Financial Services Future Regulatory Framework Review

Response to HM Treasury Phase II Consultation Paper

February 2021

Building Societies Association

Introduction and summary

BSA welcomes the Treasury's well-considered and sensible proposals in Phase II of the FRF Review. From the perspective of BSA members, we fully support the overall approach set out in the CP, which aligns closely with what the BSA has been calling for since late 2016, as outlined in our response to the Phase I consultation in late 2019. We set out below our general positive comments on the paper, respond to the specific consultation questions, and then address certain wider issues, including matters specific to our members - building societies and some large credit unions. In doing so, we advocate some improvements to the UK regime, so that the UK can truly "build back better", as well as "taking back control".

Context

The BSA represents all 43 building societies and six large credit unions, all of which are dual-regulated by the PRA (as deposit takers) and the FCA, while HM Treasury is responsible for their constitutional legislation. BSA members are also subject to the jurisdiction of the Financial Ombudsman Service, which through its decisions can function as a quasi-regulator. Some building societies and credit unions may also come under the Payment Systems Regulator in respect of payment accounts. BSA members collectively serve 25 million customers across the UK.

General comments

We are in complete agreement with the central message of the CP as summed up in this paragraph from[1] the CP's executive summary:

> *The Financial Services and Markets Act 2000 (FSMA), and the model of regulation introduced by that Act, continue to sit at the centre of the UK's regulatory framework. The government believes that this model, which delegates the setting of regulatory standards to expert, independent regulators that work within an overall policy framework set by government and Parliament, continues to be the most effective way of delivering a stable, fair and prosperous financial services sector. The model maximises the use of expertise in the policy-making process by allowing regulators with day-to-day experience of supervising financial services firms to bring that real-world experience into the design of regulatory standards. It also allows regulators to flex and update those standards efficiently in order to respond quickly to changing market conditions and emerging risks.*

[1] CP page 4

We also agree with the CP's following diagnosis[2] of the problem:

But the UK's membership of the EU has complicated the operation of the FSMA model. The EU approach to regulation of financial services involves detailed regulatory standards being set in legislation applying across Member States in order to facilitate a single market in financial services. Increasing EU competence for financial services regulation has therefore moved the UK's regulatory framework away from the model based on delegation of standard setting to regulators. To a great extent, the EU approach to regulation is preserved in the 'onshoring' of EU legislation. The vast bulk of EU directly applicable legislation for financial services will now sit on the UK statute book, with amendments made to ensure this legislation works effectively in a UK standalone regime. There are significant disadvantages to this approach. It means primary responsibility for designing and maintaining regulatory standards is removed from the expertise that is concentrated in UK regulators. And as regulatory standards are set in legislation, it is difficult to flex or update these standards quickly in order to respond to changing conditions. It has led to an unclear allocation of responsibilities across Parliament, HM Treasury and the regulators and resulted in a fragmented rulebook for firms, with regulatory requirements spread across different forms of legislation as well as regulator rules.

Finally, looking to the future, **we are fully in support of the proposed way forward** as expressed in the CP[3] :

While the onshored regime for financial services will provide a smooth transition to the UK's new position outside of the EU, minimising disruption for firms and consumers by providing continuity around the regulatory requirements themselves, this structure is not intended to provide the long-term approach for regulation of financial services in the UK. The government sees the UK's departure from the EU as an important opportunity to review our framework arrangements and ensure that we have an overall approach to regulation of financial services which is right for the UK. The government believes this would be best achieved by building on the strengths of the FSMA model as it was originally intended to operate, making important adaptations that will facilitate appropriate policy input by government and Parliament.

We would also underline several high-level issues some of which can be progressed better, smarter and more expeditiously under the FSMA architecture than under the EU regime as hitherto.

First, countering the **dispersion of regulatory material across many different instruments and texts** – so, for instance, regarding prudential material, this may be found in several directly effective EU regulations; UK implementation measures for EU directives; delegated Acts; an assortment of Level 2 texts – typically "technical standards" (ITS or RTS) from the EBA, all alongside PRA rules, guidance, and supervisory statements. We therefore strongly support the aspiration mentioned on page 23 of the CP:

Exit from the EU offers an opportunity to rationalise rulebooks and make them easier to work with. The post-EU framework proposal aims to bring about, as much as possible, a single source of requirements for firms – the regulators' rulebooks. And those regulatory requirements can be designed and expressed

[2] ibid pages 4-5

[3] ibid page 5

in ways best suited to UK circumstances. Rationalising the regime in this way would be delivered gradually over time.

We recognise this cannot happen overnight. But it is absolutely the right objective. Some of the first tentative steps in this direction in PRA's CP 5/21 are also to be welcomed.

Second, establishing a **more genuinely proportionate, and appropriate, prudential regime for smaller, simpler domestic firms** – hitherto blocked by the EU's "single rule book" ideology. We have separately welcomed the PRA's thinking in this regard, expressed in a ground breaking speech[4] **"Strong and simple"** by the PRA's CEO Sam Woods in November, and the FSMA-based approach should facilitate this.

Third, we draw attention to a possible lacuna in the treatment of **competition as a secondary objective of the PRA**. While the PRA was established initially as a separate body, since 2016[5] it has been fully part of the Bank of England, not a subsidiary. What seems odd is that its secondary competition objective was not extended to other areas of the Bank's activity – and this could now be remedied. At present, senior Bank officials must experience something of a split personality as - when constituted as the PRC- they must have regard to the competition objective, but when acting –say, as the resolution authority, they do not. It may be that some functions of the Bank (e.g. the Issue Department, and sanctions administration) should not have any specific competition objective, but other, policy areas probably should, at least in some cases. We think this should now be clarified and made explicit.

We now draw attention to several other points where either the scope of the FRF Review is not quite wide enough, or the matters – though covered in Phase I – are of such general importance that the key points need to be recapitulated here.

In the first category is the question of the role and impact of the **Financial Ombudsman Service (FOS)**, which though established and designed as a mechanism for alternative dispute resolution (ADR), has come to function through interaction with other conduct regulation as a quasi-regulator in its own right, but without the necessary safeguards. During the passage of FSMA in 1998-2000, one of the difficult issues was whether, and how, to make Ombudsman decisions final and binding on the firm, (though not binding on the complainant), and at the same time to exclude the jurisdiction of the courts (again, asymmetrically -as the complainant's recourse to the courts is unaffected – only the firm is denied recourse), so giving rise to a potential problem under the European Convention on Human Rights (ECHR) . Twenty years on, it is timely to re-examine whether this situation is still appropriate, whether a proper appeal mechanism should be introduced, and whether – given the quasi-regulatory effect Ombudsman rulings can develop – the FOS should also be, for instance, subject to the regulatory principles.

While still on the subject of conduct regulation, we propose that **National Savings & Investments** (NS&I) should become subject to FCA conduct regulation of its deposits products in the same way as all other savings providers. Clearly there is no need for prudential regulation, as NS&I constitutes sovereign UK risk, but following recent behaviours by NS&I – with market leading savings rates introduced and

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[4] Speech given by Sam Woods at Mansion House, London 12 November 2020

[5] Bank of England and Financial Services Act 2016

then rapidly cut, so benefitting from customer inertia – we can see no good reason for NS&I to remain exempt from conduct regulation, and the current regulatory lacuna is a big concern for our members.

From the perspective of competition, NS&I's interventions in the cash savings market are as disruptive as they are unpredictable. For example, in the third quarter of 2020 it had inflows of £24 billion, a ~66% share of new deposits from households. In the fourth quarter, when it promulgated drastic interest rate cuts across its product range there were big net outflows from NS&I of (minus) £9 bn. As well as the swings in market share, NS&I's forays have a disruptive impact on pricing as private sector deposit takers must each factor NS&I distortions into their retention strategy, particularly if they happen to have a fixed rate bond maturing at the same time as NS&I price changes. (Given their statutory reliance on retail deposits, this affects building societies even more than banks.) With NS&I's products backed by a 100% government guarantee, it competes in the same market as our members but does not play by the same rules. The fact that NS&I is not bound by FCA conduct rules means that it gets away with standards of customer care and processes that we consider would not pass muster in the regulated private sector. Unlike banks and building societies, NS&I is not in-scope of initiatives, such as the FCA cash savings market study and the remedies which flowed from that, so it would not have been required to implement the single easy access rate for savings accounts (SEAR), a major policy intervention for the rest of the market.

While still on the subject of **cash, savings and payments**, we draw attention to the serious failings exposed by the **Wirecard disaster**. The Treasury is already addressing one aspect through the concurrent proposals to establish a special administration regime for payment firms and electronic money institutions (ELMIs). As that consultation[6] made clear:

The Government is proposing to introduce changes that will help protect customers in the event of a payment or electronic money institution being put into insolvency. This will in turn strengthen confidence in the payment and e-money sectors by improving customer and market outcomes.

We have supported this initiative, but the problem goes wider, as the consultation document itself made clear, opening indeed a "can of worms". There have been several failures, of which Wirecard is only the most spectacular, and the common thread is that normal insolvency processes proved far too slow in getting the frozen assets realised and distributed. Underneath this, the whole EU-derived structure by which thinly - capitalised ELMIs and payment firms handle massive flows of funds has been found wanting - it appears the assets are not effectively held on trust for the customers, so they are not bankruptcy remote; the EU's insurance alternative is suspect; and the customer record keeping is poor. Above all, operational resilience is clearly inadequate. Taken together, this poses a serious risk to financial stability. Given the very high standards of capital, operational resilience, and compensation to which proper deposit takers are held, the weaknesses in this area of shadow banking are both astonishing and lamentable. Tougher regulation is necessary, now the UK is free of the EU straitjacket on ELMIs etc. Indeed, even within the EU, countries such as Germany, where Wirecard is based, have realised that the current regimes are woefully inadequate, and new legislation[7] is under way.

[6] https://www.gov.uk/government/consultations/insolvency-changes-for-payment-and-electronic-money-institutions-consultation

[7] *Finanzmarktintegritätsstärkungsgesetz* October 2020.

Turning to **coordination and possible overlaps**, especially in the area of competition, we said in our first response:

There are significant overlaps among the horizontal and vertical provisions; for example, the FCA and the PSR have competition enforcement remits, as does the CMA. The CMA will often engage in an initiative that overlaps the FCA's competition remit, such as loyalty penalties and SVR switching. This potential for overlap is also true in relation to other areas, such as fairness of consumer contract terms. And there are also, no doubt, personal motivations and organisational rather than policy pressures that lead to dysfunctional land-grabs and turf wars.

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Therefore, in view of the fact that the FCA regulates the conduct of financial services firms, including competition requirements, we believe that (within its regulatory perimeter) it should be solely responsible for regulation and enforcement (without concurrent jurisdiction from the CMA). However, because of the specialised nature of its work, and its close association with the FCA, we believe that the PSR should maintain its existing competition responsibilities

The BSA continues to advocate this simplification of regulatory boundaries and overlaps.

Another area needing simplification is in the **regulation of claims management activity**. Currently, this is done by three separate regulators: mainstream claims management companies are now regulated by the FCA, while solicitors undertaking claims management activity are regulated instead by the Solicitors Regulation Authority; and barristers by the Bar Standards Board. While these recognised professional bodies (RPBs) no doubt also seek the best outcomes for consumers, the patchwork of regulation is unfortunate – we advocate bringing all claims management activity (at least, in relation to financial services) by these other practitioners also under FCA regulation- to ensure consistency, create certainty for consumers using these services and ultimately achieve better customer outcomes.

Finally, we recapitulate arguments we have previously presented to Government over a lacuna in the regulation of **insolvency practitioners (IPs) undertaking debt advice or debt management activity**. Where this is undertaken in the context of an IVA or equivalent, the IP is exempted from FCA regulation. This exemption has clearly been abused, most recently in the serious Creditfix episode in mid-2020. Failure to address this lacuna also risks undermining the success of "Breathing Space".

Added weight in support of our advocacy comes from the recent, and excellent, Woolard review of unsecured credit published[8] and adopted by the FCA: placing special emphasis on the immediate post-pandemic needs, the review states (page 7):

To ensure that the imminent demand for debt solutions as a result of the pandemic is met, the FCA must without delay coordinate with the UK government, devolved administrations and insolvency regulators to ensure that suitable debt solutions are available to best serve people in financial difficulties. This should include identifying quick actions to remove or reduce barriers to accessing suitable solutions (including fees) and steps to reduce consumers being driven towards unsuitable solutions (including the role that marketing plays in this). Across the UK there are multiple regulators covering different aspects of debt advice and debt solutions and it is essential that this does not lead to divergent outcomes for

[8] A review of change and innovation in the Unsecured Credit Market (The Woolard Review)

consumers who are in financial difficulties. The FCA, Insolvency Service and Accountant in Bankruptcy (Scotland), with support from government, must cooperate to swiftly remedy the issues that can be observed in the Individual Voluntary Arrangement (IVA) and Protected Trust Deed (PTD) market (neither IVAs or PTDs are regulated by the FCA). This should include close attention to problems created by the fee structure of IVA/PTD products on debt advice and lead generators. In the longer-term, the FCA should collaborate with these bodies to create a coherent and consistent vision of the debt solution market and a plan to bring this about.

Privately, there is recognition that the whole area of IVAs/PTDs, and particularly the commission-driven marketing of insolvency solutions, is dysfunctional. A good example of abuse comes from two[9] recent rulings by the Advertising Standards Authority:

- Five paid-for internet search ads and a website ad for one "debt advice service" were banned for misleadingly suggesting their service was endorsed by Government bodies and for suggesting they were qualified to provide debt counselling despite not being authorised by the FCA as experts in this field.
- A paid-for internet search ad and a website ad for another "debt advice service" were banned for exaggerating the speed and ease with which debt could be reduced, and for misleadingly suggesting associations with a debt charity and the Government.
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All these matters continue to deserve attention in order to **"build back better"**.

Responses to key questions

[Box 2.A – page 25]

1 How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK's position outside of the EU?

Broadly, yes. The FSMA model was the result of extensive and careful design and consultation during 1997-2000. It has moreover adapted fairly well to the expansion of the regulatory perimeter as other activities (mortgages, insurance mediation, consumer credit, for example) have subsequently been brought under full regulation. It is the right model to build on for the future.

2 What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:

• What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?

The approach set out in paragraphs 2.24-2.26 is fundamentally the right one, as we have repeatedly advocated since 2016. In particular, the framework, architecture and scope/perimeter should continue to be set by Parliament through primary or secondary legislation drawn up by HM Treasury, along with any involvement of the criminal law, rights of appeal, and so on. But we agree with the CP that:

This would mean that the vast bulk of retained EU provisions would be transferred to regulator rulebooks. The default approach would be for any retained EU law provision that is in scope of the regulators' FSMA rule-making

[9] Fidelitas Group Ltd and National Direct Service t/a Step Debt Support , both rulings published by ASA 27 January 2021

powers to be taken off the statute book to become the responsibility of the appropriate regulator. FSMA already confers broad rule-making powers on the PRA and FCA and therefore no significant reform of regulator powers should be needed for this transfer of responsibility.

• *What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?*

We support this move. We have seen, from time to time, in areas such as the housing and mortgage markets that sub-optimal policies may emerge from either regulator precisely because of either a lack of awareness of current public policy objectives, or a reluctance to let them influence policy at all. Examples of this include the FSA/PRA's previous resistance to self-build at a time when this was positively encouraged at Government level. That is not to say that either prudential or conduct policy should be enslaved to passing political fashions. But a framework for wider public policy considerations (relevant to an area of activity) to be taken into account in policy making is desirable. Indeed, such a framework could be positively helpful to the regulators themselves – as it will allow them to reflect these policy considerations transparently, and in their own right, rather than stretching credulity by having to claim that they can be separately justified in terms purely of prudential or conduct risk.

A useful example is the now-established policy that systemic or near-systemic retail banks must be ring-fenced to safeguard financial stability. This was legislated for after extensive thought and consultation starting with the work[10] in 2010-2011 of the Independent Commission on Banking – another piece of "regulatory repair" after the last financial crisis. The UK, acting early, established a clear and successful compromise, requiring the ring-fencing of large retail deposit entities within the largest banking groups, and this has now been effected. (By contrast, the EU's belated attempt to cover the same ground, its banking structural reform proposal, only got going in 2014, by which time France and Germany as well as the UK were taking their own unilateral measures, and the EU proposal had to be quietly abandoned in 2018.) We are aware that this area of policy is due to have its own separate review later in 2021, to which we look forward to contributing. Suffice it for now simply to underline that the principle of ring-fencing must be carried through, and respected, in all relevant prudential or resilience measures – including apparent technicalities e.g. the level of application of capital constraints such as IRB floors. This principle dictates that these protections have to be applied at the level of the ring fenced entity itself – anything else makes a mockery of ring-fencing.

• *Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?*

We have no particular preference but the current manner in which both PRA and FCA outline how they have had regard to the existing principles should serve the purpose: the content is really more important than the presentation. As to substance, it remains essential that **"having regard" is built into policymaking from the beginning, and not just a matter of some spray-on explanatory text at the end of the process**.

3 ***Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?***

The existing obligation on both PRA and FCA to take account of differences between PLCs and mutuals –added to FSMA as a main regulatory principle at the BSA's instigation through the Bank of England & Financial Services Act 2016- has been a valuable check on the unquestioning PLC-based assumptions that would otherwise hold sway in policy space. But this approach should be enhanced in two ways. First, strengthened to say that PRA or FCA rule-making should afford and embody **parity of esteem and treatment to mutual/cooperative models** alongside PLCs and not be exclusively built on a PLC mind set with mutuals as a tick-box afterthought. Second, its scope should be widened. In particular it should apply to the Bank of England in certain other capacities, such as that of Resolution Authority, as it already does in its manifestation as the PRA.

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[10] ICB : Final Report

4 Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

We don't have strong views, but clarity of purpose is preferable, so the fewer objectives generally the better. The idea of activity specific regulatory principles is also a good one, so long as "activity" also takes account of business models.

5 Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

There is no real need for such consideration as FSMA isn't broken. No egregiously superior foreign model comes to mind – but if there are some good specific ideas that could be grafted onto the FSMA model, they can be considered on their merits.

[Box 3.A – page 38]

6 *Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?*

Paragraph 3.12 of the CP covers the right ground. Within that field, we do think the openness and accountability of certain aspects of the Bank's Financial Policy Committee's work could be improved – where, as macroprudential regulator it makes high-level decisions (such as its work on mortgage market tools) that then cascade down through PRA and FCA rules. There should be more formalised calls for input/evidence, clarity of process, and-perhaps – hearings on the outcomes.

7 *How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?*

We broadly agree with what is outlined in CP paras 3.4 to 3.22. Parliament should address strategic and macro-prudential matters, while we have learned from the EU experience not to over-politicise micro-regulation. See also our remarks on the FPC above.

8 *What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?*

We broadly agree with paragraphs 3.23 to 3.29 of CP.

9 *Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?*

Yes. There is an unresolved issue left over from EU policy-making which is how to have appropriate stakeholder consultation before the UK agrees to future changes to international frameworks such as Basel. When the UK authorities "consult" (post facto) on the implementation of – say – Basel 4, this is essentially perfunctory, as the fundamental decision has already been made. But in such cases there has been no stakeholder, or Parliamentary mandate for what the UK signs up to.

The EU process, for all its faults, recognised this accountability deficit, as the European Parliament was ready to depart from Basel where needed to recognise European specificities (such as the SME factor, and loan splitting). **What is needed in the UK is consultation on the mandate for future changes, at e.g. Basel, *before* the UK agrees to anything. "Consultation" after the event, with the outcome pre-decided at big picture level, is a time-wasting and misleading charade.**

Other issues relevant to our members

An important part of the overall regulatory framework for both building societies and credit unions is their governing legislation – **the Building Societies Act 1986 and the Credit Unions Act 1979**. Managing the operation and evolution of this legislation involves coordination between HM Treasury and both PRA and FCA. Experience here has been broadly positive. There has been evolution under both pieces of legislation, for instance:

- for building societies, updates to the Building Societies Act (made by the Financial Services (Banking Reform) Act 2013, Sch.9) inter alia modified the application of the funding nature limit to SME deposits; and
- for credit unions, several useful modernisations to the Credit Unions Act were made by a Legislative Reform Order in 2011, that facilitated the offer of new services to members.

But in neither case can this legislation stand still – both credit unions and building societies need to compete and innovate in the real marketplace -not in some Hovis-advert view of the world. **We outline below some of the steps which are now necessary**, again requiring coordination between HM Treasury, PRA and FCA.

Building societies legislation

For building societies, a range of amendments to the Building Societies Act are called for. While the general framework of the 1986 Act, as amended by the 1997 Act, has stood the test of time, some modifications, often using secondary legislation enabling powers already available in the 1986 Act, are necessary.

The most important group, which will need primary legislation, involves further modification of the **funding nature limit**. These would allow societies to serve small businesses better, to innovate in response to the growing prevalence of savings platforms, and to facilitate the operation of Sharesave plans and the holding of tenancy deposits. The question of savings platforms is likely to be the most important and have the widest application.

There are other, unrelated changes, some of which have been called for previously, which are set out in the Annex at the end of our previous response[11] to the FRF Phase I consultation. We, and our affected members, are happy to provide further information/assistance to Treasury officials on any of these items.

In analysing the four individual funding limit modifications below, we first approach along the route already mapped out in 2013 for amending section 7 by way of partial disregards. However, we set out below a more logical and satisfactory way to amend section 7, to embody the principle of "looking through" (for nature limit purposes) pooled deposit arrangements to the individual customers whose money it is.

1. **Extend special treatment of SME deposits**: in 2013, a change to section 7 of the Building Societies Act introduced a partial disregard for SME deposits when calculating the minimum 50% member funding limit. Deposits from SMEs that are incorporated small businesses each with a turnover of less than £1 million can be disregarded up to an aggregate amount of 10% SDL - see section 7 (3) (aa), (3A) and (10). There are a range of SME thresholds in different areas of legislation, some UK-based, some EU derived. The £1 million turnover is at the lower end. So we advocate raising the section 7 figure to one of the higher existing thresholds - a particularly suitable one, we think, might be the turnover limit of £6.5 million for an SME whose deposits (like those of individuals) must be held within the ring fenced entity of a High St banking group and not on the wholesale/investment bank side.

   This change would not in fact need primary legislation, if using the partial disregard approach, as there is power in section 7(12) and (13) for the £1 million figure to be raised by negative resolution statutory instrument.

[11] https://www.bsa.org.uk/information/industry-responses/future-regulatory-framework

2. **Cater for deposits held through savings platforms**: as intermediation by savings platforms - such as Flagstone, Hargreaves Lansdown and similar- becomes more significant, the question of how the aggregate funds received by a society through the savings platform are treated for section 7 purposes becomes more important. BSA's understanding is that, while there are other structures, a typical structure is for the cash to be held in a kind of omnibus client account, with the society not informed under normal circumstances of the identity of the underlying savers as. not surprisingly, the platform wishes to keep the client relationship.

   Consequently, these clients do not become members, and the aggregate cash cannot be held in a share account, but is held as a non-member deposit and therefore - although the underlying cash is still from individual savers - must be treated as deposits that count against the 50% nature limit. One possible mitigation would be for a partial disregard similar to the SME example above. So, an aggregate amount of savings platform deposits up to, say, 10% SDL that would otherwise count against the 50% limit, could be disregarded. This would require a change to section 7 by primary legislation. As mentioned above, a more logical and thorough reform would be to "look through" to the underlying nature of the funds.

3. **Cater for deposits arising from Sharesave facilities**: Sharesave (previously/also known as Save As You Earn) is a tax-efficient cash saving scheme that encourages employees to save small amounts regularly towards buying shares in their company at a favourable option price. The Sharesave plan providers /administrators are typically the major company registrars, who don't hold banking licences, and therefore need to place the cash savings in a bank or building society account.

   The current regulations mean that a building society can only hold Sharesave deposits in a member share account whereas banks hold such deposits in 'pooled accounts'. The 'cost to serve' per customer for building societies is thus prohibitive, and in fact Sharesave deposits are highly concentrated in two or three High Street banks, so change would increase competition.

   This problem was first pointed out in 2016 and two changes are needed: first, an amendment to Sharesave regulations to allow a building society to hold Sharesave deposits in a pooled account, and either a similar amendment to section 7 to allow a certain amount of aggregate Sharesave deposits, which are beneficially owned by individuals, to be disregarded for the purposes of the section 7 limit, or more logically, a "look through" as described above.

4. **Tenancy deposits**: building societies are at a similar disadvantage when approached to accept deposits under the statutory Tenancy Deposit Scheme which protects tenants from abuse by landlords retaining such deposits. Equivalent changes are needed to allow building societies both to hold such deposits in pooled deposit accounts, and either for a certain aggregate amount of such deposits to be disregarded for section 7 purposes, or for a "look through" approach.

We envisage the "look through" approach working as follows: While the current approach in the section 7 amendments in 2013 disregards a certain amount of one category of funds from the calculation in section 7(2), a different amendment to section 7 could simply aggregate defined categories of SME or pooled deposit accounts with the total of shares (that is, Y in section 7 (2)). This would have the effect of treating these funds – for nature limit purposes only - as being in the same bucket as share accounts.

The common thread running through all these items (above, and in the previous Annex) is the need to adapt the detail of the Building Societies Act to cater for a range of situations in everyday life, in a way that benefits ordinary people and businesses by increasing competition and supporting innovation.

Credit unions legislation

For credit unions, the changes needed are both simpler and more far-reaching. Moreover, **the necessary work has already been started within Government, but appears to have been left unfinished**. In 2014, HM Treasury carried out an excellent and thorough review of credit union legislation, based on a **Call for Evidence: "British Credit Unions at 50**". In December 2014, after extensive engagement with the sector, the Treasury published its response[12] and conclusions.

In this response, the following point was made in the Key Messages from Government (paragraph 3.3):

However, the government is concerned that the legislative and regulatory framework may be unnecessarily holding back those that want to expand and innovate.

Later, the response states that:

The government recognises the credit union sector's calls for various revisions of the current legislation. In general, these legislative changes require primary legislation and will therefore need to be considered under the next parliament.

However, the government is today committing to consider potential changes to the legislation on credit unions in the next parliament, subject to the availability of an appropriate legislative vehicle.

The useful work done in the 2014 Call for Evidence, and the sound conclusions drawn by the Government, should not be ignored or discarded, but taken up and concluded. Further consultation on specific measures would be appropriate, but it would be unnecessary –indeed counter-productive - to start at the beginning and re-invent the wheel. The first item on the Government's list for legislative changes in December 2014 was to broaden credit unions' objects, to avoid sterile interpretational arguments about whether necessary new products and services fall within the scope of statutory objects and other provisions enacted in 1979. In particular, credit unions need to be clear that they can mediate basic personal or household insurance to members e.g. contents cover, separately from a loan, and finance cars through hire purchase or personal contract plans, not only through traditional unsecured personal loans. What is needed, to address the future regulatory framework *for credit unions,* is for Government to revisit the 2014 work, pick up the conclusions, and finish the job. The item at the top of the list, to broaden credit unions' objects, could readily be accommodated by a few lines in the forthcoming Financial Services Bill.

Other regulatory matters relevant to BSA members.

Access to Bank of England reserves accounts

Currently, all building societies are within the Sterling Monetary Framework (SMF) and have access to the Bank's reserve account facilities as well as its various collateralised liquidity facilities. This was not always the case - for very many years, only the largest societies had such access, and in turn fell within the scope of the cash ratio regime. In 2010, as part of the last major overhaul of deposit-takers' liquidity arrangements, this was extended to all societies. In fact, it is the reserves account which smaller societies find most useful, and it now forms a core part of their high, prudent holdings of HQLA (high-quality liquid assets).

The time has now come to extend this privilege further, at least to the largest credit unions (CUs). There are several reasons for this. Credit unions alone of all UK deposits takers have no access to a risk-free vehicle for their substantial liquidity. Holding gilts is not a suitable alternative, and credit unions' deposits with banks or building societies are way down the order of creditor preference, along with general unsecured Non-FSCS deposits, without even the secondary preference for top-slice deposits by individuals or SMEs.

Credit unions are not, we think, able to use qualifying money market funds (QMMFs), e.g. gilt funds, either. At the

[12] British credit unions at 50: response to the call for evidence

same time, the largest CUs are now larger than the smallest building society or bank, and currently hold very high liquidity. A sensible move would be to allow SMF access to credit unions above a certain size threshold. And at the same time to exclude their central bank deposits from the PRA's credit union capital calculation – as is already effectively done for banks and building societies. Credit unions admitted to the SMF would of course hold cash ratio deposits too. This modest permissive change would cost virtually nothing but provide massive reassurance to larger credit unions, and – more importantly – support their wider societal mission. We look forward to engaging with both Treasury and Bank of England on this small but necessary improvement.

Improvements to FSCS cover post-Brexit

Consideration of the unsuitable treatment of credit union deposits with banks or building societies reveals several easy quick win improvements that are possible following Brexit. The scope, boundaries and monetary limits of FSCS coverage are at present dictated by the amended Deposit Guarantee Schemes Directive, which – at the latest amendment in 2014 – brought in some changes that in the BSA's view were neither necessary nor sensible. First, directly relevant to credit unions, the loss of FSCS protection for their deposits with banks and building societies: even PRA admitted this was not a sensible change but was forced to implement it regardless.

At consultation stage: CP 20/14, October 2014 , page 7.

Consistent with the recast DGSD, credit unions' own funds placed with other deposit-takers will lose FSCS protection. This loss of protection may mean that their deposits are not returned in full in the event that another deposit-taker fails. Credit unions' own depositors will remain protected by the FSCS.

Feedback in policy statement: PS 6/15, April 2015 , page 4.

Concern was expressed by a number of respondents that credit unions' own deposits made on their own behalf and for their own account are no longer eligible for DGS protection under the PRA's proposed rules. While the PRA acknowledges this concern, the PRA considers that to continue to provide these funds with DGS protection would not be consistent with the recast DGSD. Therefore the PRA does not propose to change its proposals in this respect.

It would be a simple matter to reverse this, as DGSD is no longer binding.

More generally, bearing in mind that the UK has chosen (rightly, we think) not to pre-fund the FSCS as regards protection of bank deposits, it is all the more important that the resource available to finance any bank compensation calls is targeted and focused to the optimum extent. So we think it makes no sense to continue with **FSCS cover for large corporates**[13] – what looks like an egregious idiocy in the DGSD. Large corporates, like banks, building societies and other excluded categories, can manage their cash holdings in a more sophisticated way – with gilts, QMMFs and counterparty risk management. FSCS cover is unnecessary and pointless for corporates much larger than an SME, but it uses up scarce FSCS capacity. Treasury should take back control here, and could also take the opportunity to permanently delink the FSCS coverage limit from the Euro figure in DGSD, so avoiding the periodic changes which confuse consumers. Any change should be carefully planned to minimise operational difficulties.

Recovery and resolution post-Brexit

There are a couple of small sensible changes which could be addressed in the FRF review. First, the question whether – under BRRD demutualisation is a pre-condition for the resolution, with bail-in, of a large building society. In implementing[14] the bail-in provisions of BRRD in 2014/15 , Treasury advanced the argument - based,

[13] "Eligibility: Most large corporate depositors will now be eligible for deposit protection." https://www.bankofengland.co.uk/prudential-regulation/publication/2014/depositor-protection
[14] Bail-in powers implementation HMT, Dec2014

we consider, on an incorrect interpretation of BRRD - that it effectively mandated the demutualisation of a building society as part of the resolution and bail-in process. The BSA totally rejected this argument at the time, laid out in a closely-referenced note. The BSA has consistently maintained its opposition to the Treasury/Bank interpretation, although the prospect of any large society needing resolution has always been reassuringly remote and remains so. As a result the question was purely hypothetical. More recently however, large societies have been required to construct play-books and fire-drills and other materials to deal with resolution scenarios, and some societies understandably object to being required to do so on the basis of a false premise. The BSA will be returning to this ongoing campaign shortly.

The BSA has never opposed demutualisation in all circumstances - merely the incorrect view that it is a necessary precursor/accompaniment to resolution and bail-in. Indeed our principled opposition to that view made very clear that demutualisation could be a perfectly proper option in resolution of a society. Consistently with that view, we are also advancing a separate case for demutualisation to be facilitated, under narrowly defined conditions, at a much earlier stage of recovery, where it is felt to be the best available option. It is in no-one's interest that carrying out that option should be beset with a high level of execution risk due to the current procedures, and we are therefore calling for some limited legal facilitation –only in these very limited cases. In all normal conditions the protective procedures for demutualisation must remain intact.

Conclusion

We broadly welcome the substance of this CP, and commend the Treasury for having proposed many of the right solutions. We look forward to working intensively with all the relevant authorities on the various other matters raised in this response.

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We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £420 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.