Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear David

CP08/15* Financial Services Compensation Scheme: Review of Limits**

This is the Financial Services Consumer Panel's response to the FSA Consultation Paper CP08/15 Financial Services Compensation Scheme: Review of Limits.

Overall we believe that it is of central importance that consumers must have confidence in the compensation scheme in order for it to be effective. Much of the content has been well trailed in the Tripartite Authorities' Consultation on Financial Stability and Depositor Protection. We acknowledge that in this Paper the FSA has addressed some of the issues we raised during that consultation. However, we repeat that the increase to a £50,000 compensation limit is inadequate and we call for a protection limit of 100% of all deposits up to £1m.

We note that paragraph 2.6-2.7 explains that the FSA has tried to remove the principle of coinsurance where possible. Coinsurance presumes that consumers should be expected to bear part of the loss, either through an upper limit; or by applying a lower % than 100% to the whole or part of the loss. The Paper acknowledges that when the limits were introduced it was thought that coinsurance could act as an incentive for consumers to spread their investments. The Paper further acknowledges that consumers are either unaware or do not understand it, so it does not influence their behaviour. We therefore welcome the FSA's decision to move away from co-insurance where possible but we believe it could go further e.g. by having a higher limit for depositors.

Here follows our comments on each of the questions raised in the Consultation Paper:

Q1: We are raising the limit for banks to 100% of £50,000 on 7th October 2008. Do you agree with this? If not, please give your reasons.

As we have stated previously, we do not believe that there should be any limit imposed on payments by the compensation scheme. Although £50,000 may cover 98% of all accounts, we believe it will only cover 70% of the total funds on deposit. Moreover, in the absence of any available data on multiple account holding, it is impossible to calculate what proportion of account holders this equates to. We remain of the view that the imposition of any limit means that in the event of a bank failure, although the number of consumers who might suffer could be relatively small, they would stand to suffer a very high degree of detriment. In particular, we note that a number of older customers move their savings from equities to cash deposits as their investment habits become more risk averse.

We would like to understand what the costs are if all deposits, irrespective of value, were guaranteed. We do not feel that the FSA has explored this option fully. We believe that the current proposals would lead to considerable movements of money in a period of market turbulence, and that the FSA has given insufficient consideration to those movements and to the fact that its own policies in this regard will distort the market. We repeat our suggestion that a formula of a 100% guarantee up to £1m would protect all but the most affluent of savers.

We do welcome the emphasis on the need to ensure that the compensation scheme is adequately understood. If there are to be limits to compensation they need to be communicated effectively in order that consumers can manage their money effectively. We would be keen to explore with the FSA how they intend to ensure that customers do understand the level of protection. We believe that consumers need to be in receipt of appropriate information to enable them to make informed decisions about where to put their savings.

There are also confidence issues to consider. Lack of understanding of compensation limits clearly accelerated the run on Northern Rock and it was not until the Treasury announced that the first £35,000 would be guaranteed that the run stopped. It is therefore important for financial stability that the compensation scheme is adequately understood.

In our earlier submission in response to the Tripartite Authorities July 2008 Consultation: Financial Stability and Depositor Protection, we said that we expect the forthcoming FSA consultation to put concrete proposals forward to deal with consumer communications. Communications will need to cover all channels and all levels of financial capability.

We note that the FSA has engaged external consultants who will help identify the gaps in consumer awareness, the degree of information needed and how it should be delivered. The Paper refers to action by the FSA, FSCS, voluntary action by firms, and FSA rules requiring firms to provide certain information to consumers. We do not believe that the FSA should feel restrained about using rules to ensure that consumers receive the information that they need. For example, we believe that there should be a personalised communication when someone's balance exceeds the compensation limit. The requirements should be contained in the FSA handbook.

We note that the Paper proposes payouts within a week of a bank failure. We repeat that any cessation of banking services would have considerable consequences for often the most vulnerable groups of consumers so we favour a seamless change in regime or an immediate payout. We would encourage the FSA to ensure that all possibilities for prompt payment have been explored before settling on the final arrangements.

Q2: Do you think that we should continue to offer compensation on a per authorised entity basis, or should we move to a per brand or per account basis? If a per brand or per account basis is preferred, please give your reasons and explain how you consider branding should be defined and applied.

In response to the Tripartite authorities CP in June we called for compensation limits to be applied to each brand, not to each authorised institution. Products are marketed by brand and customers cannot be presumed to have the sophisticated knowledge to know ultimately who holds the authorisation. We have already expressed concern that some depositors hold multiple accounts with different institutions that have only one banking license between them. So, depositors with accounts at Birmingham Midshires and Halifax for example will only be covered up to a combined account total of £50,000 at present. Even where consumers may wish to spread their risk they cannot be guaranteed to know who holds the licence. For example there are many consumers who would not be aware that their Post Office account actually rests with the Bank of Ireland.

The FSA states that there are difficulties in defining what a brand is. One way around this would be to apply the limit on an account basis. We feel that this would be a straightforward way of determining a customer's entitlement to compensation. The FSA argues that such a policy would undermine the limit as firms would encourage customers to open additional accounts. We have no problem with this. We expect firms to be obliged to inform customers when they have reached the limit of protection in any case and this would be entirely consistent with that approach. We therefore support the application of compensation on a per brand basis.

Q3: Do you agree that the limit for investments and home finance mediation be set at 100% of £50,000 to match the limit for deposits? If not please give your reasons.

Limits currently cover 100% of the first £30,000 of each claim and 90% of the next £20,000 giving total coverage of £48,000. This has afforded investors a higher degree of protection than bank depositors. This cannot be appropriate as such investments are assumed to carry a higher degree of risk than bank deposits. In each case the FSA is proposing to increase the cover to 100% of the first £50,000. We do not accept that protection should be higher for investments than for bank deposits and we feel that equivalence is an improvement. However there is a case for more security for bank deposits, recognising the less risk associated with those products. We cannot see the logic, however, in bracketing together investment and home finance mediation as the two subjects are unrelated. Home finance mediation can expose consumers to greater risks in terms of the amount of money involved, and to more serious consequences, including homelessness, if anything goes wrong.

We would propose that for home finance mediation the compensation limit be 100 per cent of all losses, with no maximum.

Q4: Do you agree that the limit for provision and mediation of non-compulsory insurance – both life insurance and non-compulsory general insurance - should be amended to 90% of the whole claim, with no upper limit? If not please give your reasons.

With regard to general insurance, the current limits cover 100% of the first £2000 of a claim, plus 90% of the remainder without any upper limit. The future level of cover will be 90% of the total claim without any upper limit. Compulsory insurance is currently covered to 100% of claims without any upper limit. This will be continued. In respect of life insurance the FSCS is required to achieve continuity of insurance by transfer of existing policies. This must be for at least 90% of the benefit that policyholders are entitled to. The proposal is that the consumer be compensated by 90% of the whole claim with no upper limit. We support the principle that a maximum limit on the amount payable would not be appropriate as it may not be sufficient to provide sufficient protection for the consumer's needs. However we believe that cover should be extended to 100%.

Q5: Do you agree that it is appropriate for home finance lending and administration, including the losses listed in paragraph 6.3, to remain outside the scope of the FSCS?

Home finance lending and administration are regulated activities and it is inconsistent that they are not covered by the scheme when there is the potential for consumer detriment. As the paper notes there are a number of losses that can be experienced by the consumer if they have been given an offer of finance but the finance has not yet been supplied. They could include fees paid directly to the failed firm for the provision of home finance; fees for services not provided by the failed lender; possible increased costs or non-availability of a replacement home finance; and costs directly associated with delayed or cancelled completion. In the latter case the losses could be significant if the customer is in a chain involving a number of properties. Failure by a homebuyer to complete a purchase because promised finance fails to arrive leaves the homebuyer open to the very real threat of civil legal action by the seller of the property.

We believe that there may be considerable consumer detriment if an offer of finance is withdrawn. For example, delayed completion can incur significant costs. The Paper suggests that fees and costs associated with home lending should also remain beyond the scope of the scheme.

We do not accept the FSA's rationale for these losses to be outside the scheme. A customer will enter into a relationship with a lender in good faith. Under these proposals the customer is bearing the entirety of the risk if a loan does not materialise. This spread of risk would not appear to encourage responsible behaviour on the part of the firm.

Q6: To protect high short term deposits, please state whether you think there should be:

a) A rules-based solution; or

b) A market-led solution.

Please give your reasons.

Q7: if you think there should be a market-led solution, what type of solution do you think would be appropriate?
For example

a) An insurance product for individual consumers;

b) An insurance product for banks themselves;

c) Special non-interest bearing accounts that would benefit from full FSCS protection.

Please give your reasons.

Q8: If you think there should be a rules-based solution, what criteria would you apply? For example, should protection be:

a) For a limited period, such as six months?

b) Just for balances linked to the consumer's primary residence?

c) For balances relating to sale of the consumer's primary residence, pension assets and inheritances?

d) Some combination of the above?

e) All temporary high balances?

f) If you think all temporary high balances should be covered how would you define these?

We welcome the FSA's consideration of the problems presented by high short term balances. For example large amounts may pass through an account within a matter of hours when the accountholder is selling one property and purchasing another. These funds cannot possibly be regarded as deposits in the same way as savings, and to refer to them as deposits is misleading. Such monies will be passing through the banking system for a short period of time and it is unrealistic and indeed impractical to expect consumers to spread risk across a number of institutions.

The paper suggests a market based solution which would lead either the customer or the deposit taker to arrange insurance, or alternatively the development of special savings vehicles which would be entitled to full protection. No market based solution exists or appears likely to exist, and therefore we maintain that a 100% guarantee of sums up to £1m is the most satisfactory way of achieving this level of protection.

Such protection should be related to the type of transaction, rather than to a set period of time.

Specifically, compensation cover should be provided for estates in the course of administration, since otherwise executors and administrators could be held personally liable by beneficiaries. Pension assets, including those held within a SIPP, should be protected 100 per cent and without limit, irrespective of the type of pension plan. And cover relating to property transactions should not be restricted to the consumer's principle private residence, since this would exclude, for example, protection for consumers purchasing a home for an elderly relative or a student child.

Q9: Should protection also cover temporary high balances held in client accounts, e.g. those of a solicitor or financial adviser?

Yes. The risk of detriment will otherwise be borne entirely by the consumer and this would be profoundly unfair, particularly in property transactions where the consumer has little or no influence over the banks used, yet would carry full responsibility for all the consequences of a bank failure or similar disaster.

Q10: Do you have any comments on our move to the rateable method for dealing with recoveries in the deposit sub-scheme?

The scheme currently operates as a loss protection scheme where all recovered monies are returned to depositors. Under the rateable scheme recovered monies are shared equally between the FSCS and depositors. We do not support the move to a rateable scheme. If recovered monies are to be shared between consumers and levy payers then consumers could foreseeably be worse off despite the increased limit. This is not acceptable.

The FSA suggests that this will further encourage consumers to spread their risk. This seems inconsistent with the FSA's earlier statements on co-insurance which suggests that consumers do not understand it. Moreover this is only to be applied to the deposit taking scheme. They do not propose to move to a rateable scheme for the other sub-schemes. We believe that the proposal is designed to appease the levy payers at the expense of the consumer.

Yours sincerely,

Adam Phillips
Acting Chairman