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BALANCE OF COMPETENCES REVIEW

SINGLE MARKET: FINANCIAL SERVICES AND THE FREE MOVEMENT OF CAPITAL

HM TREASURY CALL FOR EVIDENCE

SUBMISSION FROM THE BUILDING SOCIETIES ASSOCIATION

INTRODUCTION

The Building Societies Association (BSA) is pleased to contribute further to the Government's Balance of Competences Review through this submission to the October 2013 Call for Evidence on financial services as part of Semester 3 of the Review. We reiterate, where relevant, key points already made in our February 2013 submission to the initial synoptic review of the Single Market. We offer some general comments first, and then provide responses to some of the specific questions posed in the Call for Evidence. (Abbreviations defined in its Annex B are used in this response.)

The BSA represents mutual lenders and deposit takers in the UK including all 45 UK building societies. Mutual lenders and deposit takers have total assets of over £330 billion and, together with their subsidiaries, hold residential mortgages of over £230 billion, 18% of the total outstanding in the UK. They hold over £230 billion of retail deposits, accounting for 19% of all such deposits in the UK. Mutual deposit takers account for 30% of cash ISA balances. They employ approximately 39,000 full and part-time staff and operate through approximately 1,600 branches.

BSA members at present operate primarily, and in most cases exclusively, within the UK. However, all BSA members are for EU purposes *credit institutions*, and as such have been uniformly subject to the increasing volume of EU banking legislation ever since the First Banking Coordination Directive in 1977. Given the nature of our members' business, this submission concentrates on practical issues / competences related to banking regulation, consumer protection and payments services in the domestic UK context rather than issues around freedom of establishment, passporting, and free movement of capital. The BSA expresses at this stage no overall view on EU competences, but we do indentify certain areas where specific and detailed outcomes have been sub-optimal.

GENERAL COMMENTS

The interplay of EU and national competences, and approaches such as "minimum" or "maximum harmonization", are frequently misunderstood – with firms and commentators not always clear as to the origin of new rules and regulations with domestic impact in the UK, and the actual scope for the UK to diverge from EU level prescriptions. We found Chapter 2 of the Call for Evidence provided an excellent, helpful summary of "competences" and how they operate in financial services. Among the useful insights in Chapter 2 is the comment at paragraph 2.22 highlighting the *"shift at the EU level from a pre-crisis focus on identifying and removing obstacles to the free movement of financial services to a new, current focus on enshrining financial stability and consumer protection and addressing the risk of regulatory and supervisory arbitrage"*. But the new focus is still being implemented through the vehicle of single market legislation, with some indications of confused thinking at various EU levels as to what the actual priorities are.

It is clear, especially following the most recent examples[1] of EU legislative activity affecting our members (CRD 4, CARRP[2], DGSD, RRD, PSD, PSD 2, PAD[3] and MLD 4[4]) that the scope of EU competences has grown significantly, while the scope of independent national decision making on regulatory matters has correspondingly shrunk.

The Single Market represents a trade-off, for member states, and for individual firms, between *market access*, and *imposed uniformity / loss of local control*. But that trade-off will work differently for different member states, and for different types of financial firms. For major banks or investment firms with significant operations across the EU, *market access* is paramount, and *uniformity* will also be beneficial. For essentially domestic institutions, such as BSA members, *market access* is less important, or unimportant, but the imposed *uniformity* can prove costly and burdensome. We give some practical examples of the disadvantages that can arise from the current situation on competences.

First, the model of implementing international accords such as Basel 2 and 3 (intended for major internationally active banks) as internal market measures has necessitated their application to all EU credit institutions down to the smallest domestic savings bank. This has imposed disproportionate, and unnecessary, burdens on small firms.

Second, the growth of EU competence in financial services regulation means that any influencing of emerging legislation or rules needs to be carried out at European level. This is less straightforward, and more resource-intensive, than advocacy to national governments or regulators. For a trade association in an individual member state, it is almost essential to work through EU-level industry bodies to obtain any leverage at all.

Third, problems arise where – in any field of regulatory policy – the UK decides to act first, applying unilateral standards, which are then superseded by harmonised standards under EU legislation, potentially resulting in a double dose of compliance and adaptation costs. Examples arise in both liquidity policy and mortgage regulation. Problems can also arise where EU legislation is "gold-plated" in UK implementation.

The sequencing of the UK's Mortgage Market Review with the EU's CARRP (both covering major policy areas in mortgage lending) illustrates the above problem. The UK pressed ahead with its own MMR, in the aftermath of the financial crisis, in the knowledge that the EU was embarking on CARRP – but with uncertainty at that stage as to CARRP's likely success or timetable. The final outcome, however, was that CARRP will now be implemented within about two years of MMR, so lenders face a double dose of regulatory change, driving them to focus more on regulation rather than on new product development or new lending to the real economy.

The internal market should operate to increase competition in key financial markets, and does give our members the ability (if they wish) to passport into, or establish in, other member states. Some former building societies did begin to make use of the internal market in the 1990s, but the current BSA membership remains on the whole focused on the UK market. Especially since the banking crisis, personal financial services tend (at least in the UK) to remain largely domestic markets. Also, housing, and mortgage markets are particularly dependent on national specificities – property law, laws regarding the taking of security, custom and practice on house purchase – so one-size fits all EU prescriptions may prove quite unsuitable.

[1] We include several directives not mentioned in Annex B that nevertheless deal, with or significantly affect, financial services
[2] Directive on Credit Agreements Relating to Residential Property
[3] The recently proposed directive on Payment Accounts
[4] The proposed Fourth Money Laundering Directive

SPECIFIC RESPONSES

Q1 How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

As mentioned above, the scope of EU competence in financial services regulation has now become very extensive, with little residual scope for UK-only action. Much recent legislation, especially CRD 4, DGSD, and BRRD, while primarily addressing financial stability and/or consumer protection issues, continue to be formulated as single market measures, and as a consequence are neither sufficiently proportionate, nor do they adequately respect the principle of subsidiarity. There have been some recent, and welcome, moves towards explicit proportionality in Level 1 texts – for instance Article 4 in the draft BRRD. But CRD 4 generally lacks such proportionality, and in the absence of explicit authority in the Level 1 text, it then proves impossible for the EBA to bring in sensible proportionality when drafting the Level 2 Technical Standards. This became evident during an otherwise excellent all-day workshop on proportionality at the EBA on 22 October 2013, in which the BSA was pleased to participate. We welcome and support the EBA's genuine desire to act proportionately, and regret that this has been frustrated in so many instances by an absence of proportionality in the Level 1 text.

Perhaps the clearest recent example of bad outcomes from the EU process – through failure to respect, and build in, either subsidiarity or proportionality in the Level 1 text – is the imposition of harmonised regulatory reporting, known as COREP. Especially at the level of smaller deposit-takers, such as many BSA members, COREP has imposed a colossal burden and very substantial costs (as confirmed by the PRA's own estimates[5], which give alternative costs *for building societies only*, on two different methodologies, of £189 million and £278 million), but to no apparent benefit –PRA does not intend to make much use of COREP outputs, but instead will impose its own entirely separate prudential reporting regime. So the effort and resource involved in COREP reporting appears largely unproductive and wasted.

Q2 How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

In many areas of banking regulation, domestic UK deposit-takers would benefit from less detailed prescription at EU level. See the instance of COREP cited above. Measures derived from the Basel 3 process need not be applied in full to all credit institutions, where a more proportionate approach at national level would secure adequate consumer protection and financial stability while safeguarding diversity and competition. EU action can indeed produce perverse results – the smallest building society is subject to the full burden of CRD 4, DGSD and BRRD, while the UK's credit unions, the largest of which are now ten times the size of the smallest building society, are completely exempt, though their potential impact on consumer protection is correspondingly higher.

Other unhelpful pieces of EU harmonisation arise from CARRP. First, the harmonisation of pre-contractual disclosure through the ESIS[6] under CARRP has been taken much too far. The UK's existing KFI[7] already works better, provides entirely adequate consumer protection, but will be displaced. Instead, the ESIS will unnecessarily prescribe both content and layout, with no scope for sensible national derogations or specificities – and with no consumer benefit for the UK, only avoidable costs and upheaval. Other poor outcomes from CARRP include the 7day reflection period – entirely unnecessary at the point in the UK mortgage process where CARRP requires it – and the worst case interest rate scenario, which will only serve to confuse.

[5] See PRA's CP 5/13, pages 56-7. The estimates for the whole banking and investment sectors range from £ 1.7 billion to £ 3.1 billion.
[6] European Standardised Information Sheet
[7] Key Facts Illustration

Q3 How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

Developing the point in the previous response, the application through CRD 4 to small deposit-takers of measures designed in Basel for large internationally active banks, is inherently *anti-competitive* as it favours the large, incumbent banks who have the cash and staff resources to deal with the incredible complexity of these regulations. Smaller, simpler deposit-takers – such as most building societies – are greatly disadvantaged, and their potential role as challengers impeded.

Q4 Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

No, we think there is too much detailed prescription at EU level, with (as explained above) a loss of both proportionality and subsidiarity as a result. Having the EU Regulation as the operative text (as for instance with CRR) can be unhelpful, as our members find EU texts unfamiliar, user-unfriendly, and difficult to navigate (the latter so much so that the move to CRD 4 created an opportunity for commercial providers to try to sell expensive "navigational aids" to our members. Although maximum harmonisation can be beneficial, by preventing the customary "gold plating" by UK regulators, suspicions remain that informal "gold plating" will continue, through tools such as "supervisory statements".

Q5 How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally? Not of general relevance to BSA members

Q6 Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers? Some EU actions may well prove beneficial for consumers – for instance, BRRD mandates full retail depositor preference in bank insolvencies (which the BSA supports), with a super-preference for insured deposits. But the UK was already proposing depositor preference before this became Council and EP policy after the Cyprus debacle in April 2013, so potentially BRRD could have frustrated this instead. The benefits of EU-level regulation for consumers differ massively between member states. Those states with advanced consumer protection systems and cultures – such as the UK – typically gain little if any benefit, while those member states with primitive or non-existent consumer protection systems and cultures see EU action as a short cut that bypasses their dysfunctional domestic regimes.

Q7 What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different? The BSA has opposed transfer of supervisory responsibilities to European level bodies – this would be contrary to subsidiarity. The shift of regulatory work to EBA – in particular the drafting of level 2 Technical Standards under CRD 4 – has imposed a massive burden on the modestly-resourced EBA. Nevertheless, some initiatives from the EBA have been both welcome and successful – such as the work on proportionality mentioned above.

Q8 Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

The UK's difficulty is that while (as the Call for Evidence documents) its financial sector is far and away the most important in the EU, its formal decision-making power, being related to member-state population, and constrained by qualified majority voting, is quite weak. With its advanced regulatory culture, the UK has undoubtedly exercised a lot of soft power, but we suspect this is waning. In future, and notwithstanding the formal safeguards in place, the UK risks being further marginalised in the Council and within the EBA by the emergence of the Eurozone plus banking union bloc. The UK's influence in the EP - again, where examples of soft power (chairmanship of the key ECON committee) can be cited hitherto – is also on the wane.

As stated above, the practicalities for UK firms and trade associations in influencing EU legislation are more challenging – advocacy at EU level, mostly in Brussels, is less

straightforward and more resource-intensive. It is almost essential for a UK trade association like the BSA to work through an EU-level trade body to obtain sufficient access, influence and leverage.

Q9 How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

The EU's procedures for policy making and legislation are in theory highly accountable, even if this is not always realised in practice. Consultations by the Commission are open and accessible, and impact assessments have appropriate rigour and independence. This is true up to the point where a Commission legislative text is proposed for co-decision. Democratic due process is also evident, particularly now under co-decision, and the BSA has come across instances where the determination of MEPs has secured an important principle in level 1 texts, such as (in CRR Article 511) the differentiation of the leverage ratio framework by business model, against opposition within the Council.

The difficulty arises where substantial changes are introduced to a legislative text during co-decision – either from the Council or Parliament side. While some changes may be welcome, and correct defects in the original proposal, or respond to rapidly changing circumstances, there is no requirement for further impact assessment – though the changes may be so far-reaching that the original impact assessment is rendered irrelevant. There is also a loss of transparency during the stage of trilogue: closed-doors negotiation among representatives of the Council / Presidency, Commission and the Parliament's Rapporteurs. Again, at this stage last minute deals can be done which substantially change the impact of a text, with no opportunity for re-assessment.

We cite an example of this risk from the passage of CARRP. Whereas the original Commission proposal was, rightly, supported by a full impact assessment, the EP's Rapporteur attempted to introduce major new articles on valuation, tying and bundling, foreign currency etc. These were not supported by any impact or cost benefit analysis, and appeared largely designed to address shortcomings in the Rapporteur's home state or in another state, rather than genuine EU-wide issues.

Q10 What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives? [Not of direct relevance to BSA members.]

Q11 What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?

The BSA supports the Government's decision to stay out of the banking union, and opposes any mutualisation of either deposit guarantee or resolution funds. The development of the banking union, will, almost certainly, and notwithstanding the negotiated safeguards, contribute to further marginalisation of the UK in EU-28 financial services matters as the effective dominance of the Eurozone-based banking union caucus becomes clear.

Q12 Do you have any further comments about issues in addition to those ? No.