

Collateralising the banking system

The unsecured nature of UK banking has troubled us at The Share Centre for many years, and on several occasions we have discussed the situation with the Bank of England and others. The major clearing banks have consistently argued against such a development. However, we remain confident that collateralisation for all significant deposits could be achieved, and that it would result in a significantly more stable system, potentially lower capital requirements for banks, and therefore more availability of bank lending.

The Share Centre is responsible for c. £150m of customer trust status deposits. Its first priority is the safety of such deposits. Although the Financial Services Compensation Scheme applies to individual customer balances, we take our fiduciary responsibility very seriously: hence our search for secured deposit facilities.

Over the past couple of years we have put in place fully collateralised arrangements with two building societies which cover c. 20% of our customer trust status deposit balances. These are secured with high quality mortgage deeds with a margin of 50% over deposit value, marked to market and refreshed monthly. These arrangements demonstrate that collateralisation can be achieved where there is good will and determination to establish the necessary systems.

The prize for establishing a comprehensive structure of collateralisation for significant bank deposits is very large in terms of systemic stability and economic stimulus, and there is no shortage of collateral in bank vaults. The key challenge is to get it working.

Our solution would see Euroclear at the heart of any such system, providing a fully electronic mark to market collateral system. The costs need not be excessive, and would be covered in modest differentials between secured and unsecured deposit rates. The efficiency of the security clearing system would allow the facilities to be available for both on-call and term deposits.

We propose that the Prudential Regulatory Authority should establish lower capital ratio requirements for banks making use of a collateral system, thereby providing an incentive for switch over. They would be encouraged to seek collateral or guarantees on all significant lending to corporate or personal customers, and this again would be encouraged through flexible capital ratios.

The potential for electronic collateral has changed greatly over the past 20 years but, apart from interbank transactions, where collateral is more commonplace, the banking system remains locked in its Victorian past. If a flexible collateral system had been present, much of the chaos of the financial crisis could have been avoided. It is not too late to make this change now.

Gavin Oldham
Chief Executive (2020: now Chairman)
The Share Centre

23 July 2013

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