FRC: UK Corporate Governance Code consultation

Building Societies Association response

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Building Societies Association

Introduction

The Building Societies Association (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 £500 billion. Together with their subsidiaries, they have helped over 3.6 million families and individuals to buy a home with mortgages totalling over £370 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 £362 billion of retail savings, accounting for 19% of all cash savings in the UK. Building societies account for 41% of all cash ISA balances. With all of their headquarters outside London, building societies employ more than 51,500 full and part-time staff. In addition to digital services they operate approximately 1,300 branches, holding a rising share of financial services branches in local communities.

The BSA welcomes the opportunity to respond to the Financial Reporting Council (FRC) consultation on changes to the UK Corporate Governance Code (the Code).

Key points

- Building societies are customer-owned financial institutions and are required by the PRA to have regard to the Code in establishing or reviewing their own corporate governance arrangements.
- The proposed changes to the Code are more suited to large corporate entities with institutional investors and are therefore disproportionate/inappropriate for smaller mutual organisations.
- Certain reporting proposals should only apply to 750:750 companies and not all Code companies (including potentially building societies).
- 'Comply or explain' principle does not reflect the pressure on building societies and other small Code companies to comply with requirements regardless of how disproportionate or inappropriate they are for the size and type of organisation.
- While a number of concerns could be address through subsequent industry guidance on the Code, we would prefer they were addressed before any Code changes are finalised.

Background: Building Societies and the UK Corporate Governance Code

Building societies are customer-owned financial institutions based across the UK in local communities. Borrowers and savers automatically become a member of their society when they take out a mortgage or open a savings account. While their businesses must be run as rigorously as any plc bank on the high street - societies operate in the same regulatory environment - their purpose is different. A plc must operate to the benefit of its shareholders, a mutual operates to the benefit of its members and takes business decisions in a different way because of this.

The Code is addressed to companies with a premium listing on the London Stock Exchange. Building societies, being customer-owned financial institutions, are not listed companies. However, the Prudential Regulation Authority (PRA) expects building societies to 'have regard' to the Code in establishing or reviewing their own corporate governance arrangements (Paragraph 2.17 of PRA Supervisory Statement 19/15).

Not all elements of the Code are relevant to building societies. Therefore to assist our members, the BSA has produced guidance to help societies 'have regard' to the Code. The guidance for building societies follows a 'by exception' approach, in that it refers only to those elements of the Code which are either not considered to be relevant to building societies, or which raise particular issues for building societies considered worthy of discussion. The guidance is in the form of text boxes inserted within the relevant sections of the Code. The BSA guidance for the current (2018) Code is available on our website.

Our response

Given our members are not premium listed companies, we have not responded to the questions set out on pages 30 and 31 of the consultation document. Others, such as our associate member EY whose response we have seen, are better placed to comment on the impact of specific proposals on Code companies. Instead, our response focuses on building societies' particular concerns given their unique position of being required to 'have regard' to a code which is not directly aimed at mutual organisations.

In general terms, the proposed changes to the Code mean that it appears increasingly only appropriate for large corporate entities with institutional investors. This does not reflect building societies. Even though the Code is applicable on a 'comply or explain' basis and, as already stated, SS19/2 only requires societies to 'have regard', members' experience is that some Non-Executive Directors (NEDs) and external auditors do not make that distinction. NEDs in particular do not want their society to be seen as an outlier and view explanation/non-compliance as a negative regardless of the reason. This, coupled with the some external auditors' conservative interpretation of the applicability of Code requirements, increases pressure to comply with requirements which effectively bring little to no benefit for building society customers.

Our concern is the new proposals will add an additional order of magnitude to building societies' reporting, which is not particularly necessary or useful in the building society context. For example, one building society's Annual Report and Accounts has gone from 32 pages (2013) to 48 pages (2018) to 151 pages (2023). It is expected this will grow further once the proposals come into force in 2025.

The following areas are of particular concern:

Section 1 – Board leadership and company purpose

The additional level of mandated granularity in reporting in terms of targets, impacts and outcomes adds detail which may be disproportionate for smaller societies and not useful for members (who are not sophisticated institutional investors).

Section 4 – Audit

We understand the Government limited the application of proposed reporting measures such as Audit & Assurance Policy (AAP) to Public Interest Entity companies with 750+ employees/>£750m turnover (750:750 companies), so as to not introduce new reporting burdens too broadly. However, the proposals in the Code will apply to all Code companies, not just 750:750 companies, on a 'comply or explain' basis. We believe the FRC should remain consistent with Government policy and not require all Code companies (potentially including building societies) to prepare an AAP. Even though this proposal is subject to 'comply or explain', there will be pressure on non-750:750 companies to comply for the reasons stated earlier regarding some external auditors' and NED's attitudes to explanation/non-compliance.

Regarding the other audit related proposals –

- Generally, requirements to engage with investors are problematic when most building society members are not sophisticated or well-versed in technical audit matters.
- External audit minimum standard should only apply to 750:750 companies, but again no distinction is made in the Code proposals.
- Expanding the remit of audit committee to include integrity of narrative (non-financial) reporting and sustainability adds to workload and costs of audit.
- Additional detail required about testing and effectiveness of and wider scope of risk management and internal control systems adds another magnitude of detail to reporting which, again, may be disproportionate for smaller societies.

Section 5 – Remuneration

The additional level of detail required in remuneration reporting may be inappropriate for smaller organisations, such as most building societies, given the level of remuneration of the board.

Conclusion and next steps

Given the concerns set out above, we would appreciate the opportunity to discuss the proposals further with the FRC before any final decisions are made. We have taken part in the FRC's stakeholder webinars over the summer, but they were less than ideal for discussing concerns in detail; particularly given building societies' unique position of needing to 'have regard' to a code primarily aimed at premium listed companies.

While we recognise that we have the opportunity to address some of the issues specific to building societies via our guidance on the Code, our members may still feel pressure to comply with new Code requirements which are of little benefit to their customers. It would be better to address the issues in the final Code rather than rely on subsequent industry guidance. In particular, we feel that a number of concerns would be addressed if the proposals only applied to 750:750 companies, as the Government intended, and not all Code companies.

We look forward to liaising with the FRC in the near future.

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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 £481 billion, and account for 23% of the UK mortgage market and 18% of the UK savings market.