CFG, ACEVO, NCVO & CAF consultation response:

Banking Reform: Delivering stability and supporting a sustainable economy

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Contact:
Charity Finance Group
Melora Jezierska, policy and public affairs officer
Email: melora.jezierska@cfg.org.uk
Tel: 020 7250 8348
EXECUTIVE SUMMARY

- We strongly welcome efforts by Government and HM Treasury to enhance stability and integrity in the UK banking system. Reforms which will foster a more stable banking environment are extremely positive for charities, and society more widely. However, we have serious concerns with the proposed depositor preference principle, which will put a significant number of charities at financial disadvantage.

- We would like Government to grant registered charities preferred creditor status, so that charity liabilities are prioritised alongside those of the FSCS in the event of bank failure. However, we are also open to exploring other, more nuanced options around depositor preference and FSCS eligibility that recognise the unique position of charities and provide a greater level of protection.

- We recognise that the consequences of extending depositor preference to another group of creditors must be considered, and that protecting charities cannot come at the expense of the overarching need to ensure clarity and confidence in the banking system. However, we believe that the benefits of extending depositor preference to charities far outweigh any unfavourable outcomes and can be justified on the following grounds:

  - **Charities undertake a public benefit role.** Any losses to a charity will have a devastating impact on those they support – often the most vulnerable in society. Granting preferred creditor status is a positive move in line with wider efforts to foster a more socially responsible banking sector.

  - **Charity funds do not ‘belong’ to the charity, but are funds in transit from donors and other funders, for beneficiaries.** A loss to a charity is therefore not a loss for shareholders or private benefit, but for donors – who have chosen to give to a social cause on the grounds it will be spent as intended – and beneficiaries. This undermines the white paper’s aim of protecting the taxpayer from losses in the event of bank failure.

  - **The unique way charities are funded means the impact of any losses would be severe.** Charities typically hold high levels of cash deposits (relative to their size) to ensure commitments can be met or as funding for long-term projects. The constraints around restricted funds also mean the loss of deposits could seriously impact a charity’s cash flow and ability to meet commitments.

  - **Managing banking risk will require a niche set of skills many charities don’t have.** Under the new arrangements simply maintaining a good standard of risk management will add considerable cost and complexity to the finance function of charities. The standard of financial management is high in the vast majority of charities, yet most simply do not have the same level of technical banking knowledge and expertise as other senior unsecured creditors of comparable
size, and cannot realistically be expected to. Managing increased banking risk is extremely resource-heavy and it is difficult to justify using substantial charitable funds for this purpose.

- **Mitigating the additional risk will come at significant cost.** Charity banking arrangements are typically driven by security, rather than return. However it is likely charities will adopt even more conservative banking arrangements, resulting in lower rates of return. While the difference may be small in percentage terms losses will be significant if aggregated across a sector which holds £18bn in cash deposits. Managing the increased risk and exposures will also result in additional costs for professional fees or upskilling.

  - For these reasons the current rules undermine one of the white paper’s underlying principles that the cost of bank failures should be borne by those able to understand the risk and who can best absorb loss.

  - A number of charities were affected by the collapse of Icelandic banks, and in the aftermath the chasm between charities’ ability to manage banking risk and their lack of protection was widely acknowledged as a problem. It is concerning that the white paper’s proposals seemingly ignore the lessons learnt from the crisis during this time.

  - Conferring charities with preferred creditor status is a simple and positive change that Government can make without additional risk or expense to the Exchequer or taxpayer, but that would make a tangible financial difference to many charities.

### About CFG, ACEVO, NCVO & CAF

**Charity Finance Group (CFG: [http://www.cfg.org.uk](http://www.cfg.org.uk))** is the charity that seeks to raise the standards of financial management in the voluntary sector by championing best practice, campaigning for a better operating environment for charities, providing high quality training and events and challenging regulation which hampers effective use of charitable funds. CFG has more than 2000 members, all senior finance professionals working in the sector and collectively our members are responsible for the management of over £19bn in charitable funds.

**Association of Chief Executives of Voluntary Organisations (ACEVO: [http://www.acevo.org.uk/](http://www.acevo.org.uk/))** is the national representative body for leaders of the country’s charities and social enterprises. We support, develop and connect them, and seek to represent their views to national and local policy-makers.

**The National Council for Voluntary Organisations (NCVO: [http://www.ncvo-vol.org.uk/](http://www.ncvo-vol.org.uk/))** is the umbrella body for the voluntary sector in England, with sister councils in Wales, Scotland and Northern Ireland. NCVO has over 8,300 members, ranging from large national bodies to community groups, volunteer centres, and development agencies working at a local level.
With over 280,000 staff and over 13 million volunteers working for our members, we represent and support almost half the voluntary sector workforce.

The Charities Aid Foundation (CAF: http://www.cafonline.org) is the charity that promotes charitable giving and provides financial services and social finance to not-for profit organisations. CAF works with individuals and business to encourage and facilitate effective charitable giving. We also provide banking services, investments, fundraising support and expert advice for charities with £1bn of charity deposits entrusted to CAF Bank. CAF also campaigns to secure the best environment for charities and giving.

About our response

This response has been produced by CFG, ACEVO, NCVO and CAF, which represent charity finance professionals, donors and the wider sector. In preparing this submission the views of members and data have been gathered by:

- Discussing the white paper at a meeting of CFG’s Large Charities Special Interest Group, whose members are finance professionals from charities with a turnover greater than £50m.
- Direct engagement with CFG members on the issue: many submitted views and information relating to their charity.
- Drawing on our previous work relating to Icelandic banks and the 2008 banking crisis, including evidence presented to the Treasury Select Committee’s Inquiry into the Banking Crisis.
- Drawing on data from the Charity Commission register of charities and the NCVO Almanac, which provides information and statistics on the UK charity sector using evidence from a range of government and industry sources.

This response will focus solely on the depositor preference principle within chapter 3 (Loss-absorbency) of the white paper, and will cover:

- Our position
- The case for granting charities preferred creditor status
- Evidence and data to support our position

We would like to thank the representatives of HM Treasury working on the white paper for being so receptive to charities’ concerns and their willingness to work with us to address these. This submission has been amended following a meeting with HM Treasury on 21 August 2012.

Depositor preference

Q14. Is there a case for preferring one or more groups of senior unsecured creditors alongside the FSCS, for example banks’ own pension funds, or charities and/or local authorities? Are there any compelling reasons why these newly preferred creditors should not rank pari passu with currently preferred creditors?
1. **Our position**

1.1. We strongly welcome efforts by Government and HM Treasury to strengthen the banks and foster a more stable banking environment. Ultimately a robust banking system is extremely positive, for both charities and wider society. However, we are concerned that the current proposals, specifically the *depositor preference* principle, do not account for the unique role and structure of charities, and, crucially, put charities at a less favourable position than at present.

1.2. In our view the most straightforward and favourable solution is to grant registered charities *preferred creditor* status so that charity liabilities are prioritised alongside those of the FSCS in the event of bank failure. While this option delivers most on clarity, we are also open to exploring other options which afford a greater level of protection to charities. Ideally we would like to see a mechanism built into the white paper to achieve this to ensure long-term certainty.

1.3. The changes to creditor hierarchy proposed in the white paper will put charities at a significant disadvantage, and will impact in two ways:
   a) Firstly, if a charity continues with its current banking arrangements, then in the event of a bank or building society being taken into resolution by the authorities, the probability of losing most or all of their deposits with that bank or building society is greatly increased.
   b) Secondly, if a charity chooses to adjust its banking arrangements to mitigate the additional risk, as would be prudent, then it will need to adopt more conservative banking arrangements – moving to higher rated banks or building societies which typically pay lower rates of return. This will result in a significant drop in charitable funds if aggregated across the sector.

1.4. The underlying premise of FSCS eligibility rules and one of Government’s stated aims of the proposals for reform is that the cost of bank failures should be borne by those able to understand the risks and who can absorb loss best. However, in the context of their impact on charities, the proposals are not aligned with the policy aims. While the vast majority of charities manage their finances and related risks astutely, managing banking risk requires a niche set of skills and daily monitoring which most charities can ill afford. Charities’ funding and cash flow arrangements also mean capacity to absorb losses is limited.

1.5. We understand that there are plans in progress at EU level to extend FSCS protection to all non-financial corporate customers, with the £85,000 compensation limit applicable to all. While this is a positive development in that it provides certainty and clarity, and avoids confusion for those near the eligibility threshold, this will bring little benefit to those larger organisations with far more than the compensation limit in the bank (e.g. a charity holding £10m across four or five accounts). A very conservative estimate using data from NCVO’s Almanac indicates that in excess of 5,700 charities have cash assets of more than £85,000.
1.6. A number of charities were affected by the collapse of Icelandic banks, and in the aftermath the chasm between charities’ ability to manage banking risk and their lack of protection was widely acknowledged as a problem. It is important that lessons learnt during this time are not forgotten. Conferring charities with preferred creditor status is a simple and positive change that Government can make without additional risk or expense to the Exchequer or taxpayer, but that would make a tangible financial difference to many charities.

2. **The case for granting charities preferred creditor status**

2.1. We understand that Government has a number of concerns with the likely consequences of extending depositor preference to another group of creditors, namely:

- extending depositor preference would dilute the benefits of the FSCS as a result of the smaller pool of creditors who stand to take losses before it;
- it would create uncertainty around Government regulation, damaging investor confidence; and
- it would further subordinate other senior creditors.

2.2. We appreciate that these consequences are not insignificant, and that protecting charities cannot come at the expense of the overarching need to ensure clarity and confidence in the banking system. However, we believe the benefits of granting preferred creditor status to charities far outweigh any unfavourable outcomes.

**The public benefit role of charities**

2.3. To register as a charity, an organisation must be able to demonstrate that its aims are for the public benefit. Charities therefore fulfil a unique role in that their activities support the delivery of a wide range of social aims, many of which the state would have to step in to provide if the sector were unable to do so.

2.4. Any losses to a charity will have a devastating impact on those they support – often the most vulnerable in society. While the closure of a business will clearly have serious consequences for those involved, the effects of losses to charities are likely to be longer-term and farther reaching. The reality in the current economic climate is that it is very difficult for others to take the place of committed charities if losses result in closure. This is in contrast to the commercial sector where other organisations can step in to fill any void.

2.5. Granting preferred creditor status to charities on the grounds of their public benefit role is in line with wider efforts to foster a more socially responsible banking sector, and the Government’s big society agenda.
The nature of charity funding

2.6. Unlike other senior unsecured creditors, where funds are generated for profit and go to private owners or shareholders, charity deposits do not ‘belong’ to the charity but are funds in transit from donors and other funders, for public benefit. To note:
- Individuals give to charity as part of their personal consumption using private earnings; it is their free choice to support a social cause and would want assurance their contributions are protected, in the same way that their personal finances are.
- Giving relies on a donor’s trust and confidence that the money will be used as intended – anything that undermines this could threaten individuals’ inclination to donate, running counter to wider Government efforts to encourage giving and philanthropy.
- While there is huge variation in the way charities are funded, the sector receives £11bn\(^1\) of funding donated by individuals, which is ultimately taxpayer money, donated for social benefit. Viewed this way, any charity losses would undermine the white paper’s stated objective of protecting the taxpayer.

2.7. In many cases, charities stand to lose more from a failed bank because they typically hold high levels of deposits, relative to their size, at any one time. Unlike commercial organisations or public sector bodies that borrow and have a more fluid cash flow, charities have a different business model with fewer liabilities. Large deposits are often held for long periods to ensure future running costs are covered or to fund specific long term projects. Tearfund is just one example of a large charity which holds significant deposits at all times to support its development work in 35 countries.

2.8. Charities' banking and funding arrangements are unique in that funds are segregated into unrestricted funds, which the charity can use as they choose and to cover operating costs, and restricted funds which are given for specific purposes e.g. an international charity receiving DFID money for work in Haiti. Restricted funds must be kept completely separate and strictly cannot be used for cash flow purposes. Therefore, while a charity may be cash rich, only a small proportion of this can be used to ensure the smooth running of the organization, and thus disruption to cash flow can have very serious consequences.

2.9. The negative impact of any charity losses in a failed bank is amplified if these are restricted funds. In such cases, if the charity can no longer deliver the project the money was granted for they are, in many cases, contractually obliged to repay the amount in full, irrespective of circumstances.

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**Charities’ levels of expertise**

2.10 The vast majority of charities monitor economic and banking developments and have a high standard of financial management. However, charities simply do not have the same level of technical banking expertise as other senior unsecured creditors of a comparable size, and cannot realistically be expected to. To further mitigate the risks associated with the proposed changes would require a niche set of skills that most charities do not have.

2.11 We would strongly stress that this is not to imply that charities do not take sufficient responsibility for managing banking risk: trustees have a legal duty of care vis-à-vis charitable funds, and the Charity Commission’s investment guidance stresses the need for active cash risk management. However, charities are set up to deliver a social aim, and effectively managing increased banking risk is extremely resource-heavy. Unlike commercial organisations who can justify such a spend if it is in the interests of protecting or driving profits, charities cannot do the same with charitable funds.

2.12 The differences in expertise mean that when a bank or building society is at risk, those in the financial sector, then big business, are more likely to be able to identify the warning signs first and withdraw their deposits. It is likely other depositors will find out too late, with charities worst affected due to their ineligibility for FSCS protection.

2.13 One of the stated benefits of moving insured depositors up the creditor hierarchy is that it will shift risk onto market counterparties who can exert market discipline by demanding higher returns if banks pursue riskier activities. However, while big business and financial institutions can theoretically undertake this market checking function, it is extremely difficult to see how charities will be able to do the same. As outlined above, charities will not have the capacity or skills to monitor the behaviour of banks and ‘demand higher returns’ accordingly.

2.14 The assumption that charities have the same level of expertise as similar sized private sector counterparts and thus should be afforded the same level of protection was raised and acknowledged as a problem during the Treasury Select Committee (TSC) Banking Crisis inquiry. Their report, *Banking Crisis: The impact of the failure of the Icelandic banks*, refers to evidence submitted by Save Our Savings⁰, which highlighted that ‘the distinction between wholesale and retail depositors appeared to be “based largely upon an assumption that wholesale depositors are better placed to make informed decisions”’, yet charities were not necessarily any better placed than retail depositors to anticipate the banking crisis.

2.15 In their report, the TSC expressed concern with the eligibility criteria which charities must fulfil for FSCS protection, and recommended that ‘the FSCS re-examine the criteria

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⁰ Save our Savings was a coalition of around 30 charities who were creditors in the administration of Kaupthing Singer & Friedlander Limited (KSF), with a combined liability of approximately £50m.
for the classification of charities as retail or wholesale depositors’. While this split will not be so clear cut with the likely extension of FSCS protection, the recommendation nonetheless demonstrates the tension between charities’ expertise and the protection that is afforded to them. It is important that the concerns raised by the TSC are factored into the way in which the white paper’s proposals are taken forward.

**Case study: Naomi House hospice**

Naomi House provides care to children and young adults with life-limiting conditions. The charity held a substantial amount of money in Kaupthing Singer & Friedlander when it went into administration, and were one of the first to go public with details of their losses.

Naomi House had received professional advice prior to the crisis and were saving for a new wing of the hospice. The charity was extremely lucky and received huge support from the public after making their situation known, which, along with effective management, ensured the project eventually went ahead.

Their Director of Finance stressed that for charities, the consequences of suddenly losing such a large amount of money were extremely serious because of service delivery commitments: Naomi House makes a very strong commitment to support 250 children and their families, and to meet this costs a total of approximately £10m per year. In the aftermath of the banking crisis it was the beneficiaries who were affected; with many worried that the support received would not continue.

The Director of Finance said: ‘**Charities are not professional investors – we are not here to triple deposits but to keep the money to spend for the benefit of beneficiaries. To me, the gulf between those getting FSCS compensation and everyone else is too unsophisticated; to say that charities should be left to take the risks and rewards of the market is wrong**’.

**Likely impact of proposals – additional costs**

2.16. Gaining the necessary skills to manage the increased risk and exposures as a result of the proposed changes will come at significant cost, either through upskilling employees, recruiting new staff or investing in IT (e.g. access to Reuters or Bloomberg). While we would always advocate the value and importance of investing in training and upskilling, these changes will require a very niche set of skills. To simply maintain a good standard of risk management will add considerable cost and complexity to the finance function of charities.

2.17. It is likely that the changes will lead to an expansion of the professional adviser market in this area, as charities seek additional professional advice to make up for any skill gaps. We do not believe this would be beneficial: aside from the additional costs, the quality of advisers cannot be entirely guaranteed and relying on their advice will not necessarily lead to the best outcomes. Many charities who had taken professional advice were still affected by the collapse of Icelandic banks (see paragraph 3.8).

2.18. Government or sector-led initiatives to support charities in managing banking risk could be beneficial; however they cannot be the only solution. Training schemes can only
ever have limited reach, and even once a charity acquires the necessary skills, the time required to utilise these and monitor the markets will remain a problem. In theory some form of sector advisory board could be set up, however, there would be too many cost-related, regulatory and practical barriers.

2.19. Charities’ investment and banking strategies are typically driven by security and liquidity, then return; so while level of return is a consideration (see paragraph 2.20) it is not a priority. However, we are concerned that over time, depositor preference will lead to charities gradually adopting more conservative banking practices to mitigate the additional risk, which means depositing in higher rated, ‘safer’ banks which typically pay a lower deposit rate. While the difference may be small in percentage terms losses will be significant if aggregated across the sector, which holds approximately £18bn in cash deposits (see Evidence & Data section).

2.20. Security and liquidity are the key drivers when setting banking arrangements, however trustees have a legal duty of care to achieve the best risk adjusted returns on charitable deposits under the Trustees Act 2000. There will be a clear tension under the new rules between this requirement and the need to ensure the security of deposits.

The unique position of charities

2.21. We appreciate that other groups will be vying for preferred creditor status and that it is important that measures do not undermine Government’s efforts to ensure the banking system remains competitive and retains the confidence of investors. While we cannot speak for investors, we believe that charities – more so than other groups of creditors – should not compromise these aims as preferred depositors. There is clear justification for singling them out (their public benefit role and nature of funding), and they form a clear cut, discrete group by virtue of Charity Commission registration which provides clarity. While charities hold high levels on deposit relative to their size, the total amount aggregated across the sector is only a very small proportion of the total amount held by UK banks.

2.22. We understand that in implementing the ICB reforms Government is also seeking to reassure taxpayers and depositors that their money is protected and safer under the new arrangements. However, if the reforms go ahead in their current form, for many charities the opposite will be true. Given the disparity between many charities’ understanding and reality under the new rules, we would expect Government to clearly explain to charities their new subordinated position and what this will mean in practice.

3. Evidence and data

Number of affected charities

N.b. These workings detail the current number of affected charities. The likely extension of FSCS protection will mean the affected/non-affected charities split will not be so clear cut,
however these figures nonetheless provide an indication of how many charities are likely to find the £85,000 insufficient.

3.1. FSCS eligibility depends on organisations meeting two out of three criteria: Turnover of less than £6.5m, less than 50 staff or balance sheet total of less than £3.26m. Data from NCVO’s Almanac suggests that approximately 2909 charities will currently be classed as senior unsecured creditors and therefore affected by the changes (see diagram).

3.2. In addition to these 2909 charities, many other FSCS-eligible charities will have more than £85,000 in any one financial institution and will therefore be affected by the provisions. Unfortunately it is difficult to get a robust estimate of how many of these charities there might be. One indicator is that 81% of charities (at least 5700) that filled in Part B of the Charity Commission Annual Return in 2011 had cash assets of more than £85,000. However, the following need to be taken into consideration:

- Only charities with an income greater than £500,000 are required to complete Part B.
- The measure is fairly narrow, and if expanded, e.g. to include long-term investments, very few of these charities (income > £500,000) would have less than £85,000 in the bank.
- Many charities split their deposits between several banks, where possible, to ensure that all funds are covered by FSCS protection or to at least minimise losses.

3.3. As outlined in paragraph 2.7, charities typically hold higher levels of cash deposits than other organisations of a similar size. According to Charity Commission data (again using information submitted in Part B) the sector has around £18bn in cash on deposit.
3.4. A number of charities have provided us with details of how much they have on deposit at any one time:

- **Royal Opera House** – In 2011, £25m was held in the bank – approximately 23% of the charity’s turnover.
- **Large top 10 charity** - Has around £10m deposited in banks. The charity has said that if they were to lose deposits held in a bank that fails they would simply have to reduce their service delivery commitments.
- **Epilepsy Society**: The charity’s total annual income is around £17 million. £2.5 million is held in cash across various current and deposit accounts – around 15% of total annual income.
- **National Autistic Society** – Currently has £14m held in cash deposits.
- **Tearfund** – The charity has stated: ‘Tearfund has a loyal supporter base who give generously whether in response to a disaster situation or for our ongoing development work in 35 countries across the world. The donations collected are held on deposit and are released to serve the needs of beneficiaries over the planned response time. This means that we hold significant deposits at all times.’

**Level of banking expertise within charities**

3.5. A number of charities have provided us with details of their level of in-house banking knowledge and experience.

- **Royal Opera House** – ‘We have an excellent finance team but wouldn’t have the in-house expertise to monitor the markets and manage complex banking risk.’
- **Large member charity** - ‘We employ strong finance professionals to manage risk but they are not bank credit experts. To obtain the necessary expertise we would need to divert existing funding away from helping children and young people and towards managing this new and unnecessary risk if the measures are introduced.’
- **UK youth charity** – ‘Out of necessity we run a very small, but highly effective finance department. Our priority is to deliver the very best value services to our beneficiaries, and we do not have either the funding or the capacity to allow us to become experts in financial markets.’
- **Tearfund** – ‘We do not have the resources afforded by many large corporates to invest in up-to-the-minute treasury management and hence have been forced in recent years, with the economic downturn, to switch our investment into those financial institutions with less perceived risk and, of course, lower returns.’

**2008 banking crisis and resulting impact on charities**
3.6. The long established City institution, Singer & Friedlander had, for many years, a respected specialist charities team providing bespoke charity banking services. This is why many charities had deposits with KSF. Singer & Friedlander was taken over in 2005 by Icelandic bank, Kaupthing with the FSA’s blessing. As a UK subsidiary (as opposed to branch) of Kaupthing, KSF remained a UK bank regulated by the FSA. However, during the banking crisis in 2008, at a time when other banks were bailed out, KSF was placed in administration and many charities found themselves ineligible for compensation by the FSCS.

3.7. In 2009 CFG, along with the Charities Aid Foundation (CAF) and NCVO, attempted to collect data on the extent of charities’ exposure to Icelandic banks. 48 charities came forward, with a combined total loss of £86.6m, although it is believed the figures are much higher – many charities that had faced losses were reluctant to speak up.

3.8. One of the issues considered by the Treasury Select Committee and by various Parliamentary inquiries into the banking crisis was the extent to which the crisis was foreseeable and the effectiveness or otherwise of credit rating agencies (which only significantly downgraded Icelandic banks a few days before being placed into administration). The Bank of England admitted that it had not foreseen the crisis, and that effectively rendered the issue of charities and professional advice academic. Charities and their professional advisers could not reasonably have been expected to foresee the crisis, and the risks and consequences of systemic failure if the Bank of England had failed to do so, and nor could charities and their professional advisers have foreseen which banks would be bailed out and which would not. The tripartite regulatory system and the ‘light touch’ regulatory approach has received widespread criticism from a number of Parliamentary inquiries.

3.9. During this time, there was a great deal of confusion amongst a significant number of charities as to their status as depositors (i.e. wholesale or retail) in relation to the FSCS. To many, the scheme seemed unduly complex and in some ways inconsistent in relation to charities. Charities have a variety of constitutional and corporate structures: unincorporated associations with assets vested in charity trustees and/or corporate trustees, and companies limited by guarantee and charitable trusts. Charities with branches also have federated (i.e. separately constituted registered charities), and non-federated branch structures. Some charities were compensated but others were not depending, in some cases, upon their corporate structure.

3.10. At the time it was also felt that the assumptions underpinning the FSCS scheme in respect of ‘sophisticated’ investors were flawed in the charitable context; the Trustee Act 2000 (which sets out a Trustee’s duty of care and investment powers) applies to all charitable trustees irrespective of the size or assets of the charity. The confusion was exacerbated by the fact that some extremely sophisticated high net worth retail depositors were compensated in full under the scheme. The assumption that sophisticated investors were better placed to foresee the risk of systemic, multiple bank failure and to have mitigated that risk than others was also open to question.
While charities that were protected under the FSCS were compensated for the full amount, charities ineligible for protection had to work hard to recover even some of their losses. Those charities with deposits in KSF which weren’t eligible for compensation under the FSCS scheme have now recovered 73% of their deposits through the administration process in the UK and the administrators’ current estimated range of final recovery is between 82.5% and 86%. However, it has taken 4 years to reach that point and this has had a significant impact on cash flow for many charities and their ability to help beneficiaries.

Lessons were learnt after the Icelandic crisis: many charities reviewed their banking practices and adopted a more cautious approach – spreading risk further, restricting investments to highly rated countries rather than just highly rated banks and seeking professional advice. Bank failure also carries reputational risks for charities, as donors could be deterred if they take the view that losses were the result of poor cash management. Naomi House say that they now fully document all decisions and are more open about their banking practices, to ensure they can justify their position should anything go wrong.

Lessons were also learnt by politicians and other key stakeholders. The recommendations of the Treasury Select Committee following their inquiry into the impact of the failure of Icelandic banks were as follows:

78. We recommend that the Government consider the case for providing charities with further statutory guidance relating to the management of a charity’s finances and investments. We further recommend that the Government take steps to clarify what protection is available to charities under the Financial Services Compensation Scheme.

The TSC drew attention to the limited understanding of FSCS eligibility by charities. While the FSA and Government responses to the TSC report highlighted that charity eligibility is explained on the FSCS website, the fact remains that this is still a source of confusion, particularly for those who sit near the threshold. Gaining an extra employee, for example, could make the difference between securing compensation or not.

While the extension of FSCS protection will go some way in addressing the issue, the current proposals, if taken forward, may exacerbate confusion around levels of protection in other ways.

In implementing the ICB reforms we understand that Government is also seeking to reassure taxpayers and depositors that their money is protected and safer under the new arrangements. However, for many charities the opposite is true. Given the disparity between many charities’ understanding and reality under the new rules, Government would need to clearly explain to charities their new subordinated position and what this will mean in practice.
With regards to guidance, the Government’s response references the Charity Commission’s statutory power to give appropriate advice, and provides examples of relevant guidance they have published.

Charity Commission guidance is held in high regard by charities and used extensively by the sector. However, guidance is relatively light touch and much is left to the judgement of individual managers and trustees. The Government’s acknowledgement that Charity Commission guidance is the definitive source of statutory advice adds weight to the points made in paragraph 2.10 that while effective financial management is vital, managing complex banking risk is simply not a core issue and beyond the means of most charities.

83. We recognise that the important work undertaken by the charitable sector often provides the most vulnerable elements of society with invaluable support. At a time when more people than ever may be faced with difficult circumstances, we believe that it is imperative that charities have access to the funds that were provided to them by the public. **We are concerned that one of the tests a charity must pass to be protected under the FSCS definition of a retail depositor is inappropriate for those charities using fixed assets in the course of their work.** We recommend that, on this occasion only, all charities should be compensated for losses incurred as a consequence of the failure of the Icelandic banks. Furthermore, to avoid such problems arising in the future, we recommend that the FSCS re-examine the criteria for the classification of charities as retail or wholesale depositors in the light of this recommendation. (Emphasis added).

As detailed in this response, we are concerned that these recommendations have been overlooked in developing proposals for reform.