THE INSTITUTE OF CHARTERED ACCOUNTANTS

IN ENGLAND AND WALES

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Our ref: ICAEW Rep 91/08

David Lamb
Banking and Compensation Reform
The Financial Services Authority
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London E14 5HS

By email david.lamb@fsa.gov.uk

Dear David

DEPOSITOR PROTECTION – COMPENSATION ARRANGEMENTS

I am writing on behalf of Michael Izza in response to the letter of 29 July from Peter Smith requesting input regarding proposed changes to the depositor protection compensation arrangements.

The Financial Services Faculty leads the representational work of the Institute of Chartered Accountants in England & Wales (ICAEW) on in respect of financial services. As such, we have close contact with members working both for regulated financial services firms, and in firms providing professional services to such businesses.

Whilst we have made efforts to consult with our members over the questions raised, given the timeframe and also time of year, the level of consultation has necessarily been limited. Our comments must be construed in that light, and not be considered to represent the comprehensive views of the accountancy profession. There are other questions, for example, regarding the ability and/or appetite of our members to offer depositor protection products, where we are unable to respond.

We note the proposed increase in the compensation limit. The choice of compensation limit is a matter of judgement and we have no particular view on where that limit should lie. Whatever the compensation limit, it will be critical that payments are extremely rapid if the issue of timely compensation is to be satisfactorily addressed. However, there are investors, particularly in uncertain times such as now, when other investments look less attractive, who may prefer to keep large cash balances on deposit. There may be practical reasons why some of these large cash balances cannot be spread around institutions in amounts covered by the compensation scheme. Experience indicates that most customers with long-term cash balances significantly above the compensation limit who do not spread their deposits over several institutions are willing to take the risk of not recovering the balance over the limit. The majority of such customers have access to financial advice and ought to be capable of making an informed choice.

The issue of temporarily high balances is a different matter. The options are limited to:-

- covering large deposits but only for a very limited period;
- covering all deposits over the set limit for any period but charging per day/month/year and by the amount of the excess;
- requiring professional advisers to purchase deposit insurance to protect their clients' mortgage funds against bank default; or
- leaving the market to develop a product competitively to cover temporarily high balances – this would probably only be worthwhile for balances that are significantly over the prescribed limit.

We agree that there are practical difficulties associated with providing a solution to the problem through the depositor protection scheme. Not least of these would be in defining the period of cover and providing a robust and easily understandable cut-off for what is and is not covered. It may not be useful to introduce complexity by limiting coverage to certain types of account for certain periods.

A market-based product might provide a solution, although the economics and pricing of such products would need careful examination. We note that the financial services industry has had the opportunity to develop and market such products but are unaware of any currently on offer or for any latent unmet demand. Demand may, of course, develop.

Our responses to your specific questions are set out below. We have tried to be helpful and thorough in our responses but for the reasons noted above have only been able to provide limited information.

Question 1: Are you aware of any products which are currently marketed to UK consumers to cover deposits above the current limit against the possibility of bank failure?

We are not aware of any products currently available in the market for insuring deposits. However, for the reasons noted above, we would not normally collect this data and have only been able to perform very limited consultation upon this question but there may be products available of which we are unaware.

Question 2: Are you aware of any product currently marketed to large organizations, which are not currently covered by the FSCS, to protect their funds held with deposit takers?

See our answer to question 1 above.

Question 3: If so, do you think this model be adapted to provide a solution for individuals?

Not applicable (see above).

Question 4: Could you see the possibility of an insurance-based solution to deposits held above the current FSCS limit (i.e. an insurance policy that would pay out in the event of a bank failure)?

Yes. We can envisage the development of competitive products to cover temporarily and other high balances with the proviso that this would probably only be worthwhile for balances that are significantly over the FSCS limit. This would be subject to the insurance solution being economically viable and commercially attractive, which would require input from the insurance industry.

Question 5: If so, how would you expect this product to be marketed?

We can envisage a number of channels for marketing such products, for example by the deposit taking institution, by insurers directly or through intermediaries such as accountants, IFAs or the legal profession. However, we have no intelligence or expectations as to how in practice this would occur if such products were to be developed.

Question 6: Could you see the possibility of an account based protection mechanism for deposits held above the current FSCS limit (i.e. a product which provided coverage by virtue of the fact that customers opened a particular kind of account)?

Whilst we can see the possibility of this type of arrangement i.e. cover deposits of a particular type for a very limited period, there would be an additional cost to be borne presumably by the banks resulting in reduced interest payments. In addition this would introduce a further complexity for customers to take into account when managing their risk.

Question 7: If so, how would you expect such an account to provide this coverage (e.g. though an insurance policy taken out with a separate firm, or through the money contained in the account remaining the property of the consumer, rather than constituting a debt of the bank)?

We can envisage a number of options for providing such an account, for example, a market generated insurance product or some form of segregated funds backed by the highest quality assets (subject to the asset segregation holding up in the event of a bank failure). However, we have no particular intelligence or expectations as to how this would operate in practice.

Question 8: Another way of achieving this might be for accounts to be protected by being backed by specific assets, such as gilts, that could be realized and used to compensate customers in the event of failure. Do you think such products might be developed and marketed by your members?

We have no intelligence or expectations as to how this would operate in practice. See also our response to Question 7.

Question 9: How would you expect such products referred to in 7 & 8 above to be marketed?

We have no intelligence or expectations as to how this would operate in practice.

Question 10: Assuming these products could be devised, would it be possible to set up policies for short-term coverage of temporary high balances?

We have no intelligence or expectations as to how this would operate in practice.

Question 11: If so, how would you expect the coverage of these products to be limited e.g. by amount, by length of time?

We have no intelligence or expectations as to how this would operate in practice.

Question 12: How would you expect such products to be paid for e.g. by fee, or by requiring the consumer to forego the interest they would usually expect to be paid for a large deposit, or a combination of the two?

We have no intelligence or expectations as to how this would operate in practice.

Question 13: What is your view of the potential appetite of consumers and their advisers for such products, given that bank failure may be regarded as a low probability but high-impact event?

We have no intelligence or expectations as to consumer appetite for such products.

Question 14: Are you aware of any plans by your members to begin marketing such products in the future?

We are not aware of any plans but, as noted above, have no particular intelligence about the plans of our members in this regard.

Question 15: If protection products for temporary high balances of the kind described above were to be available on the market, in what circumstances would you expect your members might advise their customers to make use of these?

The Institute cannot comment on the nature of advice that might be offered by members to their clients, though factors might include the size of balances and product pricing.

If you would like to discuss any aspect of our response further, please contact me in the first instance.

Yours sincerely

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