Amendments to the Building Societies Act 1986

BSA response to HMT consultation

February 2022

Building Societies Association

Introduction and summary

The BSA **welcomes** the Government's proposals to amend the Building Societies Act 1986 ("the 1986 Act"), and **supports** the individual measures proposed, many of which derive from the BSA's own advocacy. We are pleased to respond to this consultation, and draw attention to a few **other amending measures** that the Treasury should address at the same time.

We welcome the Government's recognition of the **valuable contribution** building societies, with their mutual values and focus on members, make to the financial services scene. We agree with the Treasury that the **framework of the 1986 Act** remains broadly and fundamentally fit for purpose, but needs further **important but targeted updating**. That is also why we urge Treasury to undertake these additional measures to make the updating and **future-proofing of the Act as complete as possible**. In the broadest sense, that is the BSA's answer to Q7 posed in the consultation: ***How can the government best help building societies overcome these difficulties?***

While these additional measures mostly do not correspond to **existing enabling powers** in the 1986 Act, so not allowing for implementation by the conventional statutory instrument route, we urge the Treasury not to limit its ambition in this way. Some of the items may well be achievable using the delegated **Legislative Reform Order** route (now) under the Legislative and Regulatory Reform Act 2006. There are relevant precedents here from the mutual sector: the Deregulation (Building Societies) Order 1995; and the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011. But there may be some measures which will ultimately require **primary legislation** to effect satisfactory future-proofing: that too must not be ruled out.

Funding limit

We agree with the Government that the focus on longer term customer savings required by the funding limit remains an important feature of the building society model, and that the funding limit percentage (50%) does not need to be changed substantively at present. But various small modifications are needed to make the funding limit apply and work, effectively and optimally, under new circumstances.

Answer : Q5 – Yes, the outlined changes will continue to support the mutual model of building societies.

The Treasury's proposals will ease undesired constraints of the funding limit in three ways: (i) by excluding the funding derived either by using the Bank of England liquidity insurance facilities, or monetising high quality liquid assets by repo; (ii) excluding senior non-preferred debt (raised for MREL[1] purposes) in the same way that regulatory capital is already excluded; and (iii) widening the size range of SMEs whose deposits are excluded. All three are to be welcomed.

The first measure is precautionary: the Bank of England facilities referred to are indeed liquidity *insurance* - intended for use under liquidity stress rather than normal circumstances. But during a liquidity stress, it is clearly desirable that a society should not be inhibited from resorting, temporarily, to these facilities by the constraint of the funding limit.

The related measure on HQLA[2] repos is also very sensible: when using some of the high quality liquid assets, it is preferable to monetise them temporarily by a "repo" - sale and repurchase transaction – rather than by outright sale. But the repo technically counts against the funding limit. Again, it is clearly desirable that a society's use of its HQLA should not be constrained by the operation of the funding limit.

The second main measure simply extends to the new category of senior non-preferred debt, introduced specifically to help raise MREL (loss-absorbing) resources, the same treatment under the funding limit as has always applied to regulatory capital. This is really just a point of consistency.

The principle of the limited SME deposit disregard was introduced by a previous piece of legislative updating. The sensible change now proposed merely raises the upper size limit for SMEs whose deposits can benefit from this treatment to align with the size limit for SMEs that can do business with ring-fenced bank entities - another point of consistency. We suggest this is done in a way that automatically benefits from future increases in SME definition thresholds whether in companies or ring-fencing legislation.

Answers : Q1 – Yes ; Q2 – Yes ; Q3 – Yes; Q4 - Yes.

Future trends

Again, without making fundamental changes to the funding limit, we welcome the Treasury's readiness to consider future trends, and in particular the impact of technological developments that could impact on the operation of the funding limit : this is an essential part of future-proofing, as opposed to merely updating, legislation.

Answer to Q6 : Yes, there are future trends that we see as having potential to cause future funding difficulties for building societies in the next 4-5 years? For details see below.

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[1] Minimum Requirement for Eligible Liabilities (available for bail-in during resolution)

[2] High Quality Liquid Assets (composing a deposit taker's liquidity stock realisable immediately and without loss)

The first main topic on which future-proofing is needed is the treatment for funding limit purposes of retail savings mediated through intermediary platforms, and therefore typically counting as non-member funding against the 50%. We explained the problem as follows in our previous FRF (Phase 2) response[3]:

……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.

We expect savings mediated by platforms or similar intermediaries to become an increasingly important feature of the retail savings market. Societies need to be able to respond without being disadvantaged by the inadvertent result of the application of the funding limit as it stands.

In answer to Q7 : we urge the Treasury to take steps to future-proof the funding limit against that situation-either through provision for a limited disregard – or for the alternative, more radical, look through solution. We provide a more detailed analysis of the issues in an attached paper which draws on input from building societies and the providers of cash management platforms.

We also take this opportunity to draw the authorities' attention to the following. As well as an increased use of platforms, there is the potential for Open Banking and Open Finance to further commoditise the savings market. In addition there is the prospect of digital currencies, whether from the Central Bank or private providers, which could also cause a substitution away from cash deposits with banks and building societies. Additionally, at the end of a long period of accommodative monetary policy and specific interventions (such as TFSME) the aggregate and cumulative effect (possibly unintended) on funding of the parallel unwinding of all of these situations should be monitored. We expect societies to manage these effects prudently, as hitherto, while the landscape transforms from one of surplus liquidity possibly towards a scarcity of funds. But it would be sensible for the authorities to keep in reserve suitable contingency measures in case the aggregate transition proves too rapid. The exact impact on building societies funding limit of all of these changes is impossible to set out in advance. We would therefore see merit in formally setting a timetable to review the funding limit against these emerging trends, at least every three years.

We also take this opportunity to mention a small possible oversight in the onshoring of EU liquidity regulation, drawn to our attention by one of our members. The regulatory treatment of UK Covered Bonds in the LCR[4] calculation apparently not aligning to EU equivalent Level 1b could mean investors are required to apply higher haircuts and potentially demand higher returns, thus creating a competitive disadvantage for UK covered bond issuers, including building societies.

[3] Financial Services Future Regulatory Framework - Phase II Review : BSA response to Treasury's consultation
[4] Liquidity Coverage Ratio (under UK version of CRR)

Corporate framework

The opening to chapter 3 of the consultation document recognizes that while building societies operate under a separate legal framework from companies, that separate framework has not always been modernized at the same time, and consequently building societies may still remain under more burdensome and unnecessary legislative requirements as compared with companies. For instance, the 1986 Act missed out on some of the other governance modernisations in the Companies Act 2006. There has always been a clear policy intention for the building society legal framework to keep up with appropriate advances in companies legislation, and this was indeed provided for in limited contexts in section 104 of the 1986 Act : *Power to amend, etc. to assimilate to company law.* So as part of the future-proofing agenda we would be happy to work with HM Treasury to identify further suitable improvements. But, as a general proposal (and without prejudice to the specific measures covered below), we do suggest that section 104 should itself be reviewed first so that its scope can be extended. That would allow more future parallel updating to be done in a considered way by SI. Nevertheless, the Treasury has already correctly identified a series of measures which are needed to update and modernize the legal framework for society operations, and which we therefore support.

With foresight, the BSA had requested provision for **virtual and hybrid general meetings, along with electronic voting**, in our FRF Call for Evidence response[5] in October 2019 . The Treasury's indicative proposals seem to cover the ground, though we will still need to review any drafting, consider interaction with rules, and ensure nothing will cast doubt on the validity of AGMs actually held in this way during 2020-22. **Answer : Q8 - Yes**

Two minor procedural updates are also proposed: only one director needed to sign the accounts ; and relaxing the requirement to seal documents ; we support both.

Answers : Q9 – Yes , Q10 – Yes.

While fully supporting these (again, much derives from the BSA's prior advocacy), we also draw attention to certain other fairly simple and straightforward improvements which we urge the Treasury to make at the same time. We start with a couple of minor updatings, and then address two larger general subjects – the suggested removal of antiquated criminal offences ; and widening (as for companies) the scope of the fiduciary duty of building society directors.

Other minor updatings (not included in proposals)

One piece of legal housekeeping long overdue is to make the **directors' retirement age** provisions in the Act explicitly consistent with the Equalities Act. We described the problem as follows in a previous response to Treasury :

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[5] BSA Response to HM Treasury's Call for Evidence on Regulatory Coordination

Section 60(8) of the Act states that the normal retirement age for a director of a building society means 70 years or such lesser age as the rules of the society prescribe. There used to be a retirement age set out in the Companies Act for PLCs but following the Equality Act 2010 which outlawed age discrimination those provisions were deleted from the Companies Act. But the statutory normal retirement age has never been removed from the BSA 1986.

There is an informal view that because the Equality Act 2010 was made law subsequent to the Building Societies Act 1986, the statutory normal retirement age of 70 is superseded by the Equality Act 2010 so one can treat the Building Societies Act provisions as no longer applying.

That is not how English law works - the standard way is for a subsequent Act of Parliament to specifically set out any earlier legislation which is being repealed or amended. So at present there are two contradictory statutory provisions. It would be much better if the retirement age provisions of the Building Societies Act 1986 were removed as has happened for PLCs under the Companies Act.

Once again we urge the Treasury to include this minor correction while the opportunity is there. While on the subject of directors' ages, we draw attention to another small problem area (located in secondary legislation under the 1986 Act) which we suggest should be rectified at the same time. Building society directors, unlike company directors, still (apparently) have to disclose publicly their exact date of birth – see 3(1)(a)(v) of schedule 9 of the Building Societies (Accounts and Related Provisions) Regulations 1998 (SI 1998/504), as amended. Companies House recognised some years ago that this creates data protection and indeed obvious security and fraud risks for company directors – see https://www.gov.uk/guidance/your-personal-information-on-the-public-record-at-companies-house and we call for similar protection for building society directors.

Finally, for completeness, we must mention again the **deceased investor limit** (Schedule 7). The case for revalorising this limit is very strong, but successive sets of officials and ministers have seemed reluctant. However, it does not require primary legislation – there is an existing power (see Schedule 7, paragraphs 1 (4) to (6)) to update the limit by affirmative SI. We are ready to re-engage with the Treasury on this matter.

Fiduciary duty

We propose that building societies should have something equivalent to **section 172 of the Companies Act** which makes explicit the director's wider fiduciary duties, including having regard to employees, suppliers, communities and the environment, beyond the narrow focus on current shareholder interests. Currently, section 172 states ;

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

The BSA considers that making these wider duties explicit falls within the current direction of travel on general corporate social responsibility. Building society boards incline towards this thinking anyway, as they pay more attention to promoting the long term success of the building society for the benefit of present and future members. This is likely to differ from directors of companies who will typically take a shorter term view exclusively to please current shareholders: so section 172 was really needed. But a broad catch up for the 1986 Act with the spirit of section 172 in company law (though not exactly the same prescription) is timely.

Removal of criminal offences

Certain procedural infractions of the 1986 Act, currently punishable as criminal offences, should be considered for possible downgrade to civil matters, and/or to be dealt with by regulatory sanctions. Similar moves have been made for companies, and this general direction of travel was signalled in a Law Commission report[6] as long ago as 2010.

The principles on **the limits of criminalisation** called for in the Law Commission report would support the present case – see below :

1: The criminal law should only be employed to deal with wrongdoers who deserve the stigma associated with criminal conviction because they have engaged in seriously reprehensible conduct. It should not be used as the primary means of promoting regulatory objectives.
2: Harm done or risked should be regarded as serious enough to warrant criminalisation only if, (a) in some circumstances (not just extreme circumstances), an individual could justifiably be sent to prison for a first offence, or (b) an unlimited fine is necessary to address the seriousness of the wrongdoing in issue, and its consequences.
3: Low-level criminal offences should be repealed in any instance where the introduction of a civil penalty (or equivalent measure) is likely to do as much to secure appropriate levels of punishment and deterrence.

With thanks to learned colleagues at a leading BSA Associate firm, we will set out- in a separate memorandum to be provided to the Treasury - some considerations, touching on history, parallel developments, and practicalities, in support of removing or downgrading these procedural offences when the opportunity is there. To be clear, there is no suggestion that this should affect the few offences in the 1986 Act possibly involving fraud or dishonesty. The BSA would then be happy to work with Treasury on an agreed list of procedural offences in the 1986 Act to be addressed.

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[6] Criminal liability in regulatory contexts ; CP No. 195

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

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 £435 billion, and account for 23% of the UK mortgage market and 17% of the UK savings market.