security of deposits in the UK banking system.

In addition, there is a particularly important role for the regulatory authorities to play in providing proactive explanations and updates to the media in a timely manner, which takes into account how the messages will be interpreted and relayed by the media.

ENDS