Enhancing the Special Resolution Regime

BSA Response

7 March 2024

Building Societies Association

Introduction

The BSA represents all 42 building societies, as well as 7 larger credit unions. Building societies serve almost 26 million consumers across the UK and have total assets of over £507 billion. Together with their subsidiaries, they have helped over 3.5 million families and individuals to buy a home with mortgages totalling over £375 billion, representing 23% of total mortgage balances outstanding in the UK. They are also helping over 23 million people build their financial resilience, holding over £370 billion of retail savings, accounting for 19% of all cash savings in the UK. With all of their headquarters outside London, building societies employ around 51,500 full and part-time staff. In addition to digital services they operate approximately 1,300 branches, holding a 38% share of branches across the UK.

The BSA welcomes the opportunity to comment on the HM Treasury proposal to enhance and update the UK's Special Resolution Regime to better deal with failing small banks and building societies. We are pleased to see reflection and action being taken following from the failure of Silicon Valley Bank, but urge that any action that is taken considers and supports diversity in the financial services sector. It is right for HM Treasury to be analysing potential gaps and weaknesses in the resolution regime. We support a proposal to extend existing stabilisation powers to allow for the recapitalising of failing small banks and building societies, if appropriate, during the course of a resolution regime. We believe that using an organisation familiar to the public, such as the Financial Services Compensation Scheme (FSCS), to operate the recapitalisation efforts will give further credence to the efforts, and create a smoother path for the sale of the previously failing firm. However, we are not comfortable with the current FSCS levy calculation being used for recapitalisation funding. We firmly believe that there continues to be unfairness in how the FSCS levy is calculated and that building societies are asked to contribute to the levy in a manner disproportionate to the probability of their failure and the impact a building society failure would have on the market. This is even more concerning when it comes to the credit union sector who would be liable for funding the recapitalisation, despite not being in scope of Special Resolution Regime and so being fully outside the scope of its benefits. Accordingly, should the levy calculation for the recapitalisation become more fair and proportionate, we would be able to more strongly support the proposal as a whole.

Overview of Response

The below response will outline background on the interaction of building societies with the resolution regime, before addressing each of the questions posed in the consultation paper in turn.

Background

Building societies have a long history in the UK, with the vast majority of our societies being over a hundred years old. They operate firmly within the model of mutual ownership, being set up and run for the benefit of their members, placing the stability and longevity of building societies as foundational principles for each organisation. Building societies have an inherently lower risk business model driven by restrictions imposed by building society legislation, the PRA's supervisory statement on building societies' treasury and lending activities (SS20/15) and the societies' desire to serve their members by focussing on the provision of straightforward, well-designed, low cost products. Building societies have historically had very few cases where a building society's failure has meant that the FSCS has been utilised for building society customers.

Under the banking resolution regulations, a select few building societies are subject to bail-in and are required to hold the Minimum Requirements for own funds and Eligible Liabilities (MREL) above minimum capital requirements, with the majority of building societies falling below this threshold.

Credit unions are also run on the mutual model, being community savings and loan co-operatives where members pool their savings, with those savings used to make loans to other members, as well as some select other regulated financial products. Each credit union has a "common bond" which determines who can join, such as sharing an employer or living in a certain area. Credit unions are also regulated and supervised by the FCA and the PRA. The resolution regime does not apply to credit unions, although they do pay the FSCS levy as deposits with credit unions are protected by the FSCS.

Question 1: Do you agree with, or have any comments on, the proposal for the Financial Services Compensation Scheme to provide funding to recapitalise failing small banks, where these firms are placed into resolution rather than insolvency?

We agree that disorderly failure feeds into financial instability in the financial services industry, lowering confidence in financial services and causing preventable harm to firms and financial services customers. While the use of MREL may be appropriate to recapitalise larger banks and building societies, we agree that the case of Silicon Valley Bank UK highlighted that failure of smaller banks and building societies can cause systemically significant harm and more needs to be done to minimise damage to the economy. The use of existing stabilisation powers have significantly diminished the impact of failure for both cost to the taxpayer and loss of confidence in the sector, and we agree that it is sensible to have further options to stabilise smaller banks and building societies. On that basis, we are generally supportive of the proposal for funds to be provided to recapitalise failing small banks and building societies to place these firms into resolution rather than into insolvency, if that is deemed the most appropriate option. We see this additional power also sitting alongside further obligations regarding planning for a solvent exit, and continue to support proportionate action being taken to minimise the likelihood and impact of disorderly exits from the market.

We also agree that the FSCS is the obvious organisation who would have the skills, resources and expertise to deal with the recapitalisation of failing small banks and building societies, while minimising costs for the taxpayer. We feel that levying the costs associated with the recapitalisation against the banks and building societies on an ex-post basis is the most appropriate way of doing this. However, we continue to hold strong views that the fee paying structure for the FSCS levy is not proportionate to the current risk of failure in probability nor in its scale of impact posed by the firm. We have outlined further detail on our position in the response to question 2.

The consultation paper suggests other less preferable options for adding to the stabilisation powers, namely through pre-funding the recapitalisation or by amending regulations to require small banks and building societies to issue MREL in excess of minimum capital requirements. We have strong reservations about pre-funding the FSCS through additional bank levies. In our view, tying up further substantial capital in pre-funding would essentially impose an additional tax on lenders, diverting capital into non-productive risk free funds, instead of underpinning lending into a productive economy. The consultation acknowledges that it would not be appropriate to extend MREL beyond the current firms and we strongly support this view. Smaller firms are less able to issue MREL instruments and could be forced to meet any requirement with CET1 which would not be appropriate or proportionate. We firmly hold that the most preferable option is the recapitalisation of failing small banks and building societies using a FSCS levy paid for on an ex-post basis by banks and building societies.

Finally, we appreciate that recapitalisation is an important addition to the existing stabilisation powers as part of the resolution regime, and that HM Treasury are not in a position to produce an impact assessment at this time. We would welcome further information from HM Treasury on the estimated costs and benefits when it is practically possible to allow respondents to consider the impact on their industry throughout the policy delivery process.

Question 2: Do you agree with the proposal to recoup the funds from the whole deposit-taking class?

Unfortunately, we cannot support the proposal to recoup the funds from the whole deposit-taking class. Under the proposal in the consultation, credit unions will be funding the recapitalisation of firms within scope of the Special Resolution Regime, despite not being a part of this very Regime. The ability of the Bank of England to facilitate the recapitalisation of smaller banks and building societies will not even stand to directly benefit the credit unions sector. Should the funds be liable to be paid by banks and building societies excluding credit unions, we could support this funding model subject to the comments below.

We believe that amendments need to be made to the calculation of the FSCS levy as we do not believe that the current calculation base for the levy is proportionate. The current FSCS levy is based predominantly on size, and does not sufficiently focus on the probability or impact of a failure. As outlined above, building societies are inhibited in their business model as to the level of risk they can engage in, lowering their risk compared to a bank. The chances of failure are at their highest in the early years of a financial services operation, and building societies have proven their focus in delivering stability and longevity in their operations for the sake of their members.

Should the FSCS funding be rebased to take better account of risk, as well as size, we would be able to more strongly support the calculation of funds owed in this consultation paper.

Question 3: Do you agree with the proposed scope of application for the proposed mechanism?

We agree that the scope of application should be focussed on smaller banks and building societies who are out of scope for bail in.

Question 4: Do you have any other comments on the proposals set out in this consultation?

On the FSCS more generally, we welcome the confirmation that the PRA is due to carry out a regular review of the FSCS deposit protection limit in 2025. We could support an increase in the deposit limit to reflect inflation, perhaps to £100,000. We would suggest that higher net worth retail depositors have ample opportunity to protect their savings within the current FSCS limits by maintaining savings accounts with a number of different firms, and therefore the limit does not need to be raised much higher. We do continue to urge caution with increasing the FSCS annual levy limit, so as to keep the levy at a reasonable and justified level.

As outlined above, we believe that it is time to make adjustments to the FSCS funding model to take great account for proportionality, not just on a size-based approach, but on a risk-based approach which takes better account of diversity in the financial services industry. We have seen some progress in this in recent years from the PRA particularly where more attention is being given in the policy development process to the impact of policies on the mutual sector, rather than policies being created for public or private financial services firms and then inadequately adapted for mutuals. We believe that there is more to be done across financial services regulation, but in this instance, we believe that there is an opportunity to amend the objectives of the Special Resolution Regime set out in the Banking Act 2009 to support the mutual sector. There currently is no distinct objective to support diversity in the financial services industry and to protect the mutual model in the special resolution regime. We believe the addition of an objective like this would benefit the entire financial service sector and its depositors.

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