# Written Evidence to UK Regulators Inquiry

BSA Submission

2 January 2024 (see also inquiry website here)

Building Societies Association

# Executive Summary

1. The Building Societies Association (BSA) welcomes the opportunity to contribute to the House of Lords Industry and Regulators Committee's Inquiry on UK Regulators. As a representative organisation of building societies and credit unions, we are greatly interested in the work of regulators, particularly in the financial services industry.
2. We welcome the timing of this review, given that 40 years of EU financial services legislation and regulation are in the process of being reviewed and adapted for the needs of the UK under the Financial Services and Markets Act 2023, with the clear intention of increasing the roles and responsibilities of regulators. This presents a once-in-a-lifetime opportunity to question the appropriateness of the rules to the UK market and tailor them where necessary. We encourage regulators to consider not just the content of the rules but the overall structure and coherence of the framework, including being more proportionate where appropriate, without 'watering down.'
3. We strongly believe that simple rules that are easy to understand and straightforward to implement are superior to complex rules that are more likely to be misinterpreted, misunderstood or arbitraged. We believe that simple principles-based rules can therefore also be strong rules if coupled with effective supervision by the relevant regulatory body. Although too long in the making, the Prudential Regulation Authority's 'Strong and Simple' project is a good example of this, which the BSA strongly supports. We urge other regulators to do the same.
4. We also believe that regulators need to design appropriate regulations that work with the grain of a diverse range of business models including mutually-owned organisations. This should be front and centre of policy development and not an afterthought given the huge benefits to structural financial resilience, competition and consumer choice provided by a diverse range of institutions. The mutual business model, which puts customers, not shareholders, first should be actively encouraged by the regulatory framework. We welcome the Prudential Regulation Authority's (PRA) statutory requirement to 'have regard to' the impact on mutuals, and would like to see all regulators take this objective to heart in all stages of decision-making.
5. Finally, we call for essential changes to the Building Societies Act, as previously committed under the Edinburgh reforms to be prioritised.

# Introduction

6. 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.

7. Building societies and credit unions provide financial services, and are regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In addition, our members are impacted by the work of the Payment Systems Regulator (PSR), as well as the Financial Reporting Council (FRC) as the regulator and standard setter for audit and corporate governance. This is also set within the context of the role of the Bank of England's Financial Policy Committee (FPC) which is responsible for financial stability. While we are generally supportive of the approach taken by these UK regulators, we have outlined the strengths and potential enhancements for UK regulators in our evidence below, particularly in the financial services sector.
8. We thank the Industry and Regulators Committee for sharing a wide range of questions to assist in the evidence gathering. We have chosen to focus our response on the questions where we can most helpfully share our expertise – objectives, scrutiny, independence, communication between regulators, proportionality and the quality of regulation.

# BSA Response

## Regulator Objectives

9. The BSA agree that it is very important that UK regulators have clear and transparent objectives. This gives regulated firms certainty in the job which is being done by regulators, driving forward effective regulation and instilling greater faith in that sector. We note that the PRA and FCA are required to 'have regard to' the impact of their policies on mutuals. We think this should be retained and indeed implemented more effectively as we too often see that regulation is created for the purposes of being applied to the largest companies, and then adapted for building societies or credit unions assuming that the same problems exist or those problems can be solved in the same manner. Diversity of business models in the financial services sector is a huge benefit for individual customers through better pricing as mutuals do not have to pay dividends to shareholders, but also for financial stability more broadly as building societies and credit unions can provide services at times when PLC banks have had to withdraw from the market. At times, we believe that the financial regulators tend to write rules primarily for the plc bank model and consider the impact on mutuals only as an afterthought towards the end of their policy-making processes. We think designing rules for a diverse range of business models including mutuals should be at the front and centre of policy development, not an after-thought.
10. We agree with the current statutory objectives of the regulators we engage with. We welcome competition and international competitiveness objectives for both the FCA and the PRA. In terms of competition, it is crucially important for the building society and credit union sectors, with the majority of these firms being dwarfed by large, globally systemic banks in the financial services sector. We have seen the PRA instil this objective in their policy and regulation making, such as the PRA's future approach to policy making.[1] We warmly welcome this clear delivery of objectives, and we strongly support greater coordination by Government departments to ensure this is the case across all regulators.

## Regulator Scrutiny

11. The BSA see that clear objectives for regulators are also crucial for the effective scrutiny of regulators. It is right for Parliament to hold regulators to account, and we warmly welcome the good work that Parliament has done to show where regulators have room for improvement. For example, the 2019 BEIS Select Committee Future of Audit Inquiry brought forward significant evidence of improvements which were needed to the FRC and made clear recommendations to the Government to drive forward that change.
12. However, the BSA is also of the view that more needs to be done to regularly review regulators to highlight what regulators are doing well, what lessons can be learned for other regulators and further ways to strengthen those positive actions. We believe this is as important as scrutinising and critiquing when inefficiencies or mistakes have been made.

[1] CP11/23 – PRA Statement on the Review of Rules https://www.bankofengland.co.uk/prudential-regulation/publication/2023/june/review-of-rules
DP4/22 – PRA Future Approach to Policy https://www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy

13. Although it is not a regulator itself, we would also like to share some views about the Financial Policy Committee (FPC) of the Bank of England, as it operates through recommendations and directions for the FCA and the PRA. Given the technical nature of the FPC's work, it is not clear that there is currently effective scrutiny of its actions as the Treasury Committee often reviews FPC decisions after they have been made. For example, when the FPC introduced its mortgage interest affordability stress test in 2014, it was done without consultation. However, the FPC subsequently consulted and withdrew the stress test in 2022 in recognition of the disproportionate impact, which we welcome and urge for consultations to become the norm for the FPC.[2] While it is not a regulator, its decisions have the same impact as regulation, and we ask this committee to carefully consider the full impact of decisions of bodies like the FPC or the Financial Ombudsman Service. Where regulation is insufficiently clear, it leaves the door open for non-regulators who uphold regulatory frameworks to inadvertently work against the intent of regulators.

## Regulator Independence

14. The BSA strongly believes that regulators should be staffed by those with expertise and appreciation for the sector in which it is regulating. In regulated sectors, we see regulatory powers to set rules, standards and guidance in a quasi-legislative manner as a strong advantage to the sector. We welcomed this recently with the Financial Services and Markets Act 2023 which outlined high-level requirements in statute and delegated the specific detail of the requirements to the regulators. It is essential that for regulators to effectively regulate, they must have a concentration of expertise to be able to get regulation right. We see the financial service regulators trying their utmost to be considerate of the practical impacts of regulation, and most importantly, we have largely seen these financial services regulators amend regulatory proposals in consultation with stakeholders when problems are raised. We believe that in cases of technical sectors, such as financial services, the best place for regulation to be made is by the regulators, independent[3] from the Government. We agree that high levels of uncertainty and political tampering by a government would pose high risks to confidence in the sector.
15. We have unfortunately seen too many instances where the regulator is hamstrung in its ability to effectively regulate due to legislative constrictions held within the control of the Government, but the Government has failed to take action to make the necessary legislative changes. This is particularly the case with the much-needed and promised amendments to the Building Societies Act 1986, most recently proposed by the Government in 2012, confirmed in a call for evidence response in December 2022[4] and set out as a priority component of the

[2] FPC Response – Consultation on withdrawal of the affordability test recommendation https://www.bankofengland.co.uk/paper/2022/an-fpc-response-consultation-on-withdrawal-of-the-affordability-test-recommendation

[3] Basel Committee Core Principles for Effective Banking Supervision require supervisors to have operational independence from the Government and this is assessed by the IMF as part of its FSAP

[4] HM Treasury Consultation: Amendments to the Building Societies Act 1986 Call for Evidence – Response https://www.gov.uk/government/consultations/consultation-amendments-to-the-building-societies-act-1986

Edinburgh Reforms in December 2022.[5] While the changes are uncontroversial and have cross-party support, the Government has failed to outline any timelines or further commitments to changes. Under the Building Societies Act 1986, building societies are required to raise at least 50% of their funding from member deposits in saving accounts, subject to some exemptions, known as the 'funding limit.' The proposed amendments would exempt four additional sources of funding from the funding limit, making the funding limit apply and work effectively and optimally under new circumstances, and would make necessary modernisations of the governance framework. A similar picture is painted through the Government's failure to bring forward legislation to establish the Audit, Reporting and Governance Authority and make necessary changes to audit and corporate governance regimes to address the disproportionate cost paid by smaller building societies in being subject to unnecessarily extensive audits. Both of these promised legislative changes were absent from the King's Speech and there has been no formal communication from the Government on their approach going forward on these important areas of regulation.

## Proportionate Regulation

16. The BSA has long argued for greater proportionality across our sector. Building societies and credit unions make up a smaller portion of the financial markets compared to even challenger banks yet in the recent past have faced similar regulatory burdens. Building societies and credit unions engage in low-risk financial services, such as mortgage lending and retail savings, and this is constrained in statute. We are strongly of the view that a simpler approach to regulation, especially when applied to smaller members, can still be strong and resilient. We warmly welcome the PRA's Strong and Simple project, which will remove complexity, as well as address the disproportionate costs of compliance faced by small firms making current regulation anti-competitive. We strongly encourage this to be the norm across financial services and other regulators in the wake of greater opportunity and freedom to set our regulatory standards outside of the EU framework.

## Communication and Overlap with other Regulators

17. Communication and alignment between regulators is essential. We have seen good examples of collaboration, such as joint discussion papers (DPs) being issued by the FCA and PRA. However, we also note that for formal consultation documents (CPs), the FCA and PRA always issue separate consultation documents with no sign-posting or explanation on where the requirements are aligned or where they vary, leading to duplication of work by firms as they cautiously take steps to ensure full compliance with requisite obligations.[6] Where possible, the regulators should join their efforts, streamlining the consultation process and more clearly showing interconnections.

[5] Financial Services: The Edinburgh Reforms https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms

[6] Most recently, the FCA and PRA published separate and similar but subtly different consultation documents on Diversity and Inclusion, each running to 131 pages and 63 pages respectively

18. There is a sense that financial services regulators decide implementation timelines for regulatory changes in isolation without consideration of other regulatory changes. This makes the implementation of regulatory change unnecessarily more difficult, especially for credit unions and smaller building societies where resources are condensed amongst fewer expert individuals. This creates pressure on firms' capacity, which can include anything from systems development, or process change to employee training for various regulatory changes at a time. We would encourage and welcome a more integrated change management between regulators in similar or connected sectors. It is noteworthy that financial services regulators do work together to show the timelines for upcoming changes in the financial services industry through the Regulatory Initiatives Grid[7], which is helpful for a clear overview of the regulatory picture.
19. A more integrated change management programme would also assist in situations where the expectations of regulators have come into conflict. For example, the FCA's relaxing of affordability rules to support mortgage prisoners, forbearance expectations, or repossession moratoriums, do not appear to be fully aligned with PRA expectations. Through much engagement, we were able to secure some regulatory clarity, but it is a situation that could be avoided with improved coordination and communication between regulators.

## Streamlining and Simplifying Regulation

20. We believe that regulation should be well structured, easy to follow and written in Plain English.[8] There could be a 'one in, one out' rule, whereby when more regulation is created, regulators are required to revisit all existing regulations in this space to ensure the regulation works in the most efficient and intelligible way. We see a goal to remove one piece of regulation for each new piece of regulation introduced or explain how the old and new work together, as a way to deliver this.
21. Regulation often sits across multiple sources, supported with multiple iterations of Standards and Guidance, leaving the navigation and interpretation of the regulations difficult. We strongly support a culture of clearly setting out to whom the regulation applies, what is the policy intent, and how application and review will be approached by the regulator. We believe that this will create a stronger regulatory environment and improve the quality of regulatory returns. The PRA has consulted on its Future Approach to Policy[9], and we see this as a good model for other regulators to emulate. Finally, we believe that regulators across different sectors should look to each other to emulate best practices. The FCA has had rules in place for many years on how to treat customers fairly, including rules around advertising and complaints handling. More recently, the new Consumer Duty introduced requirements for financial services firms to avoid so-called 'sludge practices.'[10] Such requirements to make firms easier for consumers to do business with could arguably be relevant for all regulated sectors.

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[7] November 2023 edition of the Regulatory Initiatives Grid https://www.bankofengland.co.uk/report/2023/seventh-edition-of-the-regulatory-initiatives-grid

[8] See The Plain English Campaign https://www.plainenglish.co.uk/

[9] DP4/22 – PRA Future Approach to Policy https://www.bankofengland.co.uk/prudential-regulation/publication/2022/september/pra-approach-to-policy

[10] The FCA defines 'sludge practices' as discouraging customers from taking actions in their best interests such as switching provider or in designing overly long-winded complaints processes.

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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 £477 billion, and account for 23% of the UK mortgage market and 18% of the UK savings market.