

Is regulation driving strategy?

Dick Jenkins



No shortage of regulation

- Capital
- Liquidity
- Depositor protection
- Borrower protection
- Building Societies Sourcebook
- Governance
- All adding to a substantial burden of pre-existing regulation



Permeating our businesses

- Impacts everywhere-
 - Workload
 - All departments
 - Staff behaviours
 - Business decisions
 - Board meetings
- But to what extent is the FSA writing our **strategy?**



A small Society example

- Bath Building Society
 - £250m asset base
 - Affluent catchment area
 - Subsidiary businesses in property letting and a small IFA
 - One of the “luckiest Societies”



Performance of Building Societies

Dependent on exposure to

- FSCS bail-out of Bradford and Bingley and Icelandic banks
- Arrears
- High level of funding from other financial institutions
- Funds deposited with failed Icelandic banks
- Fraud
- High level of fixed rate and tracker mortgages
- Significant losses from poor diversification
- Pension shortfall



Bath Building Society exposure limited

- FSCS bail-out of Bradford and Bingley and Icelandic banks
- Arrears
- High level of funding from other financial institutions
- Funds deposited with failed (Icelandic) banks
- Fraud
- High level of Fixed Rate and Tracker mortgages
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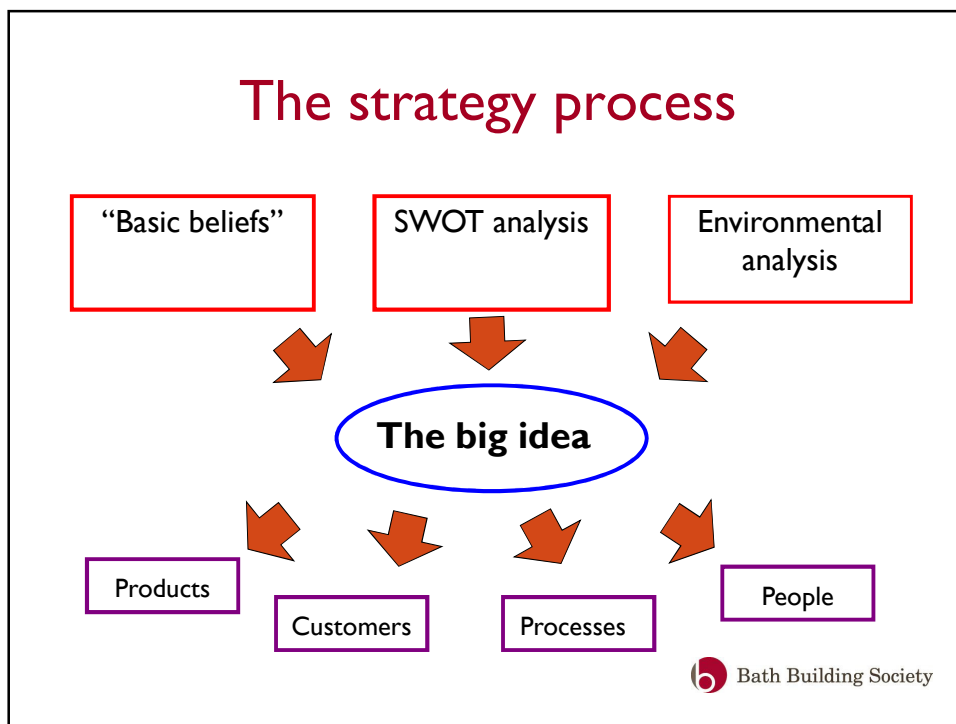
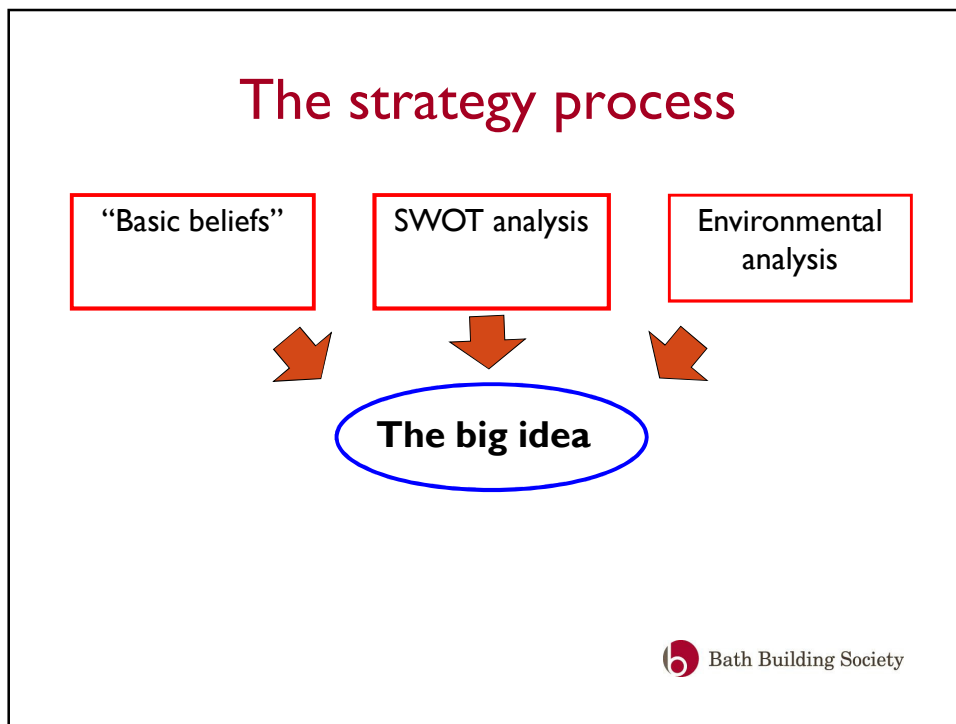
The strategy process

“Basic beliefs”

SWOT analysis

Environmental
analysis





Bath's Big Idea

Being small gives us
competitive advantage



Competitive advantage

- Scale allows us to offer
 - **FLEXIBILITY** and
 - **PERSONAL SERVICE**the big guys can't match



Competitive advantage

- Scale enables us to develop
 - **Product and customer NICHES**the big guys can't be bothered with.



Our strapline

“Closer to our customers”



Our strapline

~~“Closer to our customers”~~

**You won't get that from the
Nationwide**



The organisation reflects the big idea

- Staff who offer distinctive service
- A culture that goes out of its way...
- Mortgage distribution that finds the niches
- Grey-haired case-based underwriting
- Lots of niches for shares and deposits
- “Friends of the Society”
- High management expenses ratio



Recession has changed our focus

- Shorter strategic time scales
- Much more focus on risk
- Slight move away from riskier lending
- Increased emphasis on managing arrears
- Increased liquidity

- On the lookout for trouble ahead

“It’s hard to focus on the destination
when you’re amongst the icebergs”



The basics remain

- Irrespective of the general economic climate
 - Some people still want the kind of **service** we can offer
 - Some people still want the kind of **products** we offer
- If anything the big-bank crisis makes our hi-touch traditional model more attractive

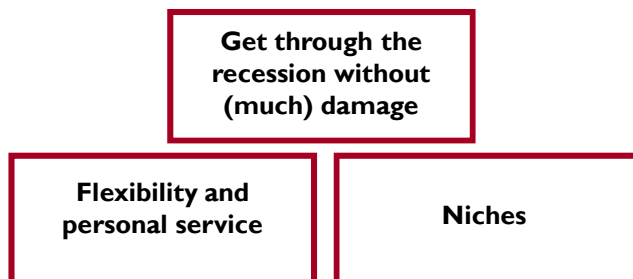


**Flexibility and
personal service**

Niches



We've just added another brick



Regulatory impact



- TCF-
 - perennial potential conflict with flexibility

Regulatory impact

Flexibility and personal service

- TCF-
 - perennial potential conflict with flexibility
- Mortgage market review-
 - more prescriptive approach to underwriting
 - arrears recording- customer relationship issue

Regulatory Impact

Get through the recession without (much) damage

- Much of the regulation designed to help resilience-
 - timing?

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Get through the recession without (much) damage

- Much of the regulation designed to help resilience-
-timing?
- **FSCS** costs
- **Capital Buffer** has slowed our growth
- **Liquidity buffer** cost partly offset by lower liquidity



Regulatory Impact

Niches

- **Building Societies Sourcebook-**
- All in the interpretation of guidance



Regulatory Impact

Niches

- Building Societies Sourcebook-

- All in the interpretation of guidance
- Fundamental problem that Niches considered dangerous for small lenders on Traditional and Limited approaches



Regulatory Impact

Niches

- Building Societies Sourcebook-

- All in the interpretation of guidance
- Fundamental problem that Niches considered dangerous for small lenders on Traditional and Limited approaches
- If we cannot convince the FSA that we can manage our risks, then there are serious consequences

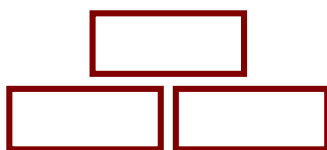


Regulatory Impact

Niches

- Mortgage market review
 - Keeps pushing us towards unprofitable mainstream business

Taking all three together



- Not too much impact YET
- BUT there is a threat to our core strategy
- AND.....

The wider impact



- Regulation driving us to distraction- **LITERALLY**
- Small Societies don't have the manpower
- Exacerbated by seemingly pointless frustrating rules
 - Arrears recording
 - FSCS blanket notification irrespective of balance
 - PSRs/BCOBS timing



And its not just the FSA...

- Example of new law change (April 2010) on definition of HMOs



- Will impact on our Buy-for-Uni and Parent Assisted Mortgage products



And the cost....

- Senior management/Board time
- Liquidity regime for many Societies
- The level of cost is a strategic issue



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- The impact of regulation on strategy is now **growing** dramatically
- Danger that regulation will **undermine differentiation**
- **Cost and distraction** of taking on all of this regulation a strategic issue

