House of Commons

Treasury Committee

Banking Crisis: The impact of the failure of the Icelandic banks: Responses from the Government and the Financial Services Agency to the Committee's Fifth Report of Session 2008–09

Fourth Special Report of Session 2008–09

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Fourth Special Report

The Treasury Committee published its Fifth Report of Session 2008–09, Banking Crisis: The impact of the failure of the Icelandic banks, on 4 April 2009, as House of Commons Paper No. 402. The HM Treasury response to this Report was received on 8 June 2009 and appears as Appendix 1, and the Financial Services Authority response, received on 11 June 2009 appears as Appendix 2.

Appendix 1: HM Treasury response

The Government welcomes the report of the Committee. The Government is grateful for the Committee's contributions and will continue to work constructively with the Committee on its proposals.

What happened in October 2008?

2. During the collapse of the Landsbanki bank in October 2008, the Chancellor of the Exchequer took steps to safeguard the deposits of UK investors. We note that his comments regarding the intentions of the Icelandic Authorities had a serious impact on the confidence held in the remaining solvent Icelandic bank, Kaupthing and it has been suggested that this may have contributed to its collapse. We note that the published transcript of the Chancellor's conversation with the Icelandic Finance Minister does not confirm that the Icelandic government had stated that it would not honour its obligations but we have seen no evidence to contradict the Chancellor's view that UK depositors and creditors were unlikely to be protected to the same extent as Icelandic ones. We also have seen no evidence that Kaupthing would have survived if the Chancellor had not expressed his views. (Paragraph 49)

3. Although the Icelandic banking system was vulnerable to the crisis that has affected the international financial system since 2007, the actions of the UK Government in making statements on the capacity and willingness of the Icelandic Government to provide assistance to non-Icelandic citizens, whether or not such statements were accurate, turned the UK Government from being a seemingly passive observer of events, to an active participant in the market. Given the volatility of the situation, and the vulnerability of Icelandic banks at the time, it appears that the Icelandic Authorities found the UK Government's approach ultimately unhelpful. (Paragraph 50)

The Government notes the Committee's comments. The Government fully understands the exceptionally difficult challenges faced by the Icelandic Government and the pressure they were under. Given the conditions in the financial markets at that time, the UK Government believes that it was right to take urgent action to protect financial stability in the UK.

The decisions to protect UK depositors in Icelandic banks were made after extensive conversations with the Icelandic Government. In relation to the UK branch of Landsbanki, despite assurances from the Icelandic Government that it would honour its obligation to provide protection for the depositors of that branch (as is required under the EC Deposit Guarantee Scheme Directive), the UK Government was unable to gain clarity around the practical arrangements by which Iceland would be able to meet these commitments. The position of UK creditors in the administration of Landsbanki was also unclear. This was of serious concern as certain statements made by the Icelandic Prime Minister indicated that while Icelandic depositors would be protected, the rights of other depositors and creditors, including those in the UK, could be prejudiced—which would be discriminatory and a breach of the EEA Treaty. The UK Government took the action it did in the light of these concerns.

Kaupthing Singer and Friedlander Limited ("KSF"), a UK subsidiary of Kaupthing Bank hf is incorporated in English law and regulated by the Financial Services Authority (FSA). The FSA took a judgement on 8 October that KSF no longer met its threshold conditions for FSA authorisation due to a lack of liquidity and applied to court for KSF to be placed into administration in accordance with its powers under the Financial Services and Markets Act 2000.

Upon learning of the FSA's decision, the UK Government moved swiftly to transfer some of the deposits of KSF to ING to safeguard depositors and financial stability within the UK.

The steps taken by the FSA and the Government had no bearing on the status of the parent company, Kaupthing Bank hf, which is incorporated under Icelandic law and subject to supervision by the Icelandic Financial Supervisory Authority (FME).

4. The use of the Anti-Terrorism, Crime and Security Act 2001 had considerable implications for the Icelandic authorities in maintaining a functioning financial system. We call on the Treasury to consider how appropriate the use of this legislation would be in any similar circumstances in the future. The use of this Act inevitably stigmatises those subject to it and a less blunt instrument would be more appropriate. We are concerned that no appropriate legislation is available and call on the Treasury to address this matter. (Paragraph 51)

The Government notes the Committee's concerns and would like to emphasise that the UK's action was not taken on the basis of the anti-terrorism provisions in the Anti-Terrorism, Crime and Security Act 2001 (ATCSA). The Government believes that it was right to take urgent action, using the statutory means available, to protect financial stability in the UK.

The Government considers that asset freezing powers on the statute book must be justified on their merits, rather than the statute in which they appear. Given that we

already have freezing powers under ATCSA that enable us to address threats to the UK economy, any amendments to establish a further set of freezing powers would create problems of overlap, uncertainty and potential inconsistency. The Government therefore believes that it is preferable for anti-freezing legislation to be consolidated where appropriate.

It is also important to recognise that the circumstances in which we would need to use such powers will be wholly exceptional, as demonstrated by the recent case of Landsbanki, the Icelandic bank. We acknowledge that UK banks may sometimes get into difficulties and it will be the UK's responsibility to resolve them. However, we would not normally expect to have to resolve foreign banks even if they had branches in the UK. To create a specific power to freeze their assets implies that it may be considered normal, rather than exceptional, for us to intervene when foreign banks are involved.

We already have powers to apply asset freezes to protect financial stability under the economic aspects of the Act, which we have used in exceptional circumstances, as demonstrated in the case of Landsbanki, and the Government considers that it would not be appropriate to create another one. It is important that any future measures should be focused on strengthening financial stability and that they do not overlap with existing powers.

Charities and Local Authorities

5. We acknowledge that some local authorities will feel hard done by as a consequence of the limitations of Government support for them. Local authorities are required to take their own decisions on the level of prudent, affordable capital investment. They have a duty to the taxpayer diligently to protect the money they are investing on their behalf. Some authorities have shown themselves to be better than others in this regard. Under these circumstances it would seem perverse to reward those authorities who failed to protect their investment with yet more money from the taxpayer. (Paragraph 72)

The Committee's recommendation on local authorities is consistent with the principled position adopted by the Government. Local authorities are informed investors by virtue of having greater ability to assess and mitigate against risk, including through diversification. As such, it would not be appropriate to use taxpayers' money to guarantee their deposits.

6. 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. (Paragraph 78)

The Government notes the Committee's recommendation on the need for further statutory guidance on the management of charities' finances and investments. However, section 4(1) of the Trustee Act 2000 already provides that a trustee of a charity must have regard to standard investment criteria. The criteria state that trustees must have regard to the suitability to the trust of the investment to be made or being reviewed; and have regard to the need for diversification of the trust's investments, in so far as is appropriate to the circumstances of the trust. Additionally, the Act states at section 5 that "Before exercising any power of investment…a trustee…obtain and consider proper advice about the way in which, having regard to the standard investment criteria, the power should be exercised."

Further, the Charity Commission has the statutory power, under Section 29(4) of the Charities Act 1993, to "give such advice or guidance with respect to the administration of charities as it considers appropriate". As such it has published advice on Internal Financial Controls for Charities (December 2003); Investment of Charitable Funds: Basic Principles (December 2004); and Investment of Charitable Funds: Detailed Guidance (February 2003).

Whilst it is Government's role to set out the broad principles and regulatory framework for the management of charitable investments, the third sector is an independent sector. As such it is not the role of Government to provide the sector with financial advice. We therefore feel that the current statutory guidance already provided is appropriate.

The Government also notes the recommendation of the Committee on the clarification of the rules of the Financial Services Compensation Scheme (FSCS). However, these rules are a matter for the Financial Services Authority (FSA) and can be found in the Compensation Sourcebook (COMP) section of the FSA's Handbook. The FSA and FSCS are separate statutory bodies that operate independently of the Treasury. The FSCS website now includes further guidance on the eligibility criteria for charities.

7. 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. (Paragraph 83)

The Government also recognises the valuable work of charities in supporting many of the most vulnerable people in society, particularly in these difficult times. That is why

the Budget announced a new £20 million Hardship Fund to provide grant support to front-line third sector organisations in England adversely affected by the recession, with demonstrable resource constraints due to cash flow difficulties or increased demand. This built on the Government's £42.5 million action plan launched in February to support the third sector during the economic downturn. This package of measures was designed to ensure resources are directed towards the areas of the sector under the most pressure in the economic downturn and to help organisations to modernise and adapt to meet current challenges. The Government recognises that many third sector organisations, and not just those with deposits in Icelandic banks, are struggling due to reduced income at this time, and that is why we have taken this particular response to supporting the sector. Compensating the Icelandic bank charities would be at the expense of providing this support to charities more broadly during the downturn.

Furthermore, 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. The justification of compensation on the basis that the Committee has suggested—that charities often provide the most vulnerable elements of society with invaluable support—could arguably equally apply to local authorities and other providers of public services.

The Government notes the recommendation regarding the criteria for classifying charities for FSCS purposes. As stated above, the rules of the FSCS are a matter for the FSA, and not the FSCS or the Treasury. The FSA and FSCS operate independently of the Treasury.

Protecting British citizens

8. We agree that the overarching principle should be that the UK Government cannot provide cover for deposits held by British citizens in jurisdictions outside the direct control of the United Kingdom. (Paragraph 88)

11. Whatever the potential limitations of Government support for these individuals, we think it is important to note that the majority of those affected are not sophisticated, investors of high net worth who are somehow insulated from the losses they have incurred. (Paragraph 97)

15. We acknowledge the severe distress shared by many individuals as a result of this banking failure. (Paragraph 105)

16. A difficult judgment though has to be made in assessing the overall case for assistance. Those involved in the failure of the offshore subsidiaries of the Icelandic banks have suffered losses to date, and many of those affected are British citizens. On the other hand, we acknowledge the clear validity of the overarching principle that the UK Government cannot cover deposits held in institutions outside its direct

regulatory control. However, we believe that the UK authorities should work with the Isle of Man and Guernsey authorities to resolve these issues, especially given the complexities arising from the take over of the Derbyshire building society. (Paragraph 106)

The Committee's recommendation that the Government cannot provide cover for the deposits held by British citizens in jurisdictions outside the direct control of the United Kingdom is consistent with the principled position adopted by the Government. Arrangements for depositors in banks in overseas territories are a matter for the Governments of those territories. As such, it would not be appropriate to use UK taxpayers' money to guarantee their deposits. This principle is consistent with that expressed by the Chief Minister of the Isle of Man.

The Government notes the Committee's comments that the majority of those affected are not sophisticated investors of high net worth and also acknowledges the severe distress shared by many individually as a result of this banking failure.

HM Treasury has been in regular contact with the Governments of the Isle of Man and Guernsey. The Administrators' of KSF and Heritable, respectively, are also in regular contact with the Provisional Liquidator for KSF IOM and the Administrator of Landsbanki Guernsey.

1. We think it laudable that Mr Shearer brought to the attention of the Financial Services Authority his concerns around the takeover of Singer and Friedlander by Kaupthing. While the Financial Services Authority appears to have investigated these concerns, this episode shows the paramount need for the Financial Services Authority to be open to those that may wish to contact it to register their disquiet over problems they encounter in financial markets. We also note with great concern the impotence of the FSA to tackle directly the concerns brought to its attention as a consequence of its lack of any jurisdiction, which we discuss below. (Paragraph 28)

9. The failure of Kaupthing Singer and Friedlander (UK), given the deposits held by it on behalf of Kaupthing Singer and Friedlander (IOM), was extremely detrimental to the ability of Kaupthing Singer and Friedlander (IOM) to maintain its operations. However, we can find no evidence that the FSA pressured the Isle of Man authorities to authorise or encourage the placement of such a significant deposit with Kaupthing Singer and Friedlander (UK). (Paragraph 91)

10. It is of critical important that regulators in different jurisdictions can communicate effectively at times of financial crisis. We note with concern the suggestion that the paucity of information provided by the Financial Services Authority may have impeded the ability of the regulators in the Crown dependencies to safeguard their own financial systems. This is a particular concern given the close working relationship that appears to have existed between the Financial Services Authority and the Financial Services Commission of the Isle of Man in relation to

previous situations such as that surrounding the failure of Bradford & Bingley just days earlier. We recommend that the Financial Services Authority review its existing powers and strategy for dealing with other jurisdictions, and reports on its efforts in this respect. (Paragraph 93)

14. In 2008, Kaupthing Singer and Friedlander (Isle of Man) took over the Isle of Man subsidiary of the Derbyshire Building Society. While those with non-term deposits could have moved their funds if not satisfied with the new parental guarantee offered by the Icelandic parent bank (rather than their old one from a UK building society), those with long-term bonds had no chance to remove their funds without penalty. Where a parental guarantee is given, the home regulator of the parent company should be aware of that guarantee, and when it is to be transferred, should work with all the host regulators to ensure that all depositors have a chance to switch their deposits if they are not satisfied with the new deal. (Paragraph 104)

These recommendations are a matter for the Financial Services Authority (FSA).

12. While the Isle of Man and Guernsey obviously have different systems of tax to that in the UK, the EU savings directive ensures some tax in respect of UK residents banking offshore is recouped by HMRC, via the retention tax operating on the islands. If the Chancellor feels that there has been an element of tax evasion, then HMRC should investigate and prosecute those involved. Furthermore, whilst the Chancellor appears to deprecate the use of offshore banks by British citizens, we note that the FCO carries advice on its website for those retiring abroad that "you may want to….consider the benefits of offshore banking before you retire abroad. An offshore bank account can play an important role in helping to minimise your tax liabilities". (Paragraph 98)

The withholding tax option under the Savings Directive framework is a transitional measure, the ultimate aim being exchange of information by all participating jurisdictions. Withholding tax is less transparent than exchange of information as the tax withheld is not attributable to named individuals. The Government has a strong record in tackling evasion and, increasingly importantly in a global economy, working closely with other countries. The Budget sent a clear message to those who seek to evade paying tax by announcing measures to tackle cross-border tax evasion including an opportunity for holders of offshore bank accounts to come forward and pay what they owe, and the introduction of legislation that will allow HMRC to publish the names of serious tax defaulters.

13. We accept that there is no specific regulation or law preventing the provision of bank accounts to expatriate British citizens, but in practice the supply appears to have been extremely limited. As such, many expatriates have been forced to deposit their money offshore, outside the protection of the Financial Services Authority, and the Financial Services Compensation Scheme, as a direct result of the way in which Financial Services Authority regulations were interpreted in the UK. We therefore

recommend that the Financial Services Authority liaise with both the Building Societies Association and the British Bankers' Association, to identify why provision is so poor, and report back to us on steps to be taken to ensure better provision in the future, whether by new products, or greater access to existing products. (Paragraph 101)

The Government looks forward to the FSA's response. The Treasury has made its own enquiries and confirms that the number of banks and building societies who are prepared to offer services to non-residents is small. The Treasury has invited the British Bankers Association to offer an account finder service to non-residents through its website at www.bba.org.uk. This free service was launched on 8 May and will help those who have difficulty in finding a suitable onshore account.

17. We further recommend that the UK authorities should seek to work closely with other interested parties such as the Financial Services Commission of the Isle of Man to maximise the transparency of the administration of KSF(UK) in order to facilitate the best outcome for all depositors including those with funds in KSF(IOM) (Paragraph 107)

KSF (UK) is currently in administration according to the provisions of the Insolvency Act 1986 and the transparency of the administration (i.e. the extent to which the administrators will share information with creditors) is established by normal administration rules. Under UK administration law, the administrators of KSF (UK) are under a duty "to perform their functions with the objective of... achieving a better result for the bank's creditors as a whole than would be likely if the company were wound up without first being in administration" (paragraph 3(1)(b) of Schedule B1 of the Insolvency Act).

The FSA's involvement in KSF (UK) is now limited as the bank is now in the hands of the administrators. The FSA maintains a right to participate in proceedings and to receive notices and documents as if it were a creditor; it is however a matter for the FSA as to whether it would be able to work with the Financial Supervision Commission to maximise the transparency of the administration as far as its limited involvement will allow.

With regard to Treasury involvement: in the transfer order of 8 October 2008, which transferred KSF (UK)'s Edge deposit book to ING, the Treasury did take supervisory powers over the administration of KSF (UK) for the initial six months of the administration in order to help facilitate the transfer of Edge deposits to ING; however the vast majority of these powers have now lapsed. Furthermore, as a result of incurring liabilities in connection with the transfer, (i.e. paying for the transfer of the deposit book) the Treasury (and the FSCS) stand as creditors in the administration along side KSF (IOM). The first UK creditors' meeting for KSF (UK) was held on 1 December 2008. At this meeting, representation for the Creditors' Committee was determined by the creditors, where five committee members were appointed following a creditors' vote,

being representatives of the FSCS, a local authority, a charity, a pension scheme, and another public body. Although the KSF IOM Provisional Liquidator is not a member of the Creditors' Committee, the administrators are in ongoing, constructive and cooperative discussions with the Provisional Liquidator for KSF IOM. They also publish information on the administration on the KSF website: www.kaupthingsingers.co.uk/Pages/4035, which is available to the public and to the creditors.

18. Bearing in mind the heavy coverage in the financial press of Iceland's fragility we would have expected offshore savers using independent financial advisers to have been advised of the changing risk profile of their savings. We hope to explore further the role of advice to customers in our forthcoming inquiry into consumers and the banking crisis. (Paragraph 108)

While advice on deposits as such is not a regulated activity under the Financial Services and Markets Act, the Government notes that the Committee's enquiry will consider further the role of advice to customers in relation to the banking crisis.

19. We draw attention to the information available to consumers on the FSA's 'money made clear' website which details what compensation a consumer is entitled to if a UK financial services firm is unable, or likely to be unable, to pay claims against it. We recommend that the FSA publishes on this website a list of all bank and building society accounts available in the UK and regulated in part by the FSA which would be covered by the Financial Services Compensation Scheme. (Paragraph 109)

The content of the 'Money Made Clear' website is a matter for the FSA. The website now includes information on the largest UK deposit takers and how the FSCS limits would apply for most customers.

20. Our Banking Crisis inquiry, and specifically the problem of the failure of the Icelandic banks, has raised issues surrounding the cross-border regulation of financial institutions. Considerable taxpayer support has been required to provide rapid compensation to onshore UK depositors in Icelandic banks that 'passported' into the UK. This area of European law requires further consideration, and we will return to this topic in our future inquiry onto the banking crisis within its international context, with specific reference to the regulation of subsidiaries and branches of cross-border financial institutions. (Paragraph 112)

The Government notes that the Committee's banking crisis enquiry will consider the cross-border regulation of passporting firms, notably branches of foreign banks.

The Committee will wish to note that amendments to the Capital Requirements Directive, which is currently before the European Parliament, build in new safeguards. These include:

- A requirement to involve host supervisors of significant branches in cross-border colleges of supervisors. This will increase supervisory cooperation and dialogue and information flows.
- A requirement for home Member States to take account of financial stability in host Member States when making decisions about a banking group, especially in emergency situations.

However, the Government believes that more is needed to prevent a recurrence of the experience of Icelandic bank failures in the UK. The Chancellor has written to European finance ministers and the European Commission proposing a review of the risks and safeguards around cross-border bank branches. This should consider the relative responsibilities of home and host state authorities for the oversight of a group's financial strength, more effective cooperation between deposit guarantee schemes and the absence of a guarantee scheme for the failure of cross-border insurance companies.

Appendix 2: Financial Services Authority response

1. We welcome the Committee's report on the *Banking Crisis: The impact of the failure of the Icelandic Banks*. In this memorandum we respond to those detailed conclusions and recommendations which are relevant to the FSA.

A Crisis in Iceland

2. **We think it laudable that Mr Shearer brought to the attention of the Financial Services Authority his concerns around the takeover of Singer and Friedlander by Kaupthing. While the Financial Services Authority appears to have investigated these concerns, this episode shows the paramount need for the Financial Services Authority to be open to those that may wish to contact it to register their disquiet over problems they encounter in financial markets. We also note with great concern the impotence of the FSA to tackle directly the concerns brought to its attention as a consequence of its lack of any jurisdiction, which we discuss below. (Paragraph 28)**

3. We agree that individuals should be encouraged to share concerns with us as we may receive valuable information to help us maintain market confidence, protect consumers or reduce financial crime. We would like to assure the Committee that we will continue to take any allegations brought to our attention seriously, and ensure they are properly and professionally investigated.

4. As we acknowledged in the *Turner Review,* the crisis in Icelandic banks demonstrated that the EU's current regime for branches is inadequate and unsustainable. We have set out some options in the *Turner Review* and the associated Discussion Paper, *A regulatory response to the global banking crisis.* There we argue for a reinforcement of host country powers over liquidity and a new independent EU authority with regulatory powers to draft rules, have oversight of EU supervision and facilitate peer reviews. We are in close contact with our EU partners and institutions and are actively seeking to influence the outcome.

Charities and local authorities

5. **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. (Paragraph 78)**

6. **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. (Paragraph 83)**

7. The rules determining eligibility for the Financial Services Compensation Scheme (FSCS) cover are made by the FSA under the Financial Services and Markets Act 2000 (FSMA). The FSCS website includes further information on the eligibility criteria for charities. The information explains that eligibility for protection will depend on how the charity is constituted.[1]

8. The rules on the eligibility for FSCS compensation do not distinguish between whether a depositor is wholesale or retail, but rather they define eligibility by the size of the entity (including partnerships and mutual societies). Where EU Member States make such an eligibility distinction on size grounds, the Deposit Guarantee Schemes Directive[2] prescribes the size criteria that must be used in the case of companies. This means that EU law prevents us from changing the size criteria for the classification of charities which are protected by the FSCS where the charity is a company.

Protecting British citizens

9. **It is of critical important that regulators in different jurisdictions can communicate effectively at times of financial crisis. We note with concern the suggestion that the paucity of information provided by the Financial Services Authority may have impeded the ability of the regulators in the Crown dependencies to safeguard their own financial systems. This is a particular concern given the close working relationship that appears to have existed between the Financial Services Authority and the Financial Services Commission of the Isle of Man in relation to previous situations such as that surrounding the failure of Bradford & Bingley just days earlier. We recommend that the Financial Services Authority review its existing powers and strategy for dealing with other jurisdictions, and reports on its efforts in this respect. (Paragraph 93)**

[1] www.fscs.org.uk/consumer/faqs/deposit_claims_faqs/

[2] Directive 94/19/EEC, as amended by Directive 2009/14/EC.

10. We recognise that it is of vital importance that we communicate effectively with regulators in different jurisdictions at times of financial crisis and in the normal course of business. We are under a statutory obligation to cooperate with other regulators.[3] In addition, we have gateways that allow us to share confidential information about firms with regulators in other jurisdictions.

11. We recognise that there is scope for improving regulatory cooperation across borders – see our comments in paragraph 4 of this memorandum.

12. The TSC report draws a distinction between the case of the Icelandic banks and the failure of Bradford & Bingley. We were the lead supervisor of the Bradford & Bingley Group, while in the case of the Icelandic banks, the Icelandic regulator, the FME, was the lead regulator of the group. Necessarily, the information exchange is different when we are not the lead regulator.

13. In the majority of cases where we interact with the regulators in the Crown Dependencies, we regulate the parent company of the branch or subsidiary that they regulate. Under the international standards governing cooperation between regulators it is clear that when we are the lead regulator for a banking group in this way, we should pass certain information to the regulators of subsidiaries in other jurisdictions.

14. However, the cases of the Icelandic banks were very different. Both we and the Isle of Man/Guernsey authorities were regulating subsidiaries of the Icelandic parent bank. There was no parent-subsidiary relationship between the respective firms we regulated. Instead, the parent was regulated by the Icelandic regulator. In these circumstances it is for the lead regulator of the parent bank—in this case, the FME—to coordinate information flows. In other words, our role was to pass our concerns to the Icelandic authorities and it was for the Icelandic authorities to keep the regulators of the subsidiaries abreast of developments.

15. **We accept that there is no specific regulation or law preventing the provision of bank accounts to expatriate British citizens, but in practice the supply appears to have been extremely limited. As such, many expatriates have been forced to deposit their money offshore, outside the protection of the Financial Services Authority, and the Financial Services Compensation Scheme, as a direct result of the way in which Financial Services Authority regulations were interpreted in the UK. We therefore recommend that the Financial Services Authority liaise with both the Building Societies Association and the British Bankers' Association, to identify why provision is so poor, and report back to us on steps to be taken to ensure better provision in the future, whether by new products, or greater access to existing products. (Paragraph 101)**

[3] See section 354 of FSMA.

16. The decision about whether to take on clients is one for individual firms to take. We do not have specific rules which prevent banks and building societies from taking on customers resident offshore. Instead, we have rules and guidance on high-level systems and controls designed to prevent money laundering; we encourage firms to take a risk-based approach to mitigating their money laundering risks. However, we recognise the importance of this issue and we have recently held a preliminary meeting with the British Bankers' Association and the Treasury about the limited provision of bank accounts for overseas expatriates. As recommended, we will continue to consult on this issue, and will update the Committee with our findings.

17. **In 2008, Kaupthing Singer and Friedlander (Isle of Man) took over the Isle of Man subsidiary of the Derbyshire Building Society. While those with non-term deposits could have moved their funds if not satisfied with the new parental guarantee offered by the Icelandic parent bank (rather than their old one from a UK building society), those with long-term bonds had no chance to remove their funds without penalty. Where a parental guarantee is given, the home regulator of the parent company should be aware of that guarantee, and when it is to be transferred, should work with all the host regulators to ensure that all depositors have a chance to switch their deposits if they are not satisfied with the new deal. (Paragraph 104)**

18. The transfer of deposits from one Isle of Man deposit-taker to another is a matter for the Isle of Man regulator. It is for them to take the appropriate steps to ensure that depositors are suitably treated in such a situation.

19. The question of the parental guarantee and the treatment of term account holders in this case was also primarily a question for the Isle of Man regulator. Depositors should have been aware under the terms and conditions of their accounts that they were at all times, before and after the transfer, subject to Isle of Man regulation. It would not have been desirable for the UK authorities to seek to impose conditions on the transfer, not least because many depositors may have had no connection with the UK. Seeking to address this issue for all jurisdictions outside the UK where firms with UK parents do business would be extremely complex, and would run the risk of unintended negative consequences. Having said that, FSMA, together with related secondary legislation, does deal with the conditions governing the marketing of such products into the UK, including the information that such promotions should contain. It may be that the statutory requirements on such financial promotions need to be reconsidered.

20. **We further recommend that the UK authorities should seek to work closely with other interested parties such as the Financial Services Commission of the Isle of Man to maximise the transparency of the administration of KSF(UK) in order to facilitate the best outcome for all depositors including those with funds in KSF(IOM). (Paragraph 107)**

21. We will continue to cooperate and share information with the Financial Services Commission of the Isle of Man and the administrators of KSF(UK).

22. **We draw attention to the information available to consumers on the FSA's 'money made clear' website which details what compensation a consumer is entitled to if a UK financial services firm is unable, or likely to be unable, to pay claims against it. We recommend that the FSA publishes on this website a list of all bank and building society accounts available in the UK and regulated in part by the FSA which would be covered by the Financial Services Compensation Scheme. (Paragraph 109)**

23. We acknowledge that action is needed to raise consumer awareness of the FSCS and the protection it offers. We consulted on this earlier this year[4] and will, with the FSCS, be proposing measures in the second half of this year.

24. The fact that a specific account is covered by the FSCS is not, in itself, sufficient for an account holder to be eligible for FSCS compensation. The question of eligibility focuses on the account holder rather than on the type of account. An account could be eligible but an account holder may not. As a result, any list of accounts could be misleading. However, we have published on our 'Moneymadeclear' website a list of the largest UK deposit takers and a description of how the FSCS limits would apply for most customer accounts.[5] The FSCS has also published information on the eligibility of individuals and organisations.

25. We believe it would be more effective to concentrate on improving the disclosure of information about FSCS coverage to customers at the point when they decide to open an account with a particular firm. In CP09/3, we published proposals to improve disclosure of compensation arrangements by firms to their customers, to be implemented from 1 January 2010. We have proposed disclosure requirements for deposit-taking firms, which include requiring a firm to disclose the compensation scheme it is covered by and any trading names that the firm operates under, and for the information to be provided directly to each customer. We have also published further proposals to implement by 30 June 2009 a new EU requirement to inform depositors if their deposit is not covered by the FSCS (because the depositor does not meet the eligibility criteria).[6]

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[4] CP09/3, January 2009, www.fsa.gov.uk/pubs/cp/cp09_03.pdf

[5] www.moneymadeclear.fsa.gov.uk/pdfs/linked_deposits.pdf

[6] CP09/11, March, 2009, www.fsa.gov.uk/pubs/cp/cp09_11.pdf