



Comments on Cm7436 "Financial stability and depositor protection: further consultation" dated July 2008

We commented 22 April 2008 on the January consultation document (Cm 7308). We have in addition comments on only two of the consultation questions set out in the new document, at 4.4 and 5.1.

4.4) What would be the best way to calculate the hypothetical net cost of depositor compensation payments, including the estimation of the recovery rate?

We consider it would be difficult if not impossible to calculate anything based on the rate of recovery in any given insolvency, except after the event; and extremely dangerous to apply any standard formula. We do, however, consider that it is important that the following factors should be taken into account in any such calculation:

- Any failing bank will have some creditors who would be entitled to depositor compensation and other creditors who would not -- whether because they are depositors outside the criteria for compensation or because they are not depositors at all.
- In the absence of depositor compensation, and apart from special rights such as security, the guiding principle should be to treat all creditors equally in the insolvency.
- Compensation for depositors improves their position, but must not be at the cost of creditors not entitled to compensation. This is consistent with rejecting the introduction of depositor preference (see paragraph B53 of the document).
- It follows that the value of all compensation that depositors receive over and above what they would be entitled to as a dividend in the insolvency, and all the additional costs of administering the payment of compensation, should be met by the industry through the FSCS. In this context it is regrettable that "a majority of respondents argued that the FSCS should not cover such costs, and that these should be borne generally by the insolvent estate rather than levy payers" (paragraph B52). What that majority is calling for is that creditors not entitled to depositor compensation should bear the cost of operating depositor compensation. This is entirely unacceptable.

Similar considerations apply to our only other comment:

5.1) The Authorities would welcome further views on the best way of introducing gross pay out when there are mutual debts.

There are sound reasons of public policy rehearsed in the previous document why gross payment should be introduced. This renders unworkable two proposals set out in paragraph 5.37.

Perhaps the typical case of operation of set off against a depositor is where an individual retail depositor owes what will usually be a substantially larger sum to the bank on a mortgage. If a purpose of compensation is to restore the depositor's access to liquid funds and to normal banking facilities, there can hardly be a requirement for compensation to be repaid.

There is then reference to the possibility of "the breaking of mutuality of debt for depositors' claims assigned to the FSCS after the commencement of the banking insolvency procedure". If this means that the FSCS would be able to prove in the insolvent estate, in competition with creditors not entitled to depositor compensation, for a debt that would otherwise be extinguished by set-off, it is wholly unacceptable. It would result in a diminution of the dividend payable to creditors not entitled to depositor compensation, so that to that extent they would be bearing the cost of compensation. If public policy dictates that depositors should be able to obtain compensation in respect of debts for which they could not prove, it is either the industry via the FSCS or the public purse that should bear the cost.

Insolvency Practitioners Association
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