

15 September 2008

Banking Reform consultation responses

Banking Reform Team
HM Treasury
1 Horse Guards Road
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FINANCIAL STABILITY AND DEPOSITOR PROTECTION: FURTHER
CONSULTATION JULY 2008

Please accept this letter as the CBI response to the Treasury's Financial Stability and Depositor Protection: further consultation July 2008.

The CBI welcomes the Treasury's further consultation and broadly supports the proposals set out. However, the CBI does have some areas of concern which we have set out in this high level response. Given the technical nature of some of the proposals, the CBI has left detailed response to industry respondents.

This response therefore will comment on the key policy areas only.

REDUCING THE LIKELIHOOD OF BANK FAILURE

- Supervisory enhancement

The CBI supports the FSA's supervisory enhancement programme which is the Authorities' response to weaknesses identified in the supervision of Northern Rock. It is imperative for maintaining confidence in the UK banking system that the emphasis in the Authorities' approach to financial stability and depositor protection is on preventing a bank from failing in the first place. The implementation of this supervisory enhancement programme will improve the FSA's day-to-day engagement with firms. The use of more specialised staff will help to ensure that the FSA has the right skills to exercise its already extensive power.

The CBI is also supportive of the FSA's intention to respond to circumstances in which a firm may face increased risk by stepping up the intensity of its supervision, referred to as "heightened supervision".

The CBI encourages the FSA to provide further detail on the actions the FSA will take in a situation of heightened supervision and how the FSA intends to return a bank to a situation of non-heightened supervision.

- Liquidity support arrangements

The CBI in general supports the actions to facilitate liquidity support. The CBI welcomes moves to strengthen the Bank of England's role in financial stability. The key to prevention of market failures lies in the appropriate combination of liquidity and solvency requirements and avenues for central bank intervention.

The Treasury has sought views on whether it should legislate to provide that restrictions on borrowing and other provisions having a similar effect are nullified to the extent that they would prevent financial assistance by the Authorities for the purposes of financial stability, or are otherwise triggered by steps taken by the Authorities. 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. The CBI is concerned about the suggested statutory overrides of contractual provisions used to protect the positions of lenders, creditors and other providers of finance or protection and other contractual provisions which seek to give creditors rights. It is important that before the introduction of any such overrides there is a rigorous assessment in respect of the impact on other creditors and any impact this would have on the cost of finance for UK banks.

We leave it to industry specialists to raise further concerns.

The CBI encourages the Treasury to consider how regulation can be used where there are issues in relation to contractual provisions rather than resort to the need for any type of statutory override.

REDUCING THE IMPACT OF A FAILING BANK

- Special Resolution Regime

The Treasury provides an outline of the mechanisms of the Special Resolution Regime ("SRR") in the further consultation paper. In-depth technical detail has been provided in the separate consultation paper: Financial Stability and Depositor Protection: Special Resolution Regime July 2008.

The CBI welcomes the general direction of the proposals to give the Tripartite Authorities new powers to deal effectively with the rare case of the failure of a UK bank.

If a bank were to fail it is imperative that any action taken by the Authorities is authoritative and swift to prevent the failure spreading to other parts of the financial system. However, that neither needs nor should mean an overriding reduction of the legal rights of investors. Although such features are part of the landscape in many other countries, introduction now and in haste would mean this happening when the system is at its most fragile.

The introduction of a SRR does have the potential to impact on the rights of shareholders, creditors and subordinated debt holders, and it will be important that these interests are properly balanced and taken into account. We look forward to seeing initial thoughts on the detailed proposed legislation and contributing to as equitable a form of wording as possible. These are extremely complex proposals, and there are grounds for concern that the time available under the Banking (Special Provisions) Act 2008 will be insufficient for both full Parliamentary scrutiny and the involvement of those potentially affected. This is particularly true in the case of the proposed partial transfer arrangements under the SRR. When banks are

raising capital, as they currently are, it is extremely important that any changes in this area are as properly thought through as possible.

We have been concerned to avoid dual regulation and welcome the suggested division of responsibility between the Tripartite Authorities. The proposals for the FSA to remain the industry regulator and to trigger the SRR, with thereafter the operation of the SRR and deciding what resolution tools to use being the remit of the Bank of England, would seem both appropriate and sensible.

The CBI also encourages the Treasury to be cautious in considering any revisions in capital requirements for banks. There is a risk that unnecessarily high capital requirements may make it harder for business to access finance which could further intensify the economic downturn. This would concern all CBI members.

EFFECTIVE COMPENSATION ARRANGEMENTS FOR DEPOSITORS

- Compensation limit

At this stage, it is expected that the FSA's consultation paper, to be published in the autumn, will propose as the lead option an increase to £50,000 on a per person per bank basis in the compensation limit for protected deposits. Given that the existing £35,000 scheme limit covers over 96% of deposits by number and is in line with limits elsewhere, the CBI does not see a prevailing need to increase the limit significantly.

We support the Treasury's goal of delivering speedy compensation payments. However, 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 would be very high. 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 may not even be practically possible. It may be therefore that greater emphasis needs to be placed on finding a means of dealing with the retail deposit base of a failed institution of a significant size in a way that permits the utilisation of the existing IT platform

- FSCS borrowing from the public sector and pre-funding

The CBI welcomes the proposal to give the Financial Services Compensation Scheme access to immediate liquidity through the National Loans Fund.

We support the Treasury's suggestions not to move to a pre-funding of the depositor protection scheme, at least at this stage. It would take a considerable amount of time to build the fund up to an amount which would deal with a failure of any size – the existing US scheme, in place since the 1930s, only has sufficient funds to deal with a Northern Rock event and the failures it has been directed to have been quite small banks. In addition, since the FSCS will have access to immediate liquidity through the National Loans Fund there will not be the need to resort to liquidity from a pre funded depositor protection scheme.

STRENGTHENING THE BANK OF ENGLAND AND TRIPARTITE COORDINATION

- Strengthening the role of the Bank of England *[This is a new section]*

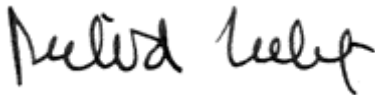
The CBI supports the changes the government intends to make to strengthen the role of the Bank of England, primarily being as follows:

- 1) provide the Bank of England with a statutory responsibility for contributing to the maintenance of financial stability;

- 2) improve the policy instruments available to the Bank of England in support of financial stability, including through the special resolution regime;
- 3) legislate for the creation of a Financial Stability Committee to support the Governor and Bank of England, drawing upon external expertise;
- 4) give the Court a formal role in overseeing the Bank of England's performance on financial stability;
- 5) legislate to require the Bank of England to consult with the Treasury, on a periodic basis, when setting the detailed financial stability objectives for the Bank of England and the remit for the FSC;
- 6) bring forward legislation to restrict the size of Court to a maximum of twelve members, including a majority of non-executives, one of whom will Chair Court as has been the case in practice since 2003; and
- 7) legislate to facilitate the reduction in the size of Court by terminating the membership of all non-executive members when the measures come into force, allowing for their subsequent reappointment.

These changes appear to be quite reasonable.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Lambert', written in a cursive style.

Richard Lambert
Director-General