

Banking Reform discussion response
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Dear Sirs,

I have pleasure in submitting a response on behalf of UK Shareholders Association ("UKSA") to the October 2007 discussion paper. The membership of our volunteer association is made up entirely of private small individual shareholders investing their own money. Our evidence has been produced by a representative group, all with substantial practical experience of the investment world. UKSA has also been a prime mover in the Northern Rock Shareholders Action group and our response draws on that experience.

We have decided that it is appropriate for us to comment on only a few of the questions where we feel that we have relevant knowledge, as follows:

2.1: Do you agree that these are the right objectives? **Yes**
Are any of these objectives more important than others? **No**

2.2: What other issues should the Government consider when reviewing the framework for depositor protection?

It is apparent that any system of depositor protection will have to be funded by the industry. Accordingly it must protect the interest of investors (both depositors and shareholders) in institutions which are prudently run against having to bear the cost of losses by other institutions which, while just satisfying the regulators, are run aggressively (in order to pay higher rates of interest than the competition).

One way of doing this would be to relate any levy to the risk profile of the institution as in the Pension Protection Fund. An alternative would be to relate the level of compensation to the risk profile. Either would involve an ongoing risk assessment process. A simpler approach is to limit protection to a percentage, high but less than 100%, in order to give consumers an incentive to consider risk level when seeking higher returns. There is no reason why investors should be led to think they can just go for the highest rate of interest without regard to how that is being achieved or to the risks being run.

We agree that the Government should not use public money to protect shareholders. However, this does not mean that Government, in dealing with the problems of a bank in difficulties, and in its haste to protect depositors, should ignore the interests of shareholders. Examples of such actions by Government would include (i) pressure to achieve a sale of the bank at any price when it is capable of continuing as a going concern, or (ii) actions that, by depressing the price of distressed assets, favour new owners at the expense of the old.

3.4: What issues should the Government take into account in any further review of the funding mechanisms for the FSCS?

There seems no good reason for different levels of compensation according to type of investment.

3.6: The Government would be interested in views on the best way to help consumers understand how banking deposit guarantees affect them?

A paragraph describing briefly but clearly the compensation arrangements should be included in all prospectuses. Possibly it should also appear in the annual statements of account issued to depositors.

3.10: What, if any, lessons can the Government learn from other sectors and other economies? For example, from special administration regimes and pre-funded insurance type schemes such as the Federal Deposit Insurance Corporation in the United States?

It should be remembered that "administration" as currently operated under UK law favours secured creditors but does very little to protect other stakeholders (such as the owners of the business). It does not typically provide the protection against creditors necessary for the business to recover and administration is therefore almost always a precursor to receivership and liquidation. Accordingly a totally different type of "administration" is necessary when there is cash crisis and a "bank run" as was apparent in the Northern Rock case.

Yours faithfully,

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