SOCIETY matters

No.12 Summer 2009

The changing regulatory landscape

A policy special

John Mc Fall MP,
Treasury Committee Chairman

Robert Skinner,
Banking Code Standards Board

Five minutes with...
Graham Beale, BSA Chairman

Free BSA Annual Conference DVD

Building Societies Association

WELCOME TO THE SUMMER EDITION OF *SOCIETY MATTERS*, THE BSA'S QUARTERLY MAGAZINE.

IT'S NOT JUST THE REGULATORY LANDSCAPE THAT'S CHANGING. SO TOO IS THE SCOPE OF THE BSA. AT OUR ANNUAL CONFERENCE IN MAY, MEMBERS VOTED TO CHANGE THE ASSOCIATION'S RULES TO ALLOW OTHER MUTUAL LENDERS AND DEPOSIT TAKERS TO BECOME MEMBERS OF THE ASSOCIATION

After the turmoil of the past two years, very few people would have expected the regulatory landscape to have remained the same. Indeed, the times they are a changing.

In this edition we focus on the various regulatory changes afoot and what this means for the sector and wider industry. We examine the FSA's new Banking Conduct of Business Sourcebook (BCOBS) and its implications for societies and the Banking Code. Robert Skinner, of the Banking Code Standards Board, talks to us about the Board's forthcoming transformation into the Lending Standards Board as a result of the introduction of BCOBS.

John McFall MP, Chairman of the Treasury Select Committee (TSC), looks at the work the TSC have undertaken in their wide ranging *Banking Crisis* Inquiry. He focuses on the action that financial services firms should take to change for the better. McFall notes that the Committee is keen to encourage the building society sector - indeed he says there are some lessons that banks can learn from building societies and his Committee have recommended the Government examine whether any legislative changes are required to facilitate building society start-ups. The TSC also believe that remutualisation should be an option considered for the nationalised banks.

The BSA's resident Turner Review expert, Jeremy Palmer, gives us an overview of the proposals for reform set out by Lord Turner.

It's not just the regulatory landscape that's changing. So too is the scope of the BSA. At our Annual Conference in May, members voted to change the Association's rules to allow other mutual lenders and deposit takers to become members of the Association. This means Britannia Building Society will remain a full member of the BSA once it merges with The Co-operative Financial Services on 1 August. We hear from Neville Richardson, Britannia Chief Executive, on the Society's forthcoming merger.

The Yorkshire Building Society tell us of the importance of maintaining the Barnsley brand after the merger and we take a look at the arrears situation and what societies are doing to help their members keep their homes.

Enjoy.

Rachel Le Brocq
Society Matters Editor

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FIVE MINUTES WITH…
GRAHAM BEALE,
CHAIRMAN OF THE BSA AND CHIEF EXECUTIVE OF NATIONWIDE BUILDING SOCIETY

GRAHAM JOINED NATIONWIDE IN 1985 AS A CHARTERED ACCOUNTANT AND BECAME CHIEF EXECUTIVE IN 2007. IN HIS FIRST YEAR HE OVERSAW THE SUCCESSFUL MERGER WITH PORTMAN BUILDING SOCIETY AND HAS SINCE EMBARKED ON A TRANSFORMATION PROGRAMME AFFECTING ALL PARTS OF THE NATIONWIDE GROUP

Graham Beale

If I could change one thing in my time as Chairman of the BSA it would be the current system for calculating Financial Services Compensation Scheme levies. It is grossly unfair that institutions' levies are based on the deposits they hold, with no differentiation made based on the risk of contributors' respective business models. As a result mutuals have ended up paying for the failure of institutions that engaged in much riskier business practices than their own.

The building society sector's main opportunity over the coming months and years is the chance to demonstrate to members the value that mutuality can offer. Clearly societies do face challenges but there is still a lot of value and strength in the mutual sector, and the mutual model itself remains robust.

The building society sector's main threat in the coming months and years is the competition posed by nationalised, or part-nationalised, banks for access to retail funding. There is a huge potential for market distortion. In the second half of 2008 Northern Rock and NS&I took 70% of retail funding in the UK. The Treasury needs to understand that retail funding is finite and if government backed organisations take funding out of the system it diverts funding away from building societies which in turn means that we will be unable to lend in the mortgage market. And this in turn has consequences for the economy.

How do you feel building societies have performed during the banking crisis so far? Nobody can be immune to the consequences of the credit crisis in particular the dysfunctional wholesale market, the historically low interest rate environment and the impact of the recession. So it should come as no surprise that building societies have been affected. However, the building society business model is very resilient and the combination of high levels of capital, a low dependency on wholesale funding, high levels of liquidity and high quality assets means that the majority of societies have performed very well when compared with the banks.

What is the main issue posed by the current economic environment? Interest rates are at their lowest level for 300 years so we are in uncharted territory. There is no doubt that negotiating the low interest rate environment will be particularly challenging as low rates compress margins and make it more difficult to maintain profitability.

What challenges do you think the BSA faces over the next 12 months? The BSA needs to continue getting across the message that societies are strong institutions that offer long term good value, great service and provide a secure home for people's savings. No investor in a building society has lost their money since at least 1945, that's a great record and one the BSA continues to hammer home very effectively. They also need to continue getting across the message that societies play a very important role in local communities around the country and are valued by members across the country.

The most important financial lesson I have learnt is not to get carried away and stay true to my appetite for risk. Both in business and at a personal level there are many temptations to make a greater return. It is rarely the case that this can be achieved without greater risk.

The thing I worry about most is - my long term worries are for future generations, my children in particular, who will have to work through the consequences of the national debt, will have limited or no pension provision and probably have to work for much longer than the current national average. It is going to be very tough for them.

I am currently reading *The Girl with the Dragon Tattoo* by Stieg Larsson, a recommendation from my wife's book group.

What book, luxury item and music track would you take to a desert island? Book choice: *Tom Jones* by Henry Fielding. I first read this book for English 'A' level. It is regarded as one of the first and most influential English novels. As well as providing a social insight it is very amusing and helpfully, for a desert island, very long. **Music track:** *Love and Affection* by Joan Armatrading. It reminds me of the time when I first met my wife. **Luxury item:** the biggest bar of Green and Black's almond chocolate permissible.

ARREARS AND REPOSSESSIONS –

WHAT ARE THE SECTOR AND GOVERNMENT DOING TO HELP BORROWERS?

BY VICTORIA BARNARD, BSA MORTGAGE POLICY ADVISER

WITH STARK PREDICTIONS FOR REPOSSESSIONS, 2009 WILL SEE A RISE IN THE NUMBER OF CUSTOMERS EXPERIENCING PAYMENT DIFFICULTIES, MANY AS A RESULT OF THE ECONOMIC DOWNTURN AND THROUGH NO FAULT OF THEIR OWN.

Building societies have always strived to offer assistance to borrowers who find themselves in difficulty and have generous, pragmatic and effective forbearance policies.

Over the last few months the BSA has been working with Government and money advice organisations to help demonstrate to a wider audience that building society members who encounter repayment difficulties can access a wide range of help, to give them confidence that repossession really is a last resort.

Can't Pay Your Mortgage?

Working in conjunction with Money Advice Trust, the BSA has produced a consumer leaflet to provide straightforward advice to customers on what to do when they have difficulty paying their mortgage.

One of the key aspects of the leaflet - *Can't Pay Your Mortgage?* - is providing the customer with information about what happens once they make that important and often difficult step to contact their society.

The aim of this is to demystify the process and provide comfort to the customer that making contact will not start repossession proceedings. It outlines the many different techniques and measures that societies are able to use to work with their customers to help them stay in their homes. It stresses the highly individual approach applied to customers with repayment difficulties, to ensure they receive the appropriate help.

> BUILDING SOCIETIES HAVE ALWAYS STRIVED TO OFFER ASSISTANCE TO BORROWERS WHO FIND THEMSELVES IN DIFFICULTY AND HAVE GENEROUS, PRAGMATIC AND EFFECTIVE FORBEARANCE POLICIES

Getting the message out

Over 15,000 copies of the leaflet have been widely circulated. As well as being sent to all MPs for use in their surgeries, it has also been sent to money advisers and citizens advice bureaux. A number of societies have also placed copies of the leaflet within their branches and on their websites.

Customer Commitment Statement

In order to demonstrate that building society customers will benefit from similar help to that given under the Government's Homeowner Mortgage Support scheme, the BSA, in conjunction with societies, developed a customer commitment statement.

The statement outlines the basic principles which will be applied by societies when dealing with a customer with mortgage repayment difficulties.

Building Society Customer Commitment Statement

Building societies are committed to working closely with borrowers in financial difficulty and who are willing to resolve their financial situation. Building societies want to help their customers remain in their home, and will provide support which best meets the individual circumstances and interests of its customers to help achieve this.

Underlying this aim are the following guiding principles:

- We will speak with the borrower to assess their specific circumstances and needs before agreeing appropriate solutions.
- Solutions agreed by the society with each borrower will vary from customer to customer, so that it is most effective. The range of options available will be consistent with the society's overall business model and what works well for its customers. This may include, for example, a change of payment date and/or

method; transferring the repayment to interest only; reduced payments or other concessions; or an extension to the mortgage term.

- We will recommend the borrower seeks independent, free, money advice.
- We will look to extend payment arrangements and exercise forbearance for a reasonable duration of time reflecting the circumstances of the borrower and what is in the best interests of all parties.
- We will work with the borrower to help them move to full payments over a realistic period of time.
- We will maintain a regular dialogue with the borrower, reviewing their circumstances on a regular basis.

All borrowers who are willing to work with their society will benefit from these principles, demonstrating that Treating Customers Fairly is at the core of our mutual values.

Government schemes

As well as building societies doing their utmost to help borrowers in difficulty, the Government has launched a couple of schemes. In January, the Mortgage Rescue scheme for England was launched.

Under the scheme, local authorities can arrange for a property to be bought outright and rented back to the former owner via 'Mortgage to Rent'; or for a share of the property to be purchased under the 'Shared Equity' scheme.

The Government anticipate that the scheme will avoid 6,000 repossessions over two years.

The latest figures show that over 3,000 applications were made, resulting in over 400 cases meeting the eligibility criteria. As of April, only two cases had been completed so far. However, because of the detailed assessment it is inevitable that the scheme will take some time to build.

In May, the Government extended the scheme to help those previously excluded due to negative equity. The maximum LTV which will now be considered is 120%. In addition, the scheme has received an extra £80 million of funding, to support the demand for the mortgage to rent option.

Homeowner Mortgage Support scheme

The Homeowner Mortgage Support scheme (HMS) launched in April. The intention of the scheme is to support borrowers who are unable to make full mortgage payments due to a temporary loss of income.

The scheme requires the lender to defer up to 70% of the monthly interest payment, with the borrower paying the remaining 30%. In return the Government will provide the lender with a guarantee covering 80% of the interest deferred, which will be paid if the borrower defaults and the lender suffers a loss on repossession.

A borrower may remain in the scheme for up to two years. The guarantee will last for four years from the date the borrower exits the scheme.

The BSA arranged for two workshops held in April to provide members with an overview of the scheme and an opportunity to raise questions with Government.

The BSA remains supportive of the intentions behind the scheme. However, it is unlikely to help additional building society borrowers who find themselves in payment difficulties, as they are likely to be receiving a similar level of forbearance under societies' existing policies.

i For more information on arrears and repossessions, contact **Victoria Barnard** at **victoria.barnard@bsa.org.uk**

RETAINING THE BARNSLEY BRAND

BY TANYA JACKSON, CORPORATE AFFAIRS MANAGER, YORKSHIRE BUILDING SOCIETY

YORKSHIRE BUILDING SOCIETY MERGED WITH BARNSLEY BUILDING SOCIETY ON 31 DECEMBER 2008 AND WHILST THE COMBINED SOCIETY IS CALLED YORKSHIRE BUILDING SOCIETY, BARNSLEY'S IDENTITY AND NAME WAS RETAINED.

Retention of the Barnsley brand was an important decision in the merger discussions. Brand value, like corporate reputation, is difficult to measure in monetary terms, but is nevertheless a valuable asset in retaining and attracting customers.

Commitment to members

At the Yorkshire we recognised the strengths of the Barnsley franchise and the loyalty of the members it serves in the South Yorkshire communities and we were keen to maintain this post-merger. Retaining the brand identity demonstrated to the Barnsley members the commitment Yorkshire had to their communities and to maintaining service standards in their local branches, whilst they benefited from our additional financial strength and the security the merger would bring.

This was backed up with a further commitment to retaining the Barnsley's strong community connections through its sponsorship and affinity arrangements, such as sponsorship of Barnsley Football Club and its Yorkshire Air Ambulance savings account. This commitment to retaining the Barnsley brand and activities was also a huge positive in managing the media relations messages, particularly in the local area.

FSCS benefits

Apart from the feel-good factor of preserving the local character of their building society, retaining the Barnsley brand enabled its members to benefit from dual protection under the Financial Services Compensation Scheme (FSCS). Those who were members of both Yorkshire and Barnsley building societies at the time of the merger retained their £50,000 protection in each society, giving £100,000 cover in total per individual - and double for joint accounts. If following the merger the Barnsley brand had disappeared, similar members would have lost the FSCS protection they had previously had with the Barnsley Building Society.

A REVIEW OF BUSINESS VOLUMES IN THE FIRST FEW MONTHS SINCE THE MERGER SHOWS THAT MEMBERS HAVE STAYED WITH THE BARNSLEY BRAND, WITH SAVINGS BALANCES INCREASING IN THE BARNSLEY ACCOUNTS

Commercial sense

Retaining the Barnsley brand also has some commercial benefits. The Yorkshire and Barnsley brands are run separately with different products. Customers can purchase only Yorkshire products from branches of the Yorkshire and on the Yorkshire's internet, whilst Barnsley products are available only in Barnsley branches and on the Barnsley website. This distinction between the brands means that new products can be designed and tested on different markets.

Shortly after the merger Iain Cornish, chief executive, hosted a member question time meeting in Barnsley for Barnsley members. Comments from this meeting indicated the appreciation of the members to the Yorkshire for retaining the strong local heritage and preserving the character of their local building society. A review of business volumes in the first few months since the merger shows that members have stayed with the Barnsley brand, with savings balances increasing in the Barnsley accounts.

THE **BRITANNIA/CO-OP** MERGER

BY NEVILLE RICHARDSON, CHIEF EXECUTIVE, BRITANNIA BUILDING SOCIETY

IT'S NOW SEVERAL WEEKS SINCE OUR HISTORIC AGM AND I'M SURE, BY NOW, YOU'LL KNOW THAT BRITANNIA'S MEMBERS OVERWHELMINGLY SUPPORTED A MERGER WITH THE CO-OPERATIVE FINANCIAL SERVICES (CFS).

I'm delighted that our members recognised the benefits this merger will bring to them and also to the mutual sector as a whole. Everyone knows the last twelve months have been challenging, and building societies have not been immune from the difficult market conditions. However, in the last year we have seen people turn to mutual organisations more than ever, as disillusion with shareholder banks grows.

Events within the financial services sector in the last year have left people with even higher expectations of the organisations they do business with. Now, they're not only looking for a safe place for their money, with a provider they trust, but they want an organisation which behaves ethically and fairly towards its customers.

FOR OUR MEMBERS, THE COMBINED BUSINESS WILL OFFER EVERYTHING THEY LOVE ABOUT BRITANNIA - WE'LL REMAIN MUTUAL, WE'LL MAINTAIN AN EXTENSIVE BRANCH NETWORK AND WE'LL CONTINUE TO SHARE PROFITS WITH THEM

Mutual relevance

The co-operative and mutual movements have never been more relevant, which is why this merger offers a unique opportunity to create a business with the scale to offer customers a full range of products and services that are ethical, mutual and co-operative.

Britannia and CFS are two of the biggest customer-owned financial services businesses in the UK, run for the benefit of their members, not shareholders. Members and customers are already at the heart of the two businesses and always come first - this is something which will continue to be the main concern of the new organisation.

For our members, the combined business will offer everything they love about Britannia - we'll remain mutual, we'll maintain an extensive branch network and we'll continue to share profits with them. It will also offer much more including enhanced products and services, the benefits of being part of a larger group and the chance to earn even greater member rewards.

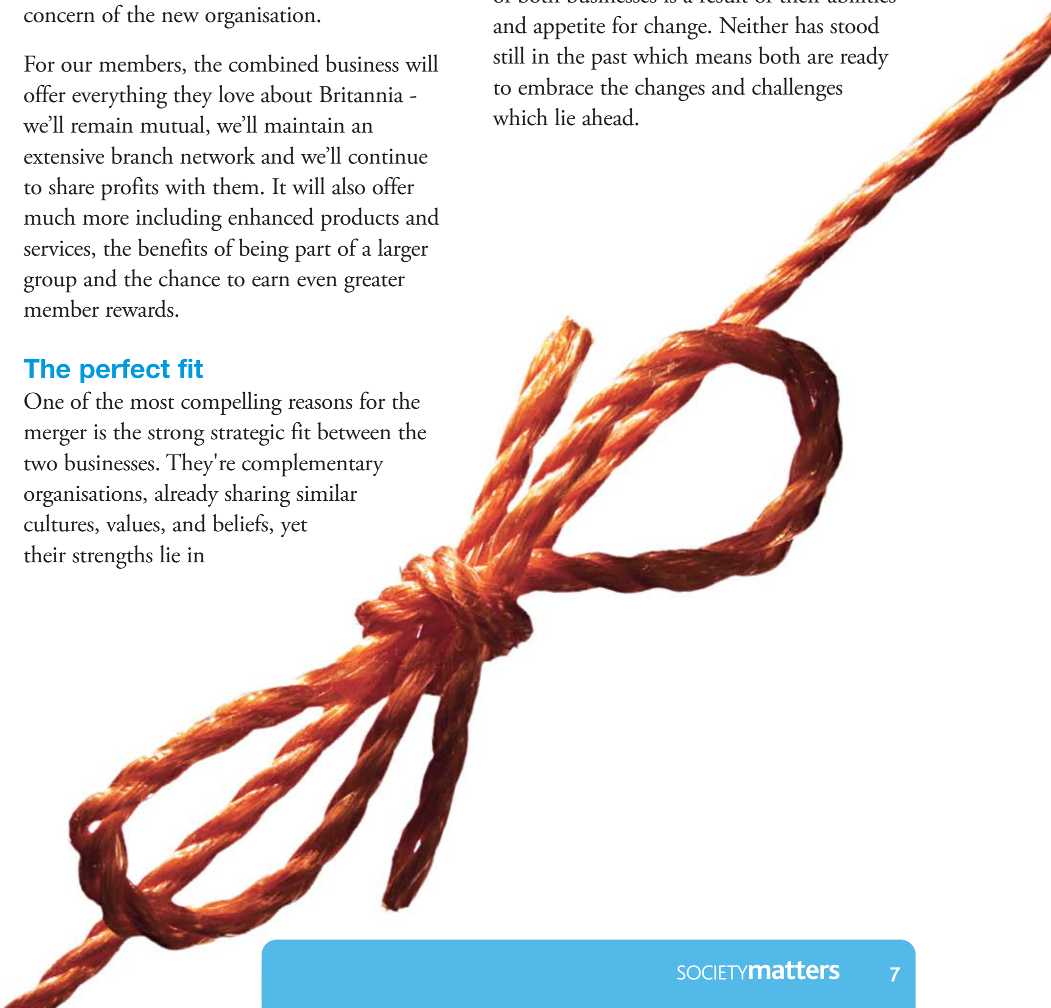
The perfect fit

One of the most compelling reasons for the merger is the strong strategic fit between the two businesses. They're complementary organisations, already sharing similar cultures, values, and beliefs, yet their strengths lie in different areas - CFS has strong internet capability, personal and corporate banking, insurance and investment expertise, while Britannia has an extensive high street presence and savings and mortgage product strength.

Once all the legal and regulatory arrangements are completed, we expect to become one business on 1 August 2009. Full integration will take a lot longer, we expect up to three years, although both organisations already have experience of organisational mergers - Britannia following its acquisition of Bristol & West in 2005, and CFS when it was created by the coming together of The Co-operative Bank and Co-operative Insurance in 2003.

Appetite for change

In the coming weeks and months we'll begin shaping the new business and I'm very excited about the future opportunities. I've no doubt that bringing together two organisations of this size will be challenging, but, the success of both businesses is a result of their abilities and appetite for change. Neither has stood still in the past which means both are ready to embrace the changes and challenges which lie ahead.



NO RETURN TO BUSINESS-AS-USUAL

BY RT HON JOHN MCFALL MP, CHAIR OF THE HOUSE OF COMMONS TREASURY SELECT COMMITTEE

SINCE THE FAILURE OF NORTHERN ROCK IN 2007, THE HOUSE OF COMMONS TREASURY COMMITTEE HAS BEEN AT THE FOREFRONT OF INVESTIGATING THE CAUSES OF THE BANKING CRISIS, AND HAS NOT SHIED AWAY FROM MAKING THE PROPOSALS IT BELIEVES ARE NECESSARY TO RESTORE TRUST IN FINANCIAL SERVICES. IN THIS ARTICLE, THE COMMITTEE'S CHAIRMAN, THE RT HON JOHN MCFALL MP, SETS OUT SOME OF THE COMMITTEE'S FINDINGS WHICH ARE OF MOST RELEVANCE TO BUILDING SOCIETIES.

The Treasury Committee is now approaching the end of its extensive inquiry into the banking crisis. Since November 2008, we have held 17 hearings at Parliament, received hundreds of written submissions and published three reports: on the failure of the Icelandic banks; the failure of the UK banks and the Government's bailout package; and remuneration and corporate governance in the financial services sector. As we are still to report on the role of the Tripartite Authorities - HM Treasury, Bank of England and FSA - this article focuses on the action that financial services need to take themselves, rather than the role of the regulation.

The banking crisis

The origins of what is an international banking crisis are many and varied, including low real interest rates, a search for yield, apparent excess liquidity and a misplaced faith in financial innovation. These ingredients combined to create an environment rich in over-confidence and over-optimism amongst the leadership of financial institutions. The Treasury Committee is in no doubt that those banks which failed were the principal authors of their own demise; bankers made an astonishing mess of the financial system. However, it was a failure not only of individual banks but also of the supervisory system designed to protect the public from systemic risk. Governments, politicians, regulators and central bankers in the UK and across the world must also share responsibility for sustaining the illusion that banking growth and profitability would continue to rise inexorably.

Poor corporate governance

Risk and complexity within the banking sector have increased dramatically over the last 20 years, in part driven by the widespread, but mistaken, belief that risk was being dispersed by techniques such as securitisation. Bankers complicated banking to the point where the location of risk was obscured, they abandoned time-honoured principles of prudent lending and they failed to manage their funding requirements appropriately. They were able to do this because corporate governance was often totally ineffective. What we need now is substantial change to the remuneration practices, corporate governance and culture of banking. I would hope that the nature of banking would change of its own accord in response to the crisis, but I fear that as soon as public and media attention turns away, we may see a return to 'business as usual.' This absolutely must not happen; we have before us a once in a generation opportunity to fix the financial system, which we ought to seize.

Some lessons can be learned by banks from building societies. Certain features of the building society model, including the comparatively low reliance on wholesale funding, the relative simplicity of operations and the focus on the protection of members rather than the (sometimes excessively short-termist) satisfaction of shareholders, have left most building societies better equipped to defend against the shockwaves of the current crisis.

Back to basics

Commentators have called for a return to 'traditional banking,' perhaps involving the prohibition of firms serving both the retail and investment banking markets. I find this idea inherently attractive, although there are, of course, many complicating factors. I believe a debate should be opened up on the possibilities of aligning bank operating models closer to those of a building society or old-fashioned retail bank. But rather than encouraging building societies, our Committee heard evidence that the establishment of new building societies was now harder than it has been in the past. We have therefore called on the Government to examine whether any legislative changes are required to facilitate building society start-ups. We also believe that remutualisation should be amongst the options the Government considers when it comes to selling the temporarily nationalised banks.

The current financial crisis has also exposed serious flaws and shortcomings in the system of non-executive oversight of bank executives. Too often, non-execs operated as members of a 'cosy club' rather than as tenacious scrutineers of bank executives. This failure to act as an effective check on senior managers has a number of causes. First, there is the paucity of time many non-executives can devote to their role, with many combining it with that of chief executive of a FTSE 100 company, or with several other director or trusteeships.

Second, too many non-executive directors within the financial sector lack relevant banking or financial experience, so struggle to understand, let alone challenge the managers of today's complex banks.

Finally, the Committee is concerned that the banks are drawing upon a non-exec talent pool which is too narrow to provide sufficient diversity of views. We believe that where a non-exec holds several other posts, they should be obliged to explain how they will manage the workload. Serious consideration should also be given to whether all non-execs - or at least a proportion - on bank boards should be required to have relevant professional qualifications. Lastly, there is a strong case for non-executive directors in the banking sector to have a dedicated secretariat to help them perform their responsibilities effectively. The scale of the current banking crisis stands as testament to the fact that risk has not been well-managed by the boards of banks. Non-execs need to exercise more effective oversight and resist the urge to ally themselves too closely with the managers they are charged with scrutinising.

To aid this, we also believe that risk management functions should report directly to the non-executive members of boards.

Inappropriate FSCS levies

Deposit protection is one issue which, sadly, has climbed up the ladder of public awareness. The Government has increased the formal limit of protection to £50,000 per customer, but has also given an implicit guarantee of 100%, by promising that no depositors in UK institutions will lose anything. The Committee believes that there should be a genuine limit to the level of deposit protection offered by the Financial Services Compensation Scheme (FSCS) once financial stability has returned. This would reintroduce the depositor's obligation to consider matters other than the most attractive interest rate in choosing where to locate their investments, thus reimposing market discipline.

We have been recommending for some time that contributions to the FSCS should be varied according to the riskiness of each fee-paying institution. We are therefore very sympathetic to the plight of building societies in funding more than their share of the FSCS burden and have called on the FSA to review the situation with urgency. It is entirely inappropriate that those institutions recognised as having a safer funding model should be required to contribute a larger share of profit to the industry's insurance scheme than their riskier competitors.

THE TURNER REVIEW

- A SEA-CHANGE IN REGULATION?

JEREMY PALMER, BSA'S HEAD OF FINANCIAL POLICY, APPRECIATES THE BOLD THINKING BEHIND LORD TURNER'S MAJOR REVIEW, AND COMMENTS ON A FEW KEY POINTS.

So – what did you really expect from this FSA review?

Be honest… was it

- reams of back-covering self-justification?
- ostrich-like denial of reality, and repetition of discredited slogans?
- macho posturing to camouflage supervisory failings?

...or some toxic cocktail of all of these?

And what came out in the end?

The correct answer, in my opinion, is:

None of the above - instead, you get:

- a painfully honest examination of what went wrong
- rigorous re-basing of regulatory philosophy
- discarding of fashionable ideas that were found wanting
- a common-sense rebuilding of the prudential framework

You do not have to agree with every finding or recommendation to recognise the excellence of the analysis. More likely, you may ask yourself - much of this stuff is so good, and so sensible, why was it never said before?

Regulatory philosophy

“...the crisis also raises important questions about the intellectual assumptions on which previous regulatory approaches have largely been built”

A promising start - when confronted by unprecedented events which your world-view didn't see coming, at least question your assumptions! The review disdains cheap sound-bites, but its measured prose is surprisingly accessible (nor, you will be relieved to know, does it descend to the Listen with Mother language sometimes encountered in FSA CPs). And what is said about these previous assumptions - the key passage starts on page 39 - is little short of revolutionary. Step by step, the idolatry of *“efficient and rational”* markets is undermined.
Try these, for instance:

- Market efficiency does not imply market rationality.
- Individual rationality does not ensure collective rationality.
- Individual behaviour is not entirely rational.
- Allocative efficiency benefits have limits.
- Empirical evidence illustrates large scale herd effects and market overshoots.

And at a more practical level the review raises these other questions :

- Misplaced reliance on sophisticated maths: fixable deficiencies or inherent limitations?
- The failure of market discipline?
- Financial innovation: rent extraction rather than value added?

Perhaps most worrying of all to the denizens of the City:

“The future world of banking probably will and should be one of lower average return on equity but significantly lower risk to shareholders as well as to depositors.”

Building societies, which are not driven by earnings per share, but regard the safety of their members' savings as paramount, can readily go along with this provided its practical expression avoids overkill. And we will also be vigilant to ensure that the translation of the review's high-level prescriptions into working-level policy doesn't try to fit everything just to the PLC mould. Instead, we will expect FSA to embed the thinking on mutuals from text-box 3.9 of the Chancellor's Budget Report.

Proposals for reform

While the analysis in Chapter 1 of the review rightly challenges much of the orthodoxy to which FSA hitherto subscribed, Chapter 2 prefigures major demands on deposit-takers, as prudential requirements, especially for capital and liquidity, are going to get tougher. As Turner says later on:

> *"The crucial trade-off ...is between a small net cost to the economy during 'normal times' and the benefits of the reduced probability of extreme adverse events."*

After the events of 2007-8, taxpayers will not accept further socialisation of banking risks, so the challenge is to improve prudential regulation so that it is smart and efficient rather than blunt and wasteful. And here, Turner tosses in this depth charge for good measure:

> *"The fundamental question which international debates on bank capital adequacy have therefore never answered and indeed hardly addressed is what overall level of bank capital is optimal."*

What - all these years spent on Basel 2 and we don't even know if it produced the right answer? (Indeed, given the widespread release of capital under Basel 2, was it actually taking us in the wrong direction? Turner is too well-bred to say. But another sacred cow slumps to the floor). Sensibly, FSA has now commissioned research to help us all get to the right answer, while pointing out the arguments that suggest that the optimal level should be higher than today's. And the review recognises that "*to avoid procyclical pressure on bank capital adequacy in the current economic downturn*" the transition has to be carefully phased - the same thought could, we suggest, be usefully applied to regulators' current craze for extreme stress-testing. Anyway, look out for the paper, promised for later in 2009, *"to stimulate debate on the optimal level of bank capital."*

The review comes down against separating casino from utility banking. We suspect the wider jury is still out on this one though if the casino bankers keep their heads down for a couple of years - no more flaming Ferraris - they may just get away with it. But the review sensibly highlights that if the casino activity is to stay within *"broad"* banks that take insured deposits, it needs shed-loads more capital to contain the risk to the rest of the financial system.

Some of the review's most profound insights lie in the *"macro-prudential area"* - the interplay between the policy on banks' capital and liquidity, and the economic consequences for the supply of credit to households and businesses in the wider world. Turner goes beyond curing the procyclicality of Basel 2 to call for explicitly counter-cyclical capital buffers. In the wicked old days this profit smoothing was done by *"transfers to inner reserves"* - remember those? - until they were deemed to be A Bad Thing, and then, to an extent, by general provisions (until the accounting ayatollahs stopped that too). As Turner delicately puts it:

> *"The essential challenge is therefore that the accounting regime which makes sense from the point of view of idiosyncratic risk and of the shareholders of banks operating in stable conditions is quite different from that which may be optimal when viewed from a regulatory, systemic and macro-prudential viewpoint. These different perspectives have in the past been the cause of some disagreements between accounting bodies and regulators on the appropriate way forward."*

Perhaps the regulatory understatement of the century!

So what comes next?

Expect a lot of discussion within and outside the banking industry, learned papers, expensive conferences, weighty responses winging their way to the North Colonnade, and the sound of axes being ground - plus further evidence-based output from FSA both on the optimal level of capital and on the question of product regulation. The debate will continue, and we are planning a seminar for mid-September at which societies can get to grips with the radical thinking that has inspired the Turner review.

The Turner review represents what is arguably the greatest change in regulatory philosophy since the creation of the FSA. Its final proposals may not please everyone, but at least it has asked the right questions in an open and intelligent way. We wish the Turner team well as the work moves on to the next stage.

i Access the Turner review and associated speeches and documents on the FSA's website **www.fsa.gov.uk** and the BSA's response(s) on our own website **www.bsa.org.uk**

i For more information on the Turner review, contact **Jeremy Palmer** on **jeremy.palmer@bsa.org.uk**

NEW RULES FOR RETAIL BANKING

BY ANDREW HOPKINS, POLICY ADVISER, BSA

ON 1 NOVEMBER 2009, THE FSA WILL INTRODUCE THE BANKING: CONDUCT OF BUSINESS SOURCEBOOK (BCOBS) WHICH WILL PROVIDE NEW RULES FOR RETAIL BANKING.

Retail banking includes the sale of current and savings accounts and credit products. Responsibility for retail banking regulation is split between the FSA covering deposit taking under the Financial Services and Markets Act 2000 and the OFT covering credit products under the Consumer Credit Act 1974.

The FSA has been responsible for retail deposit regulation since 2001. However, it has not produced comprehensive rules in this area except where required to do so under European law or where it has been necessary to deliver specific consumer outcomes. Instead, detailed rules on retail banking conduct of business have been provided under the Banking Code and the Banking Code Standards Board (BCSB). The BCSB monitors and enforces most of the FSA applicable rules on its behalf for firms that subscribe to the Banking Code.

From November, the BCSB will lose this role. This has major implications for the Banking Code and the BCSB and Robert Skinner outlines the future of the Banking Code and the BCSB in his article on page 13.

Regulatory double jeopardy?

The introduction of BCOBS follows a FSA review last year on the current regulatory arrangements for retail banking and a consultation on proposals for change. While the FSA review confirmed that the Banking Code's scope is broadly correct and the BCSB monitors and enforces effectively, it was felt that the BCSB regulatory approach is less principles-based and transparent than the FSA's approach. In addition, the FSA believes that deterrence may be limited by the fact that the BCSB does not have the power to fine.

The BSA responded to the FSA's consultation on proposed changes to the regulatory arrangements in February 2009. The BSA expressed concern that the split of retail banking regulation between the FSA and OFT would cause confusion for firms and consumers and risked regulatory double jeopardy. For example, current accounts would be regulated by the FSA where the account is in credit, but would fall under OFT jurisdiction when the account is in overdraft. Both regulators also have jurisdiction over matters relating to customers in financial difficulties. The FSA acknowledges this concern and proposes to enter into a memorandum of understanding with the OFT to clearly set out their respective roles and jurisdiction.

Guidance

Now that BCOBS is set to go ahead, the BSA is committed to make its implementation as smooth as possible. The BSA, together with the British Bankers' Association is currently drafting detailed guidance for building societies and banks on how to comply with BCOBS. The guidance should be available in July and is expected to be approved by the FSA. The guidance will be based, wherever possible, on the existing requirements in the Banking Code.

A number of issues need to be resolved before full implementation is possible. The FSA is planning a further consultation in July on transitional arrangements and the possible extension of Payment Services Regulation requirements to BCOBS products and services. The BSA will remain actively involved in discussions with the FSA up to and beyond November. Societies should be gearing up for the regulatory regime change now.

i For more information on these changes, contact **Andrew Hopkins** at **andrew.hopkins@bsa.org.uk**

THE LENDING STANDARDS BOARD

BY ROBERT SKINNER, CHIEF EXECUTIVE, BANKING CODE STANDARDS BOARD

IN HIS ARTICLE ON PAGE 12, ANDREW HOPKINS REPORTS ON THE FSA'S DECISION TO IMPLEMENT BCOBS WHICH WILL REPLACE THE DEPOSIT AND PAYMENTS PROVISIONS WITHIN THE CURRENT BANKING AND BUSINESS BANKING CODES FROM NOVEMBER 2009. BUT WHERE DOES THIS LEAVE CONDUCT OF BUSINESS REGULATION FOR CREDIT PRODUCTS?

Maintaining consumer protection

A number of key stakeholders, in responding to the FSA's consultation, highlighted a need to ensure that the consumer protection afforded by the existing provisions in the current Banking Codes relating to credit products, and the Banking Code Standards Board's monitoring and enforcement, should not be weakened as a result of the implementation of BCOBS.

Responding to these concerns, the BCSB Board, in consultation with the industry bodies, has agreed proposals to provide continued monitoring and enforcement of lending and credit card standards, including those governing the treatment of customers in financial difficulties.

> THE BCSB BOARD, IN CONSULTATION WITH THE INDUSTRY BODIES, HAS AGREED PROPOSALS TO PROVIDE CONTINUED MONITORING AND ENFORCEMENT OF LENDING AND CREDIT CARD STANDARDS, INCLUDING THOSE GOVERNING THE TREATMENT OF CUSTOMERS IN FINANCIAL DIFFICULTIES

The BCSB will be renamed the Lending Standards Board (LSB), which will utilise existing resources and expertise. The LSB will begin operations on 1 November 2009 following the transfer of the BCSB's existing responsibilities for deposit and payments products to the FSA.

Transformation

The LSB will continue to operate independently of the industry and be governed by a board of directors, a majority of whom will be independent "public interest" directors. The Lending Standards to be monitored will cover all unsecured lending products that fall within the scope of the existing Banking Code - overdrafts, loans, and credit cards; there will therefore be no dilution of coverage. Additionally, secured lending to small businesses, currently covered by the Business Banking Code, will also be covered.

Industry guidance

The Lending Standards will be contained within a section of the "Industry Guidance" document being drafted to sit alongside BCOBS. The Standards will incorporate all relevant existing Banking Code requirements (including card industry Best Practice Guidelines and the BBA Statement of Principles), plus any new measures resulting from agreements reached with the industry in the current discussions at BERR's Consumer Finance Forum.

The LSB will oversee periodic reviews of the Lending Standards for negotiation with the sponsoring industry bodies, who will own the standards. The first formal review will be for implementation in March 2011 i.e. three years from the previous Banking Code review. An LSB Consumer Forum will be established to ensure full engagement with consumer and debt advice bodies.

The Board hopes that all existing Banking Code subscribers (banks, building societies and card providers) who provide credit products within the scope of the LSB will continue to be covered by these monitoring and enforcement arrangements, to ensure that there is no dilution of existing protection and that the concerns of stakeholders are satisfied. The BCSB will be contacting all subscribers who provide credit products to discuss the new arrangements in more detail. We expect that those subscribers who do not provide unsecured lending products will resign from our register at the end of October and our Relationship Managers will liaise with firms regarding this.

i For further information on the Lending Standards Board, please contact **Robert Skinner** on 020 7012 0085 or **robertskinner@bcsb.org.uk**

Payment Services Directive
21 July 2009, London

The Payment Services Directive, as implemented by the Payment Services Regulations (PSR), will come into effect on 1 November 2009. This half-day event will provide guidance to societies from both legal and FSA experts.

An Introduction to Treasury Management
2 September 2009, London

Aimed at non-executive directors and senior management as well as those who have recently started work in treasury or related areas, this workshop assumes no previous knowledge or experience of treasury management.

Treasury Risk Management
3 September 2009, London

This workshop is designed to further participants' knowledge and understanding of treasury management. It is aimed at non-executive directors and senior management with a basic knowledge of the subject.

Audit and Accounting Seminar
1 October 2009, Leicester

In a highly specialist and regulated sector it is important for firms and auditors to keep up to date. Regulatory, auditing and accounting requirements are constantly changing and this seminar provides a summary of the key implications of such changes for societies.

BSA Annual Lecture
13 October 2009, London

The Annual Lecture, sponsored by Collins Stewart ISTC, provides an excellent opportunity for networking with building society executives, representatives from regulators, government, trade associations, the media and others with an interest in the sector.

Annual Conference
20-21 May 2009

If you missed the conference, many of the highlights are featured in this specially commissioned BSA TV News DVD, producing by NICE TV and ITN Consulting.

The programme also includes interviews with Adrian Coles and John Goodfellow, 'vox pops' with participants, and much more.

i If your DVD is missing, please contact **charlotte.bell@bsa.org.uk**

BSA Annual Lunch
12 November 2009, London

The Annual Lunch, sponsored by Legal & General, is a popular networking event that attracts around 170 guests from building societies, suppliers to the sector, regulators, government, trade associations, the media and other organisations.

Seminar for Chairmen of Audit Committees
19 November 2009, London

This seminar will update chairmen of audit committees on their key duties and responsibilities, and provide practical advice on how they should fulfil their responsibilities.

Seminar for New Directors of Building Societies
3 December 2009, London

Designed for newly appointed directors, the programme covers issues such as competitive pressures facing societies, the regulatory and legislative framework, the role of the board, systems of control, and financial policy issues.

Seminar for Established Directors of Building Societies
10 December 2009, London

This seminar provides directors with an update on matters affecting the sector and enables participants to exchange views and ideas on strategic issues.

i For more information on our events, visit **www.bsa.org.uk/events** or contact **christie.sharp@bsa.org.uk or charlotte.bell@bsa.org.uk**

OUTSOURCING IT SERVICES THROUGH HML

HML
the **ability** in financial outsourcing

With building society mergers the order of the day, operations managers face some tough challenges, particularly in the IT department. Integrating two or more systems and processing platforms is a complex, time-consuming and costly process. The integration must remove cost and maximise service quality, while guaranteeing full regulatory compliance, with no interruption to operations during the transition.

Frequently, legacy systems are mutually incompatible, although use of middleware and open systems architecture can help build the links between the platforms. But before beginning the process, management needs to consider the options available. This is particularly important in an environment where investment spend is under pressure but the business needs to be in good shape for when market conditions improve.

One potential option that avoids a lot of IT integration work is the outsourced solution. This is not only cost effective, but can allow the society to 'leapfrog' in terms of the quality and sophistication of their IT platform and processes, collections and arrears management, and service delivery.

As the UK's leading financial outsourcer, HML can support and advise societies as they make these vital decisions. With our roots in the mutual sector, but extensive experience with banks, we can offer a wide range of tailored solutions offering world class services at a highly cost effective price.

Recent developments include a series of important IT initiatives, the launch of special servicing and the purchase of a sophisticated analytics business. This is supported by a continuous improvement programme delivered using Lean tools and techniques, with initiatives to strengthen staff engagement and steadily raise the level of the service provided to clients.

As building society management teams face the challenge of successfully integrating two businesses against a backdrop of increasing regulation and pressure on costs, an outsourced solution has much to recommend it.

i For more information please contact **Neil Warman,**
Chief Commercial & Finance Officer, HML
neil.warman@hml.co.uk
Tel: 01756 692000

Want to be better connected with the building society sector?

Building Societies Association

Join the BSA as an Associate

Much of the material the BSA produces for its members will be of interest and use to professional firms which advise societies, to organisations that supply services to building societies and to institutions with a similar constitution to that of societies, such as mutually owned insurance companies, banks and friendly societies.

What are the benefits of Associateship?

Information, help and guidance

Associates receive all the BSA's Circulars, providing information on policy developments, are able to attend most of the BSA's seminars, as well as its Annual Conference, Annual Lecture and Annual Lunch, at members' prices.

Associates are able to access members-only resources on the BSA website, which are organised by policy area for easy search and selection. The members-only section, updated daily, contains unique website-only content, such as policy briefs that summarise developments on policy work, and a complete archive of circulars that can be searched by subject, author or date.

As well as receiving research reports and having access to the electronic manuals produced by the Association, Associates are able to contact the Association's staff for help and guidance and also make use our library.

Publicity

A link to each Associate's company website is placed on the BSA's website. We also tell our members, and others, that a new Associate has joined by putting an item in our monthly newsletter, Newsbite, and this magazine, Society Matters – see the above article for an example.

Networking

We also seek to give Associates networking opportunities; first refusal on sponsorships, for example, if these become available; occasional invitations to BSA Chairman's lunches, and the opportunity to run joint seminars with the BSA.

i For more information on becoming an Associate of the BSA, please contact **Keeley Baker** at **keeley.baker@bsa.org.uk**