

Response to the FSA consultation on  
**Financial Services Compensation Scheme  
Reform** – Fast payout for depositors and  
raising consumer awareness.

Charities Aid Foundation  
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# **Response to the FSA consultation - Financial Services Compensation Scheme Reform: Fast payout for depositors and raising consumer awareness**

## **Charities Aid Foundation**

### **1. Background and Introduction**

1.1 The Charities Aid Foundation (CAF) is a registered charity that aims to help charities and social enterprises make the most of their money. CAF provides financial, investment and fundraising services and works directly with tens of thousands of charitable organisations across the UK and internationally.

1.2 CAF has a strong history of campaigning for changes in policy and legislation in order to improve the giving environment and to secure supportive legal, fiscal and regulatory conditions for donors, charities and social enterprises. Our knowledge and understanding - gained through direct experience and research - makes us a trusted voice on giving and the effective use of charitable funds.

1.3 In August 2008, CAF wrote to the Chancellor, calling for improvements to the protection available to funds banked by charities. The letter highlighted that the future failure of any bank would place vital charitable services in jeopardy. Following the collapse of Icelandic banks, CAF has continued to lobby for changes to the Financial Services Compensation Scheme.

1.4 In February 2009, Dr John Low, Chief Executive of CAF, appeared as a witness at the Treasury Select Committee hearing, as part of their on-going inquiry into the Banking Crisis. The report<sup>1</sup> published by the Treasury Committee on April 4<sup>th</sup> 2009 supports CAF's call for a review of the eligibility criteria and improved guidance for charities.

1.5 CAF operates a deposit taking banking subsidiary, CAF Bank. CAF Bank has worked with the banking industry and contributed to the response to this consultation made by the British Banking Association (BBA).

1.6 This consultation response relates entirely to the impact of the proposed changes to the FSCS upon the broader charitable sector. Our comments are focused on the eligibility criteria for FSCS compensation for deposits (chapter 2) and raising consumer awareness of the FSCS (chapter 8).

### **2. Principles of reform**

2.1 CAF supports the overall principles of the proposed reform; to simplify the eligibility criteria, raise awareness and understanding of the scheme and facilitate rapid compensation payments to depositors.

2.2 We believe, however, that further consideration should be given to the particular needs of charities.

### **3 Eligibility Criteria for FSCS Compensation for deposits**

Q 1 – Should the eligibility criteria for deposit claims be simplified as proposed?

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<sup>1</sup> Treasury Committee Fifth Report 'Banking Crisis: The impact of the failure of the Icelandic banks'

Q 2 – Do you agree with the proposed approach for identifying smaller entities?

3.1 We welcome the acknowledgement within the consultation paper that: ‘Charities, depending upon their size and how they are structured, may be eligible for compensation. This was seen in the recent default of Icesave, where some charities were protected as they fell into the smaller entity category, while others were large entities and were not protected’<sup>2</sup>.

It is not, clear, however, how they proposed changes would improve this situation.

3.2 While the proposed flagging system will help to address the very real concerns and confusion relating to the fluctuating circumstances and eligibility status of small entities, the consultation paper does not recognise the distinct nature of charities, which act to both raise and use funds for public good.

3.3 Currently the rules governing eligibility are based on organisational form rather than organisational purpose. The criteria for eligibility, established by the FSA, is based on the Companies Acts 1985 and 2006 and equates charities to small businesses.

3.4 Many charities will qualify as ‘small entities’ and will therefore be afforded compensation up to £50, 000 (if Government did not intervene to guarantee all deposits). However, many larger charities will fall outside of the criteria for the FSCS, as they are deemed ‘wholesale depositors’ and will therefore not be entitled to any compensation should a bank fail. This places vital services at risk.

#### **Extent of exposure and impact of Icelandic bank failures**

3.5 Following the collapse of Icelandic banks in early October 2008, it became clear that charitable funds were in jeopardy. CAF, together with the National Council for Voluntary Organisations (NCVO), Charity Finance Director’s Group (CFDG) and the Association of Chief Executives of Voluntary Organisations (ACEVO) were asked by the Financial Services Secretary, Lord Myners, to collect data about the extent of exposure. 48 charities came forward with a combined total of £86.6m deposited funds.

3.6 Subsequently, Naomi House Hospice and Cats Protection have spearheaded the ‘Save our Savings’ coalition to lobby the government for assurances that their savings will be returned in full. The 30 charities involved with the coalition have stated that they have collective potential losses of £50 m.

3.7 The organisation with largest amount at risk is Cats Protection, who held £11.2m with KSF. However the greatest proportionate impact has been reported by Naomi House Hospice, with £5.7m which equated to a third of its total assets.

3.8 We believe that the full extent of the exposure is likely to be considerably higher than £86m. Some depositors who would have qualified for compensation as retail depositors would be unlikely to come forward and other potentially large amounts may be missing due to fear of reputational risk.

3.9 Prior to entering administration, the website of KSF claimed to hold £230m of charitable funds on deposit.

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<sup>2</sup> FSA CP 09/03 Financial Services Compensation Scheme Reform – Fast payout for depositors and raising consumer awareness. 2.22, p11

3.10 The amount of charitable funds tied up in failed Icelandic banks is relatively small compared to the estimated £12bn total funds banked by UK charities.<sup>3</sup>

3.11 The relative impact varies across these organisations, dependent upon the amount deposited by the charity as a proportion of total assets. Many organisations will have diversified their deposits across a number of separate authorised entities and managed their funds so that this loss does not immediately jeopardise their sustainability.

3.12 The real impact is beginning to be felt by some charities. On 25<sup>th</sup> November 2008, Naomi House was forced to suspend services. Its hospice-at-home service, which provides carers for families with terminally ill children in emergency situations, will not be resumed until the charity has had its money returned.

3.13 The charities have received no guarantees that they will be able to retrieve any lost funds and the administration process could take years. This presents very real problems for these charities, especially as they try to weather the current economic storm with stretched resources and increasing demands on their services.

3.14 The impact of the lack of these funds is exacerbated by additional difficulties including falling interest rates and the decreasing value of sterling.

### **Proposals for reform**

3.15 CAF strongly believes that charitable organisations should be classified as a separate depositor class which would be automatically eligible for compensation, irrespective of organisational structure. This would recognise the nature of how these funds are both raised and used, and the unique and vital role played by the third sector in society.

3.16 It is, we believe, unpalatable for such organisations to be placed in jeopardy through failure of the banking system, especially where the organisation has taken every reasonable step to act responsibly. The immense social return generated by charitable organisations and the potential long term costs to society resulting from loss of charitable services should be considered a priority.

3.17 It is the assumption that, compared to small retail depositors, wholesale depositors have a greater ability to access and mitigate financial risk. Although we would agree that there should be strong requirements for charities to act responsibly and accountably, we would assert that charities often behave more like individuals than commercial operators, irrespective of the size of their assets.

3.18 Unlike businesses, which more routinely rely on equity and debt finance, it is important for charities to maintain sufficient levels of reserves and unrestricted funds to ensure sustainability and survival, especially in difficult times.

3.19 Angela Eagle (4<sup>th</sup> Dec 2008 Debate on the case of Naomi House Hospice) stated that additional protection for Naomi House was problematic as it was deemed a wholesale depositor and 'there are no easy answers available, short of guaranteeing all the wholesale depositors as well as the retail depositors. That is a large amount of money and we would be criticised for using it in this way' and went on to state that it would be equally undesirable for Government to make judgements about which charities were 'worthy' and which were not. We believe that a separate

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<sup>3</sup> CAF estimated based on NCVO Almanac (2007)

depositor classification, based on definitions of charitable purpose, would address these understandable difficulties and enable the Government to demonstrate support to the sector.

3.20 The classification of charities as a separate depositor class would also allow for greater clarity of communication and increase understanding and confidence across the sector.

#### **4 Raising consumer awareness of the FSCS**

Q 30 - Do you have any comments on the proposed generic disclosure requirements?

Q 31 - Do you agree that we should require EEA branches to adequately disclose their compensation arrangements to the consumer? If not, why not?

Q 32 - Do you agree that this information should be provided on a quarterly basis?

Q 33 - Do you agree with these proposals? Are there alternative delivery mechanisms which should be used?

Q 34 - Do you agree with our proposed implementation date for disclosure requirements?

Q 35 - Do you have any comments on how this approach could be improved?

4.1 CAF welcomes measures to improve consumer awareness and understanding of the FSCS.

4.2 The existing eligibility criteria for compensation under the FSCS is opaque and it is difficult for some charities to assess their own eligibility or to seek reassurance. This poor communication leads to increased insecurity in the sector and lack of confidence in the banking system.

4.3 In early October, after the collapse of the Icelandic banks, clarity was sought from the Charity Commission and the FSA on how the compensation scheme applied to charities. As a result of lobbying from CAF, information was subsequently placed on their websites.

4.4 CAF supports the dual approach of a strategic awareness campaign, combined with a requirement for banks to provide targeted information to customers on a regular basis.

4.5 There is very little clarity on how banks are authorised and which banks are part of a larger group or parent company, where the FSCS would pay compensation up to the limit of £50,000 only once, irrespective of how many different institutions a person held accounts with. CAF therefore would support the FSA's proposed requirement for this information to be disclosed to depositors and made more generally available. We suggest that there is additional prescribed wording for authorised firms who operate under a number of trading names.

4.6 The consultation suggests that information should be made regularly available to 'eligible depositors'. We believe, however that it is vital that organisations who do not qualify for compensation are aware of this. We suggest, therefore that information regarding eligibility is made available to all depositors.

4.7 Information should also signpost depositors to reliable and up to date sources of information about the security, liquidity and additional factors such as country risk together with advice about how to minimise financial risks.

**Collaboration between regulators**

4.8 Tailored or accessible financial information could be made available to charities through the Charity Commission, perhaps in partnership with the Institute of Credit Management (ICM).

4.9 CAF would call for the FSA and Charity Commission to work more closely together to ensure that issues for charities are effectively taken into account by the FSA.

4.10 Closer working would also enable the Charity Commission to interpret and effectively communicate financial regulatory issues for the sector.

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