

## **Response to guidance consultation: senior asset and liability management committee practices, FSA GC 10/6**

### **Introduction**

1. The Building Societies Association represents mutual lenders and deposit takers in the UK including all 49 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 21% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

### **Executive summary**

2. We welcome the opportunity to comment on this draft “Dear CEO” letter and broadly support the four key themes identified from the FSA review. The adequacy of firms’ asset and liability management practices is of course of legitimate interest of the regulator, even if some of the prescriptive detail contained in the letter is perhaps excessive. Firms may need, and indeed, welcome suggestions on governance in general but not to the degree where, for example, the contents and circulation of committee minutes are specified. That should be left to the individual firm to decide.

3. Building societies are already subject to a specialist sourcebook, unlike banks. The sourcebook covers guidance on societies’ financial risk management activities and therefore has references to asset and liability committees for those societies that have them. The guidance in the Dear CEO letter, while interesting, may be less relevant to most building societies as it appears to be based more on findings relating to large banks. We also identify below one major point of apparent divergence between the draft letter and the sourcebook.

4. Given the implications of this “guidance”, a draft letter, particularly one issued close to the Christmas period and to the year/end and with a deadline of just over two weeks, is hardly an appropriate way for the FSA to engage in genuine consultation – if that is what is desired. This adds to our existing reservations about the “guidance consultations” process. The drip-feed of short-notice GCs makes it very difficult even for our largest members to engage with their content.

### **Discussion**

#### **Draft “Dear CEO” letter and appendices**

5. The draft letter and the appendices are, on the whole, a useful checklist for firms such as building societies *to use selectively, where applicable to their own circumstances*. They will give firms a series of benchmarks against which to appraise their own asset and liability management. A useful addition would have been a breakdown by sector of good and bad findings.

7. The letter suggests that asset and liability management committees (ALCOs) should be chaired by the chief executive (“The most effective senior ALM committees appear to be those that are chaired routinely by the CEO”). For many firms, the CEO may be the most appropriate chairman – but not all. There is at least one smaller society, for example, that uses a non-executive director to chair the ALCO – so a firm should remain free to adopt this suggestion or not.

8. Similarly, the composition of an ALCO should be driven by the firm's business model and needs, rather than be set down by the regulator. The draft letter sets out that each business line head should attend. In smaller building societies the work of, for example, the group treasurer, head of market risk and head of ALM, may be performed by the same person. They may not even have an economist, let alone a chief one. Emphasising these separate specialised functions underlines the large-bank slant of the findings, as well as possibly leading to ALCOs that are too large to be effective. We agree, however, that, non-executive directors play a useful role in smaller firms. As we say above, a non-executive as a chair should not be discouraged.

9. We agree that discussions in ALCOs should focus on the future but consider that some reference to the past is both logical and inevitable, given committee members' legitimate concerns about performance, accountability and monitoring. Lessons can, and should, be learned by review after the event. In addition, the FSA itself requires firms to produce legions of returns, mostly referring to past activities – so it is inevitable that past performance will be discussed. The FSA suggests, for example in the key observation section at appendix 2, that the monitoring of limits could be delegated to a sub-committee, rather than discussed at the ALCO. While such monitoring should always be done quickly and efficiently, many smaller societies may wish to reserve this to ALCO given the importance they attach to observance of limits.

10. Challenge is healthy, and is key to optimal decision-making, but we do not agree that detail of every challenge need be reflected in the minutes. Once again we consider that the extent of recording of dissent or challenge should be left to the individual firm. If a non-attendee wishes to question a decision, s/he can raise it through normal channels and/ or at the next meeting.

#### **Overlap with (and possible divergence from ) building societies specialist sourcebook**

11. Guidance in the specialist sourcebook came into force on 1 April 2010. This additional handbook guidance aims to ensure that building societies diversifying from traditional business models have the risk management systems and skills necessary to operate safely. It covers areas such as liquidity, wholesale funding and financial risk management. Consequently, asset and liability committees are explicitly mentioned, though regarded as normal only for those on the "extended" and "comprehensive" approach to treasury management, i.e. the larger societies. **For the two least complex approaches – administered and matched – an ALCO is not envisaged at all – see BSOCS 1.6.1 and 1.7.1 G.** It would be sensible if this apparent contradiction is resolved in the final letter – we take it that as BSOCS constitutes formal Handbook guidance, benefited from a full consultation period, and was made by instrument by the FSA's Board, in the event of any conflict or discrepancy with the proposed letter, the text of BSOCS should prevail. ( Although the draft letter does say in the first paragraph that small firms should consider the content of this letter proportionately and in the context of their own business model, the flavour in the letter that an ALCO is normative is so strong, that the result is quite confusing for smaller societies.)

12. Paragraph 1.8.5 G of BSOCS refers to management of interest risk for those on the extended approach. It says that at such societies this risk will typically be controlled by the board acting through an ALCO or equivalent sub-committee, which will normally be responsible for agreeing any interest rate view. Reporting to the ALCO, there will typically be a treasurer running a small treasury department with appropriate segregation between dealing and settlement activities. But there is no mention of other committee members; this suggests strongly that for such societies only the participation of the treasurer is mandated – contrast the long list of participants recommended at the top of page 3 of the draft.