

# **Intellect submission to the Bank of England, HM Treasury and the FSA**

## **Financial stability and depositor protection: further consultation**

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## Background

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Intellect is the UK trade association for the IT, telecoms and electronics industries. Its members account for over 80% of these markets and include blue-chip multinationals as well as early stage technology companies. These industries together generate around 10% of UK GDP and 15% of UK trade. Intellect provides a singular voice for these industries across all market sectors, and is a vital source of knowledge and expertise on all aspects of the technology industry.

Alongside the technology industry's considerable footprint in the UK, it also enables many other industries in today's economy:

- financial services
- creative industries
- retail
- transport and logistics
- manufacturing
- defence and aerospace
- pharmaceuticals

Intellect welcomes this consultation into financial stability and depositor protection by the Bank of England, HM Treasury and the FSA. Intellect values the opportunity to provide input to the consultation process and looks forward to a programme of continual engagement with relevant government departments, agencies and other stakeholders on this and related issues.

## Intellect's response

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Over the last year, developments in the financial services industry have presented the retail-banking sector with information technology challenges of a new, complex and more demanding nature. The failure of Northern Rock and the financial difficulties of other large banking institutions have confirmed the importance of these systems to financial institutions. This response identifies some of the key challenges and hurdles that will need to be overcome in order to make the proposed regulatory regime framework operate effectively.

### Compensation payments

*D.27 The Authorities remain committed to a target of seven days for providing the depositors of a failed bank with access to at least a proportion of their funds, and the balance within the following few days, consistent with the aim of minimising disruption for depositors.*

*D.34 The Government intends to legislate to give the FSA the power to make new rules to specify the circumstances in which consumers need to make a formal claim to the FSCS before receiving a compensation payment and to allow for the automatic conferral of rights on the FSCS to make recoveries in place of claimants.*

*D.35 The Authorities will work with banks and the appropriate trade associations to ensure that depositors can open up a new account quickly enough to facilitate fast compensation payments and minimise disruption.*

Intellect agrees that designing a compensation system is a system of balance. If there is too little protection, depositors could face significant losses in the event of bank failure, furthering undermining confidence in the banking system. However, an excessively generous and/or

poorly designed compensation scheme could impose excessive costs on the financial services industry.

Following the identification of customers and their details, a challenge that the financial institution(s) must face is making compensation payments within the proposed seven-day period. The implications for the technology systems within the relevant organisations are significant, whether this compensation should be effected through cheques, or electronic payments, or by some other means.

If a bank were to default, these institutions would be entering a brave new world – as a legal situation where payment must be made within a certain timeframe has never occurred in the past. As such little experience exists of dealing with such issues on such a scale within such tight timeframes.

Increased consumer awareness will be necessary to ensure that, in the circumstances following the collapse of a bank, they are aware of what is expected/required of them, in order to aid a smooth payout of the funds. If customers are to receive compensation via electronic payments, they will be required to hold another account with a different and potentially temporary institution. For those customers that only have one account, which is with the defaulting bank, there will be a need to open another account as soon as possible (particularly if the desired timeframe of seven days is to be met), unless individuals already have another bank account with another institution. An additional consideration with setting up new accounts will be ensuring access to wealth, the payment of standing orders, direct debits etc from the new account.

Although there are some difficulties with electronic transfers that would need to be addressed, payment via cheque, however, also raises some notable problems. Firstly, it requires the failing bank to have accurate address details for every single one of its eligible customers; secondly, it is potentially more prone to widespread fraud; and thirdly, the logistics around printing and distributing millions of cheques must be considered.

Intellect welcomes the assurance that the Authorities will work with the industry to ensure the resultant model of payout is workable and provides depositors with confidence. Intellect's Concept Viability service (see below) may be able to assist with this.

## Information sharing

*D.28 The Government intends to legislate to enable the FSA to collect information from firms that the FSCS requires (and share this with the FSCS) before default, and ensure that the FSCS can require and obtain information directly from firms as soon as a firm is declared in default.*

*D.29 The FSA will consult on how the information held by banks will be reviewed, including through options for the ongoing, routine involvement of the FSCS.*

*D.30 The Government also intends to legislate to ensure that there are no barriers to the Bank of England, once resolution is invoked, being able to collect and share with the FSCS relevant information on the bank in question.*

*D.31 The FSA intends to consult on new rules requiring banks to have readily available information including balances, on the accounts held by depositors eligible for compensation from the FSCS.*

Financial services organisations generally have a good track record on information sharing. For example, the advent of increasing customer applications for credit, have heightened the industry's interest in information sharing. Furthermore, collaborative efforts to tackle financial

crime where have increased the speed to which information sharing can take place. However, these incidences typically relate to data sharing on individuals; the proposed mechanisms described in the consultation would require information sharing on a previously untried level, in terms of the numbers of individuals involved and during a period of significant pressure. However effective the ability to share information might be, it depends wholly on having accurate information.

The consultation notes the information provided by banks will need to be reviewed on an ongoing basis to confirm its accuracy and usefulness. The importance of this, considering the process that will occur should a bank default, cannot be underestimated.

One of the perennial problems faced by the banking sector is their reliance on their customers to provide them with accurate and up-to-date data. Recent data security breaches in both the public and private sector have led many customers to refuse to share data which they are not legally obliged to provide to their banks. In turn, this limits the banking institutions' ability to correctly identify some of their customers and authenticate their details.

Furthermore, the compatibility of data will be crucial, particularly as the Government has confirmed its intention to legislate to facilitate the FSA obtaining and sharing information with the Bank of England and HM Treasury for purposes related to financial stability and also to enable the FSA to collect information from firms that the FSCS requires (and share this with the FSCS) before default, and ensure that the FSCS can obtain information directly from firms as soon as a firm is declared in default.

Authentication systems will also need to be considered, as banks authenticate in different ways, using different technologies. In terms of information sharing, the interoperability of this data may prove difficult and challenging. This, in turn, may impact on the ability of the defaulting bank to share data quickly and accurately, particularly as this could be the authentication details of hundreds of thousands or even millions of accounts.

Intellect welcomes the proposal for the FSA to act as the data collection agency so that there is one point of contact for firms for the collection of such data.

### Consumer awareness

One of the main lessons illustrated by the collapse of Northern Rock was the public's lack of understanding of the nature of the compensation scheme. The public displayed concerns over the level of protection they could expect. One way to help provide depositor confidence will be via clear guidelines over compensation levels and the means by which compensation payments are issued – the speed and ease of these payments will be important. Depositors will need to be aware of the 'what if' scenario i.e. what if their bank defaults, how would they receive their payment.

There is a wider point which needs to be considered regarding consumer confidence. One of the issues which led to significant queues of customers outside Northern Rock branches was the failure of the bank's online payments system: the sheer number of hits on the website caused the online banking facility to shut down, which may very well have exacerbated the public's concerns and fear over the safety of their deposits. Robust IT systems, particularly in times of crisis, are therefore an important factor towards ensuring customer confidence.

The consultation notes that 'the Authorities remain of the view that demanding targets for payouts are essential for consumer confidence'. There is a danger, however, that if a target (of seven days, for example) becomes too 'demanding', and is not achieved in the case of a bank failure, the target which was meant to help increase consumer confidence will have a contradictory effect as the built-up expectations of the consumers will not equal the actuality of the situation.

## Concept Viability

The proposed regulations present a massive task to the financial institutions and the regulatory bodies in this area. However, because of the issues that are being dealt with and the number of bodies involved, there is great value in encouraging a wider dialog with other stakeholders, who will be able to assist the relevant institutions by helping to develop innovative solutions to problems that may be raised via the new regulatory regime.

A means to achieve this might be through Concept Viability, a service that Intellect has successfully developed that allows both public and private sector clients to take market soundings to test the practicability of their ideas at the earliest stage. Flaws in proposals can be highlighted without competitive issues being compromised, and innovative solutions through emerging technologies can be discussed alongside frank dialogue of the risks incurred. This is a service supported by the Office of Government Commerce and the Cabinet Office.

## Conclusions

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There is no doubt that the banking reform proposals, outlined in the HMT/FSA/Bank of England consultations, will prove to be a challenging test for the technology systems and staff within UK incorporated banks. It is difficult to assess to what extent their current IT systems would be able to cope with the pressures placed upon them by the new regulations, however, to ensure financial stability and consumer confidence, failure is not an option.

An interesting paradox emerges through the consultation and expected implementation of the proposals; how much is the banking industry willing to invest in IT infrastructure (particularly in a period of economic difficulty), which if successful, will become redundant? Investment becomes more likely when it is engineered in a way to provide a competitive advantage, as well as meet regulatory requirements.

Other industries have faced similar sudden new and complex demands on their IT systems. The retail and telecommunication industries, for instance, have faced similar problems but dealt with them relatively successfully. In both these industries, understanding the customer view proved beneficial. Examining other industries' responses to similar demand could prove a useful start when determining which model the banking industry chooses to adopt to deal with the new requirements it has to meet.

The complexity and bespoke nature of information technology systems within financial institutions provides a challenge that needs to be overcome, but technology is capable of solving some of these problems. Like many companies, financial institutions are keen to put in place effective IT systems that help their business to grow. These systems can be subject to incremental changes, ensuring the systems remain responsive to business demands. However, the proposed regime – and timescale – places enormous pressures on the systems and staff within these institutions and the scale of the task in front of them should not be underestimated.

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