

Bank of England Bill

Response to technical consultation

10 September 2015

General observations (chapter 1)

The BSA welcomes the Government's commitment to achieving strong, sustainable and balanced growth that is more evenly shared across the country and between industries. BSA members all have their main operational headquarters away from the City of London, and are a significant regional presence – as businesses and as employers- in the Midlands, the North of England, and in Wales, Northern Ireland and Scotland. So we share the Government's desire to see growth more evenly distributed, and our members will be instrumental in the wider spread of prosperity across the country.

We also applaud some of the key statements and remarks in the Chancellor's letter¹ dated 8 July 2015 to the Governor of the Bank providing the coming year's remit and recommendations for the Financial Policy Committee.

First, we agree with the Chancellor's analysis that, while financial stability and growth can be complementary, in some circumstances there may have to be trade-offs, which should be managed and communicated transparently. The BSA has long argued that such trade-offs should be recognised, and that the cumulative impact of micro- and macro-prudential measures should be assessed so that they do not go beyond the "tipping point" into a net negative effect on economic welfare. So we are pleased that the FPC now accepts that such cumulative assessment is necessary.

We also applaud the Chancellor's recognition that ensuring a diversity of business models is part of achieving more competition and innovation in retail banking and in the financial services industry generally.

We encourage the Treasury to provide legislative underpinning for the Chancellor's words through a suitable diversity objective. We return to this suggestion below. And as a specific instance of ensuring this diversity, we also make a modest request on behalf of our three credit union members.

Regulatory architecture (chapter 2)

Consultation question : Do you have any views on the government’s proposals to end the PRA’s status as a subsidiary and integrate it within the Bank, while retaining its independence in making rules, policies and supervisory decisions?

We appreciate the organisational attractiveness of the “One Bank” concept espoused by the Governor. But the statement :

“Our strategy will be to conduct supervision as an integrated part of the central bank and not as a standalone supervisory agency that happens to be in the central bank”

poses a false dichotomy : PRA is not at present a stand-alone supervisory agency that happens to be in the central bank, and - as the consultation document admits – there are principled and legal reasons for a degree of independence for the PRA’s microprudential function that mean it cannot be conducted simply as a fully integrated part of the central bank. In short, we see no good reason to change the current structure.

The consultation document gives two specific reasons why a degree of independence is needed. Appropriate structural separation and operational independence between the microprudential regulator (the PRA) and the resolution authority (the Bank) is a legal requirement under the EU Bank Recovery and Resolution Directive (Article 3). Operational independence is also a requirement under Principle 3 of the Basel Committee’s Core Principles for Effective Banking Supervision.

There is also a wider policy reason why microprudential supervision should be independent – it has different objectives. As recently rehearsed in a speech² by Deputy Governor Sir John Cunliffe :

“the objective of ensuring the financial system as a whole is stable is different to the objective of promoting the safety and soundness of individual firms...”

There is no absolute reason why the microprudential regulator should *a priori* not be part of the central bank, but the obvious need then to create somewhat artificial structures³ to assure separation and independence, and the fact that the current arrangements -agreed only in 2012 -appear to be working perfectly well, all suggest the case for change has not been made. This seems to be a solution in search of a problem.

Nevertheless, if the integration of the PRA is to proceed, the BSA considers it to be of the utmost importance that certain clear statutory disciplines and safeguards (under the Financial Services and Markets Act 2000 (FSMA)) that PRA has inherited from the former FSA are preserved, and not lost in the transition. We give four examples : consultation, cost-benefit analysis, assessing differential impacts on mutuals, and maintaining a practitioner panel.

Consultation in advance of making rules or policy is a prerequisite of good modern regulation. The Chancellor’s letter underlined the importance of proper consultation by the FPC, and the same is at least as true, and relevant, for the PRA, given the immense power vested in the current PRA to make rules binding on financial firms. The current statutory safeguards (sections 2L and 138J of FSMA) generally work well, and must not be watered down.

The obligation to carry out **cost benefit analysis** (CBA, also in section 138J) is a critical component of making rules that are appropriate, proportionate and well-targeted. We sense that the Bank is less committed to CBA than the PRA’s predecessor, the FSA. One recent major PRA consultation omitted proper CBA altogether. We think it is extremely important that the CBA obligation is in no way watered down in the transition.

¹ <https://www.gov.uk/government/publications/remit-and-recommendations-for-the-financial-policy-committee-summer-budget-2015>

² Macroprudential policy: from Tiberius to Crockett and beyond - (page 5)
<http://www.bankofengland.co.uk/publications/Pages/speeches/2015/836.aspx>

³ See paragraphs 2.7 to 2.11

Another specific requirement on PRA (under section 138K (2) of FSMA) is to consider whether its proposals may have a **differential impact on mutuals**. While this is only a first step towards a legislative steer to wider promotion of diversity, it should be retained in any transition. We comment at the end of this response on how the wider diversity objective should be secured.

Finally, **involvement of practitioners**. We note again the Chancellor's encouragement⁴ to the FPC to engage properly, in an open and collaborative way, with industry participants. Again, this is at least as important when applied to the PRA. Sections 2L to 2N of FSMA require the PRA, like its predecessor the FSA, to maintain effective arrangements for consulting practitioners, including (in section 2M) a specific requirement for the maintenance of a Practitioner Panel, to which the BSA has been pleased to nominate two leading experts from the building society sector. The PRA has a statutory duty to consider any representations made to it by that Panel. We understand that the Bank initially opposed the concept of a Practitioner Panel, so at this stage it is **all the more important that the Practitioner Panel is retained**.

While on the same subject (open and collaborative engagement with industry participants), we also draw attention to an unwelcome change at the PRA even while it remains a separate entity. The PRA now signals that it is unable to undertake sensible, informal pre-consultation with stakeholders and their trade associations. The PRA, and its predecessor the FSA, has done this both sensibly and effectively in the past. We are not aware of any legislative change that justifies discontinuing this practice – rather it appears to be a cultural change imported from, or imposed by, the Bank. We consider this a retrograde step, and it strengthens our view that the PRA would be better kept as a separate legal entity.

Resolution policy and crisis management (chapter 3)

Consultation question : Do you have comments on the government's proposals to further strengthen the framework for resolution policy and crisis management?

Appropriate flows of information between Bank and Treasury are clearly necessary on any resolution situation that might risk public funds. The proposals look reasonable and sensible.

Governance and accountability (chapter 4)

Consultation questions : Do you have comments on the government's proposals to strengthen and simplify the Court? Do you have any views on the changes the government intends to make to the MPC and FPC? Do you have any views on the government's proposal to bring the Bank within NAO oversight?

We support the extension of NAO oversight to the whole Bank.

⁴ <https://www.gov.uk/government/publications/remit-and-recommendations-for-the-financial-policy-committee-summer-budget-2015>

Diversity

Leaving aside the organisational issues covered in chapter 4, we think this Bill also provides an excellent opportunity to provide **legislate underpinning for the diversity objective** already mentioned in the Remit and Recommendations for the FPC in the Annex to the Chancellor's letter⁵ of 8 July (emphasis added):

*The Government is keen to see more competition and innovation in all sectors of the industry, particularly retail banking. This includes minimising barriers to entry and **ensuring a diversity of business models within the industry.***

What is needed, we think, is clear recognition in the legislative framework within which the Bank and its various Committees operate, that **policy should be designed to maintain and enhance the diversity of business models in banking**. Such diversity should not be an afterthought, or a “nice to have” that can always be ignored in the face of financial stability considerations. Rather, diversity should be part of policymaking *ab initio*, and serve as a better route to financial stability – avoiding *inter alia* the PLC banking groupthink that led to the last crisis.

Clearly it is premature to consider detailed drafting, but the general principle should be that the Bank's macroprudential functions, and the PRA's regulatory functions, should have “ensuring the diversity of business models” as a formal subsidiary objective, or as a specified matter to which the Bank or PRA must have regard when formulating policy.

An increasingly important part of competition and diversity in retail banking are the major **credit unions**. Three large credit unions are full or associate BSA members (Glasgow CU, Capital CU and No1 CopperPot CU), and on their behalf the BSA makes the following specific request.

The recent changes to the FSCS compensation arrangements, as a consequence of the amended EU Deposit Guarantee Schemes Directive, have **deprived credit unions of the FSCS protection** that their deposits with banks and building societies previously enjoyed, and - moreover- by virtue of the implementation of the EU Bank Recovery and Resolution Directive, credit union deposits could *in extremis* be written-down during the bail-in and resolution of a failing bank.

Credit unions consequently need some practical low-risk or risk-free alternatives for holding at least some of their liquid assets. One obvious measure, at least for the largest and most established credit unions, is **access to reserve accounts at the Bank of England**. Since late 2009/early 2010 access to these sterling monetary facilities has been widened to all banks and building societies, even the smallest. **Moreover the Bank has, for understandable reasons, already widened access to its facilities to certain privileged non-bank institutions** – to central counterparties, and to major broker-dealers – as announced in 2014, and recently explained again⁶ as part of the Bank's Open Forum initiative. For operational reasons, the SMF would not be suitable for smaller credit unions, but we think there is now a strong case for the largest credit unions to be able to hold reserve accounts at the Bank. **Such credit unions are, for different reasons, no less deserving of these facilities than the large investments banks⁷ which have begun to take advantage of the opening of access last year.** This request has been made by one of our members before – we are unclear whether such a change would need legislation, but if so, the Bank of England Bill provides the vehicle.

⁵ <https://www.gov.uk/government/publications/remit-and-recommendations-for-the-financial-policy-committee-summer-budget-2015>

⁶ “Open Forum – Building Real Markets for the Good of the People”, paragraph 181.

⁷ Goldman Sachs Gains Approval to Access Bank of England Window, Bloomberg 19 August 2015.

Jeremy Palmer
Head of Financial Policy
jeremy.palmer@bsa.org.uk
020 7520 5912

York House
23 Kingsway
London WC2B 6LU

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

BSA EU Transparency Register No: 9: 24933110421-64

www.bsa.org.uk

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.

Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets