Response to HM Treasury consultation on Reforming Financial Markets

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For more information contact Hannah Terrey
Head of Policy and Public Affairs
020 7832 3055
hterrey@cafonline.org
Response to the Treasury consultation – Reforming Financial Markets

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 and other banks, CAF has continued to lobby for changes to the Financial Services Compensation Scheme (FSCS).

1.4 In February 2009, John Low, Chief Executive of CAF, appeared as a witness at the Treasury Select Committee hearing, as part of their inquiry into the Banking Crisis. The subsequent report from the Treasury Committee, published on April 4th 2009\(^1\) supported CAF’s call for a review of the eligibility criteria and improved guidance for charities.

1.5 CAF also responded to the recent FSA consultation on the Financial Services Compensation Scheme reform\(^2\) in April this year and has written again to the Chancellor, with the support of other key sector bodies, calling for the Government to act on the recommendations of the Treasury Select Committee. CAF was disappointed that the Government’s response to the recommendations of the Treasury Select Committee failed to address the issues for charities.

1.6 CAF operates a deposit taking banking subsidiary, CAFbank. CAFbank continues to work with the banking industry and regulatory bodies to support reforms to ensure better regulation and protection for consumers.

1.7 CAF also has a high-risk social investment fund, Venturesome, and as such welcomes the Government’s proposals to support the Social Investment market (9.70 – 9.76). We will respond separately to the Government consultation on the Social Investment Wholesale Bank

1.8 This consultation response, therefore, relates principally to the proposals on supporting and protecting consumers (Chapter 8). Our comments are focused on financial capability (8.16-8.21), access to simple transparent products (8.22 – 8.29) and depositor protection and compensation (8.70-8.72).

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\(^1\) Treasury Committee Fifth Report ‘Banking Crisis: The impact of the failure of the Icelandic banks’

2. Supporting and Protecting Consumers (Chapter 8)

2.1 CAF welcomes the Government’s focus on the key aspects of supporting and protecting consumers:
- ‘consumers must be given the support they need to access and select the products and services they require in the modern economy’; and
- ‘they must have complete confidence in the processes that are put in place to make sure that, in the unusual event of a firm failing its customers – either through its conduct, or through a corporate failure – they are protected and compensated quickly and effectively’.

2.2 Government action on this consumer agenda is, however, primarily aimed at retail depositors and individuals. CAF believes that the financial capability and confidence of all charitable organisations and small enterprises is also of critical importance to the stability of the economy. The distinct needs of charitable organisations should, in particular, be recognised and addressed.

3 Strengthening the FSA's work on financial capability (8.16 - 8.22)

3.1 CAF agrees with the Government’s vision of ‘better-educated consumers who have the skills, motivation and confidence to make informed and responsible financial decisions’.

3.2 We recognise that third sector organisations do, of course, have an obligation to make sound investment and financial decisions on the basis of risk and return, and must be accountable for how funds are managed. However, in reality, some organisations and their boards of trustees contain limited financial expertise. Financial management may be carried out by volunteers or by workers with little knowledge of these areas. We want to see this situation improved.

3.3 The level of complexity in the market and the contamination of deposits and investments have created an environment that is incredibly difficult to understand. Independent financial advice can be very costly for organisations with very limited resources.

3.4 CAF would firstly call for improved comprehensive and reliable credit rating information. We would suggest that a separate rating based on true security and resilience of deposit takers could be developed. Information available to financial managers must go beyond interest league tables and clearly show security and liquidity. We are pleased that reform and supervision of credit rating agencies has been recommended by the Lord Turner Review of Regulation and supported by Government.

3.5 ‘Reforming Financial Markets’ also proposes the introduction of primary legislation requiring the FSA to establish an independent consumer education and information authority, which would be responsible for expanding the programme of work to increase financial capability. CAF believes that the remit of this new authority must include targeted action to address the financial capacity of the third sector.

3.6 We believe that in order to strengthen the sector and levels of accountability, Government should invest in capacity building of financial acumen across the sector.

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3 HM Treasury ‘Reforming Financial Markets’ July 2009, p
The new consumer education and information authority could build on the valuable work of the Finance Hub (part of the Capacity Builders pilot programme) which has unfortunately been allowed to decay since funding was withdrawn. We would see real value in developing some of the projects – particularly the Funding Advisors National Network (FANN).

3.7 The proposals state that the consumer education and information authority would work with ‘regulatory bodies and consumer representatives, including the Consumer Advocate proposed in the recent consumer white paper, to ensure an effective, strategic approach to crosscutting issues affecting consumers’. CAF suggests that the authority should work closely with the Charity Commission and representative third sector finance infrastructure organisations (including CAF) to ensure that the needs of charitable organisations are effectively addressed.

4. **Access to simple, transparent products (8.22 - 8.29)**

4.1 CAF supports the Government’s proposal to introduce standard labelling to increase access to simple, transparent financial products.

4.2 In written evidence given to the Treasury Select Committee⁴, CAF called for ‘Greater clarity about risk and compensation eligibility to be made available with financial products, perhaps through a ‘traffic-lights’ system or health-warnings available at account-opening. This would alert customers to issues such as country risk and how individual institutions are authorised and relate to others, as well as the financial security of the bank itself’.

4.3 CAF would agree that this initiative should be compulsory for all financial institutions.

5. **Depositor Protection and Compensation (8.70 – 8.72)**

5.1 The document refers to work being undertaken by the FSA to improve the provision of effective compensation to consumers by the FSCS, including:

- simpler eligibility criteria for claimants;
- improved communication about compensation arrangements with bank customers

5.2 CAF responded to the recent FSA consultation, ‘Financial Services Compensation Scheme Reform – Fast payments for depositors and raising consumer awareness’⁵, which gave detailed proposals for changes to the scheme.

Simpler eligibility criteria for claimants

5.3 We welcome the acknowledgement within the FSA 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’.⁶

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

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⁴ Written Evidence – Treasury Committee (ev475)
http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/144/144ii.pdf


⁶ FSA CP 09/03 Financial Services Compensation Scheme Reform – Fast payout for depositors and raising consumer awareness. 2.22, p11
5.4 The consultation proposed a flagging system which would 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, however, recognise the distinct nature of charities, which act to both raise and use funds for public good.

5.5 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.

5.6 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**

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 total of £86.6m deposited funds.

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. 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 equating to a third of total assets.

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

The relative impact varies across these organisations, dependent upon the amount deposited 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.

The impact is, however, now being felt by some charities. In 2008, Naomi House was forced to suspend services. Its hospice-at-home service, which provides carers for families with terminally ill children, will not be resumed until the lost funds have been returned. The charities have received no guarantees 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. The impact of the lack of these funds is exacerbated by additional difficulties, including low interest rates and the decreasing value of sterling.
5.7 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.

5.8 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.

5.9 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.

5.10 The Treasury’s response to the Treasury Committee report⁷ argued against compensation for charities affected by the Icelandic crisis on the basis that ‘Government cannot treat charities any differently from the other creditors of the failed Icelandic banks that are not eligible to claim compensation under the FSCS. There would be an unrealistic precedent set if we were seen to be making a special exemption for charities, as many other not-for-profit bodies such as police authorities, councils and universities have been affected in a similar way and could lead to them having a legitimate expectation that they too would be compensated’. We believe that a separate depositor classification, based on definitions of charitable purpose, would address these understandable difficulties and enable the Government to demonstrate support to the sector.

5.11 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.

6 Raising consumer awareness of the FSCS

6.1 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.

6.2 A survey of 280 charities by CAF revealed that only a quarter (25%) are certain they know how much of their funds are protected under the Financial Services Compensation Scheme (FSCS) should their bank fail. Over a third (35%) of charities find the scheme is unclear about the level of protection given to charity funds.

6.3 This poor communication leads to increased insecurity in the sector and lack of confidence in the banking system.

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

⁷ http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/656/656.pdf
6.5 In October 2008, following the collapse of 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.

6.6 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.

6.7 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.

6.8 The consultation suggests that information should be made regularly available to ‘eligible depositors’. We believe 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.

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