

Call for written evidence: Bank of England and Financial Services Bill

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 **Building Societies
Association**

Executive Summary

1. This inquiry response outlines the views of the Building Societies Association, representing its members, in relation to the Bank of England and Financial Services Bill.
2. In essence we welcome a number of aspects in the Bill. These are:
 - the new diversity clause, requiring regulators to promote financial diversity;
 - the proposed extension of rules for strengthened accountability to all sectors, because it will promote fair competition;
 - the proposed application of the conduct rules to all directors is welcome, removing the risk of 'two-tier' NEDs;
 - the proposed removal of the requirement on firms to report every conduct breach is welcome if it means that junior staff breaches will not have to be reported on an individual-named basis; and
 - the proposed abandonment of the reversal of the burden of proof is welcome because it is contrary to natural justice.

Building Societies

3. The Building Societies Association (BSA) fulfils two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the Government and Parliament, the Bank of England, the media and the general public.
4. Although building societies compete with banks in the cash savings and residential mortgage markets, they do so with a very different fundamental purpose. As customer-owned mutuals, building societies have a social purpose by providing a safe home for savings and finance for home ownership, working in the interests of their customers, not seeking to maximise profits for the benefit of external shareholders.
5. Our members have total assets of over £330 billion, and account for approximately 20% of both UK mortgage and savings balances. It is estimated that over 20 million consumers has a financial services relationship with a building society. Between 2012 and the end of September 2015, building societies provided £56 billion new mortgage lending net of redemptions (80% of the total) out of a total of £70 billion net by the mortgage lending sector as a whole.

6. Building societies range in size from the Nationwide with over 14 million members, around 17,000 staff, £190 billion assets to our smallest society with 61,400 members, 18 staff and assets of £93 million.

Clause 19: Diversity

7. **We strongly welcome the amendment requiring the regulators to promote financial diversity.**
8. In the past a 'one size fits all' approach to regulation has given rise to problems, for both smaller and customer-owned financial institutions. The impact can be magnified for organisations which belong to both categories.
9. These problems can arise at both a domestic UK and a European level. Either the UK measures do not cater appropriately for mutuals or the UK fails to champion the necessary recognition of mutuals' interests in European or international negotiations. Sometimes, after extensive advocacy, changes can be made – but this cannot be guaranteed and it is more difficult than giving due consideration to diversity at the outset.
10. Examples of where regulators have not considered smaller customer-owned financial institutions include:
 11. In summer 2015 the PRA was implementing the Bank Recovery and Resolution Directive. The directive permits reduced reporting requirement and frequency for smaller institutions. In practice this would have allowed smaller institutions not to submit annual updates for instance, but instead do this every other year, saving significant resource. The PRA decided not to allow this, in spite of the plain words of the directive.
 12. In June 2015 the PRA proposed reforming the prudential regime for credit unions. The PRA proposed a substantial increase in the capital requirements for large credit unions, taking them to a leverage ratio of 10%. By contrast, the leverage ratios expected to be applicable to banks range from 3% to 5% depending on systemic impact. It is difficult to see the justification for requiring a large, established credit union to hold more than twice as much capital in relation to its assets as a large bank. We strongly criticised this move in a response on behalf of our credit union members, and it was generally slated by the various trade bodies in the credit union sector and it has now been revisited. But paying attention to size diversity across the board would have challenged this proposal before it saw the light of day.
 13. The FCA's original proposals for regulating the sale of retail capital instruments were lacking in consideration of financial diversity and were inconsistent. After advocacy work, the final version was amended and proved satisfactory, but during the process the capital raising plans of at least one small society was adversely affected. A diversity objective would have put the onus on the FCA to get it right first time.

Clause 20: Extension of relevant authorised persons regime to all authorised persons

14. The BSA welcomes the proposed extension of rules for strengthened accountability to all sectors because it will promote fair competition.
15. While virtually all of the serious prudential, retail conduct and market conduct problems were caused by big banks, the decision had already been made to extend *strengthening accountability in banking* regimes to other banks, building societies, credit unions, large investment firms and insurers. It would have been anti-competitive and prevented to a level playing field, not to extend relevant requirements across *all* regulated financial services sectors.
16. To take a practical example, a mortgage adviser with a bank or building society might have been tempted to move to an introducer or intermediary in order to escape the stringent requirements of *strengthening accountability in banking*. The proposed change mitigates this risk.

Clause 23(2): Rules of conduct

17. The proposed application of the conduct rules to all directors is welcome because there was no corporate governance justification for 'two-tier' NEDs.
18. The conduct rules generally mirror the regulators' expectations of the firms that directors are engaged with, in particular those set out in the PRA's Fundamental Rules and the FCA's Principles for Business (such as integrity, due skill and care, strong systems and controls, openness with regulators). Therefore, firms and individuals have a shared interest in getting things right.
19. While there are different individual responsibilities, important decisions (such as those regarding business strategy) are made by a board as a whole. Even before the Treasury's announcement in October 2015, the PRA had already moved to a position where it expected firms themselves to apply key conduct requirements to *all* directors.
20. Our view is that all directors are part of this overall framework of expectations and we are pleased that the 'two-tier' NED provision, which would have breached EU law, has been dropped. We now look forward to boards being able to move ahead on a collegiate basis.

Clause 23(3): Rules of Conduct

21. The proposed removal of the requirement on firms to report each and every conduct breach is welcome if it means that junior staff breaches will not have to be reported on an individual-named basis.
22. The current legislative provision appears to be the basis for the FCA's decision to require firms to report every conduct rules breach on an individual-named basis. While we support such a reporting provision in respect of senior staff and the application of strong conduct rules to all relevant staff, the reporting requirement on junior staff would be counter-productive and would lead to unintended negative consequences for consumers and for firms.
23. Our members encourage junior staff to be open and honest about their mistakes, so that they can be remedied through support and training, so that, where relevant, customers can be apologised to or remediated. Once it had become known that a firm would have to report every junior conduct rule breach on an individual named basis, this would have risked a new culture of concealment among junior staff in financial services firms. It would have also raised serious questions about consistency of reporting across the financial services industry.
24. Therefore, we strongly support Clause 21(3) and believe that, once implemented, the FCA should alter its rules reporting position accordingly – something that it is in the process of doing.

Clause 24: Misconduct

25. The proposed abandonment of the 'reversal of the burden of proof' is welcome because it is contrary to natural justice.
26. We fully understand and support the desire to make senior individuals accountable for their failings. It is extraordinary that, among all the massive prudential, retail conduct and market conduct failings over the last decade or so, of which we are now well aware, hardly any senior people have been held to account. For instance, even since the beginning of 2013, about 91.5% of the total fines levied by the FCA/FSA have been the responsibility of ten banks, yet we could find examples of only a tiny number of, relatively junior, individuals fined for breaches.
27. However, the way to achieve proper accountability is to introduce simple, sensible rules (that are not constantly changing) and to ensure that they are enforced strongly, fairly, proportionately and equally. It would not be achieved by the introduction of unfair procedural devices.
28. In recent years, the term 'natural justice' has largely been replaced by a simple duty to act fairly - see Lord Scarman *Council of Civil Service Unions v Minister for the Civil Service* (1985) -and, as an integral part of this fairness, it has long been recognised in English law that the burden of proof rests with the prosecution or the claimant - *Joseph*

Constantine Steamship Line Ltd v Imperial Smelting Corp Ltd (1942), BHP Billiton Petroleum Ltd and Others v Damine Spa (2003).

29. The lack of individual accountability to date is mainly the result of a failure to allocate responsibilities in firms' corporate governance frameworks. Because this deficiency will be fully addressed by the new *strengthening accountability in banking* rules (through responsibility maps, individual statements of responsibility, handover arrangements), the reversed burden of proof is unfair and is redundant.
30. While, as stated, we fully support a move to proper individual accountability - clearly largely absent so far - we believe that, as a matter of principle, the onus should remain on the regulator to establish its case. Therefore, we support the abandonment of the reversed burden of proof.

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The Building Societies Association (BSA) is the voice of the UK's building societies.

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.

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