BSA Response to EU Commission Green Paper on retail financial services

11 March 2016

Building Societies Association

Introduction

1. The Building Societies Association (BSA) represents all 44 building societies in the United Kingdom (UK) and two credit unions. Building societies have total assets of over £330 billion, and account for approximately 20% of both UK mortgage and savings balances. It is estimated that more than a third of the UK population has a financial services relationship with a building society.

2. Building societies operate on a customer-owned model – they are run in the interests of their savers and mortgage borrowers rather than PLC shareholders. This enables them to provide long-term sustainable lending and savings products for their members, rather than delivering dividends. The BSA is a member of the European Association of Cooperative Banks (EACB), which has contributed to the European Banking Industry Committee (EBIC) response to this Green Paper. We have seen and support the comments made by EBIC in response to the specific consultation questions. The purpose of this BSA response is simply to add further colour regarding building societies, and more widely on financial services in the UK.

3. While we welcome the opportunity to respond to the Commission Green Paper on Retail Financial Services, we do have a number of concerns about the form and timing of this consultation. On a general level it is concerning that responses to the consultation can only be submitted through the online EUSurvey form. Although we understand that this is designed to achieve some level of standardisation across response formats, we feel that it unduly narrows the range of responses. We do not believe that the form gives enough scope for respondents to give the answer 'no action needed'. That is why we have chosen to write to DG-FISMA in this alternative form.

4. In terms of timing we are worried that the Commission appears to be scoping out a significant plan of action at a time when many major regulatory interventions have not even reached full implementation – let alone been allowed to bed in. The Mortgage Credit Directive (MCD) aims to foster a single market for mortgages in the EU and takes effect from March 2016. This has been a major regulatory initiative and we believe the Commission should take time to carry out an assessment against its objectives before undertaking yet another project. Although our members will generally be less affected, we take a similar position on the Payment Accounts Directive (PAD). We would not want to see either of these files reopened as a result of this Green Paper.

5. We also note that, while understandable from the perspective of deepening the Single Market, regulatory action resulting from this Green Paper would risk running counter to Commissioner Hill's other objective of reducing any unnecessary regulatory burdens on firms. For this reason, we welcome Commissioner Hill's pledge at the Commission's Public Hearing on the Retail Finance Green Paper that 'I won't reach for the rule book unless I have to'. We hope this will continue to be the Commission's default position.

6. Below are some high-level comments explaining why cross-border trade in financial services would, in the most part, not suit the business model of building societies.

Building Societies are domestically focussed

7. In section 1 of the Green Paper the Commission notes that:

'Europe-wide markets in retail financial services do not really exist at present. Only a small minority of retail financial service purchases take place across borders. There are many good products which exist in domestic markets, but it is difficult for consumers in one EU Member State to buy products provided in another.'

8. The implication of this analysis appears to be that action on the part of the Commission to strengthen the Single Market can provide solutions to the range of reasons why there is a lack of cross-border trade in financial services. We question whether this is the case.

9. Building societies in the UK are all domestically focused. They provide two core services: retail savings and mortgages. For many, the focus of their savings business may be even smaller than the national level, as these customers tend to value having easy access to a branch and are therefore largely concentrated locally, or regionally at most. While digitisation and online banking are useful tools in helping customers to monitor and administer their savings, it is our experience that savers want the ability to access a branch if anything goes wrong.

10. At present, other than in very few cases outlined below, building societies do not have a presence in other EU member states and have no desire to establish one. Some larger building societies have savings customers all over the UK but even they would find it difficult and administratively burdensome to serve customers in another EU member state.

11. In terms of mortgages many building societies have national distribution networks through mortgage intermediaries, enabling them to lend across the country. However, still some building societies choose to lend locally and regionally. In many cases this is in order to capitalise on their knowledge of local housing markets and economic conditions. For some, this local or regional focus is an important part of their risk mitigation strategies. These would undoubtedly be diluted if they were somehow compelled to lend cross-border.

12. The Commission notes that 'good products' exist domestically. We do not believe that this is by chance. We argue that specialist knowledge of the market and customers is the very thing that makes many domestically-focused mortgage and savings products 'good products'. This knowledge does not easily transfer to conducting business in other markets without significant investment in talent, training, systems and processes. This is especially so when we talk about moving into other countries where different language, laws and culture make the process particularly difficult.

Building societies do not plan to expand into Europe

13. Building societies' customers are comprised overwhelmingly of UK residents. Some minor exceptions exist in terms of cross-border activity between the UK and the Republic of Ireland, and some customers in the Isle of Man and Gibraltar though these are in turn a Crown Dependency and an Overseas Territory. There are also some very small pockets of 'ex-patriot' building society customers living in Spain. Other than this, cross-border activity largely

comprises of UK nationals who move abroad and want to keep their savings in the UK or continue to service a mortgage on a property located in the UK.

14. We would question whether any significant number of 'new business' enquiries come from abroad. Building societies do not at the moment actively seek to offer services in other EU Member States except as outlined above. Although this may be the case in other EU states which share the Euro or have a common language, it is simply not a pressing issue for our members.

15. We share the view of EBIC that this is largely because EU Member States have 'very mature' financial markets which already satisfy the needs of their consumers domestically. In particular we echo their quoting of the Eurobarometer 373 survey which found that '80% of the Citizens questioned do not plan to purchase financial products in another member state in the future because they feel that they can access everything they need in their own country[1]'. We believe that if asked whether they plan to purchase financial products in the UK, even fewer would plan to do so due to the exchange rate risk associated with dealing in Sterling.

16. In any case, for any financial organisation considering doing so, expanding internationally should be purely a business decision. The Commission should not seek to make it so through legislative or regulatory measures. In fact, we would go even further where building societies in particular are concerned. Given that building societies are customer-owned businesses, any capacity directed towards putting special systems or processes in place to serve customers abroad would be a cost borne by the rest of the customer base. Again, therefore, we argue that any move to compel building societies to offer their services cross-border would be detrimental.

17. Below we will briefly focus on the core financial products building societies offer – mortgages and savings.

The Mortgage Market

18. There are very good reasons why there is very little – if any – cross-border mortgage lending. Cross-border lending might be considered desirable within the Eurozone, where exchange rate risk is eliminated. However, this consultation has not been restricted to the common currency zone. Moreover, mortgage lending is inherently a risky business which requires the lender to know their customer, understand their income and expenditure in detail, as well as their needs, other circumstances and future aspirations. We would question whether this is possible when lending to a customer residing in another EU member state and would even argue that doing so could put lenders in breach of conduct regulation.

19. Then of course, there is the question of the property. Mortgage lending is, of course, secured against the customer's property and lenders need to be satisfied that the property is structurally sound, has proper title, that it meets their lending criteria and is located somewhere where it would be possible to sell in the event of a repossession. Again, these are all factors which lenders can only exercise control over when they understand the housing

[1] EBIC response to Q1A

markets they are lending in, as well as the legal framework and valuation framework they are working within.

20. Another thing to consider is the system of land registry. Mortgage lenders rely on their legal charge over a property they lend on to be registered, as a means of protecting their security. Much of the land register in the UK is still not in a digital format – though projects are underway in the various land registries within the UK to digitise this information[2]. However, this means that lenders in other EU states would at present only be able to access an incomplete form of the register through digital channels. We assume this would also be the case for UK lenders offering mortgages in other EU member states. Clearly this is an unacceptable position as lenders must have absolute confidence in the integrity of the land register as a pre-requisite of lending any money secured against property.

21. While we understand that distributed ledger technology[3] may eventually lead to the need for a centralised 'EU land registry' becoming redundant, this technology will still require many years to develop. A prerequisite, in any case, will still be to make current land registry data accessible online.

22. A list of other elements of mortgage lending which are likely to have discrepancies compared to other EU states would include:

- Mortgage adviser qualifications (even after minimum harmonisation under MCD)
- Consumer protection legislation
- Contract law
- Property and land law
- The transfer of title and registering of charges
- Planning law
- Valuation practices
- Professional indemnity
- Credit ratings
- Arrears and forbearance regulation
- Debt collection and bankruptcy law

23. Many of these are vital elements of a lender's approach to credit and conduct risk. We believe that compelling building societies to lend in other EU member states without full knowledge of these elements would make mortgage lending far riskier. Of course, lenders must also provide post-contractual services for customers with a mortgage and are likely to find it challenging to support customers in another state effectively – for example if they get into problem debt and need to access support.

24. While lenders have put significant resource into implementing MCD in recent years, one of the perverse consequences is that for the UK, MCD could actually reduce cross-border lending. This is due to the rules around 'foreign currency loans' which mean that many lenders are pulling out of this market due to the unsustainable administrative burden.

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[2] See for example, Land Registry blog on digital mortgages at http://blog.landregistry.gov.uk/tag/digital-mortgage/ or Registers of Scotland on the online discharge service https://www.ros.gov.uk/about-us/ros-blog/2015/discharges-done-digitally
[3] See the Government Office for Science report, 'Distributed Ledger Technology: beyond block chain' p. 37, accessible at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf

25. In its analysis of the current state of financial services in the EU the Commission describes the situation as one of 'insufficient competition and minimal consumer switching'. In our experience this is not the case in the UK. Price competition is very fierce currently due to low base rates and a buoyant housing market. Most consumers will re-mortgage after 2 to 5 years with the option of moving to another lender. Many lenders are increasingly looking to attract 'underserved' customers with new products and adapting their lending criteria.

26. In any case the UK has three bodies with a competition remit. In terms of our financial regulators, the Financial Conduct Authority has an active remit to look at competition and indeed is currently looking into a 'Study of Competition in the Mortgage Sector'[4]. Our other financial regulator, the Prudential Regulation Authority has competition as a secondary objective. Thirdly, the Competition and Markets Authority looks at competition across the economy but has recently looked into the financial sector (outlined below) and will issue a final report in due course.

The Savings Market

27. In terms of the savings market, there are =important anti-money laundering reasons why it would be difficult for building societies to look after the savings of customers from other EU states. While we accept that e-identification and e-signature may overcome these barriers in future, we would echo the EBIC response stating that:

'The 4th AML Directive, which is currently being transposed into national law, holds that entering into relationships with customers not physically present in a bank branch is inherently considered high risk'[5].

28. We have also outlined above our experience that savings consumers prefer to have access to a branch. Indeed, for building societies keeping branches open across the UK to suit the needs of customers such as the elderly and digitally excluded is a key part of their ethos. This would not be possible for customers in the rest of the EU. Rather than focussing on firms operating cross-border, we believe that the best way of interpreting the single market in financial services is to envisage a level playing field across the EU. This means reducing the barriers to entry – for example, a German bank entering the UK.

29. In terms of the Payment Accounts Directive, there was considerable debate about the definition of what constitutes a 'payment account'. We feel that the final definition settled on in the UK, which specifically excludes savings accounts, is the correct one and we would not wish to see this file reopened as a result of the Commission Green Paper.

30. Again we would like to draw the Commission's attention to domestic initiatives on competition in the savings market. In 2015 the FCA concluded its Cash Savings Market Study by proposing potential remedies in a number of key areas:

[4] https://www.fca.org.uk/news/call-for-inputs-competition-mortgage-sector
[5] EBIC response to q 8

- considering whether interventions to increase interest rates on back book accounts will affect the interest rates payable on new accounts.
- raising consumer awareness of the rate they are receiving, the rates on offer on other accounts and how they can switch
- the feasibility of giving consumers information about how their interest rate is likely to change over time.
- whether providers can make it easier for consumers to manage accounts held with multiple providers
- exploring options to make it easier to switch savings accounts

31. As with the mortgage market therefore, building societies are currently dealing with initiatives by our national regulators and would not welcome further intervention from the Commission at this time. Since the vast majority of savings and mortgage business is domestic, we feel that competition initiatives rightly sit with the national regulators rather than the EU.

Current accounts

32. A few building societies also offer current accounts. These are Coventry Building Society, Cumberland Building Society, Leeds Building Society, Nationwide Building Society and Yorkshire Building Society (through its subsidiary Norwich and Peterborough). Current accounts are, of course, subject to the Payment Accounts Directive.

33. The current account market has also been subject to recent competition action – this time by the Competition and Markets Authority. The final report will be published in May 2016. However the CMA has listed a range of possible remedies[6] to increase competition, in the following areas:

- Prompting customers to review their current account provider at times when they may have a higher propensity to consider a change.
- Increasing public awareness of the potential savings or rewards that could be obtained by changing one's current account provider and of the benefits of using the Current Account Switch Service (CASS) to do so in terms of security and convenience
- Facilitating price comparisons between providers by making customer-specific transaction data more easily available and usable, including by price comparison websites
- Enabling consumers to make comparisons between current account providers on the basis of their service quality
- Making it easier for prospective current account customers to find out, before initiating the switching process, whether the overdraft facilities they were seeking would be available to them from another provider
- Requiring payments into an old current account to be redirected to the new one for a longer period than at present
- Requiring banks to retain and provide ex-customers, on demand, with details of their current account transactions over the five years prior to their account closure

[6] We have picked those relating to personal current accounts rather than business current accounts, https://assets.digital.cabinet-office.gov.uk/media/5627c23aed915d101e000004/Notice_of_possible_remedies_-_banking.pdf

- Requiring Bacs to transfer continuous payment authorities on debit cards when switching through CASS
- Requiring all banks to support the partial switching service and to provide an equivalent guarantee to that offered as part of CASS
- Changes to CASS governance
- Data sharing with credit reference agencies
- Commercial open data and data sharing proposals
- Requiring banks to provide a loans price and eligibility indicator

34. As can be seen, these are wide-ranging remedies which will require significant implementation if the CMA settles on these in the final report. As such, we would repeat our call that further action from the Commission would not be welcome while domestic initiatives such as these are ongoing.

Below we answer a selection of questions relevant to the BSA and its members:

Can any of the barriers which prevent firms from directly providing financial services cross-border be overcome in the future by digitalisation and innovation in the FinTech sector?

35. Notwithstanding the many barriers we have outlined above, and those we echo from the EBIC response, there are some areas where digitalisation is enabling remote access to financial services. One good example is in the area of advice. One of our members, Nationwide Building Society has a service called Nationwide NOW which enables customers to access advise – from Mortgage Advisers, Financial Planning Managers and Personal Banking Managers – via a high definition video link service. They are the first financial services provider in Europe to use this technology in this way and it is a service which could conceivably be used cross-border. Another member, Skipton Building Society, offers a webchat service for mortgage intermediaries which could also enable cross-border business. Challenges would, of course, remain in terms of language barriers for both of these technologies to function effectively.

What can be done to ensure that digitalisation of financial services does not result in increased financial exclusion, in particular of those digitally illiterate?

36. The BSA is a member of the UK Financial Services Vulnerability Taskforce which recently published a report on Improving Outcomes for Customers in Vulnerable Circumstances including those who are digitally excluded. As mentioned, the building society sector prides itself on maintaining a branch network. However, the report recommends that where branches are closed, financial services firms should offer supported services, such as assisting the customer to gain digital access or supporting them with switching to an alternative firm with local branches.

What should be our approach if the opportunities presented by the growth of digital technologies give rise to new consumer protection risks?

37. It is our experience in the UK that fintech firms currently operating in the area of mortgage lending, for example, only operate in non-regulated sectors of the market. One of these is Land Bay which does Buy-to-Let lending. A Buy-to-Let mortgage is one which is secured against a

residential property that will not be occupied by the owner of that property or a relative, but will instead be occupied on the basis of a rental agreement. Of course, under the MCD part of the Buy-to-Let market will come under conduct regulation under the 'Consumer Buy-to-Let' regime. It will be interesting to see whether fintechs choose to continue operating within regulated Buy-to-Let.

38. Another example is Lend Invest which operates in the bridging finance market. Bridging loans are typically taken out to enable a property transaction where the borrower wishes to buy a new home before the sale of their current home has been completed. The question for the Commission, therefore, is what action should be taken if fintechs which have up until now functioned in non-regulated financial services begin to move into regulated areas. There are examples where this has already begun – in investments for example – though unlike mortgages, these are not areas in which advice is mandatory for most customers.

39. In allowing a single market for fintech and innovative products, one area for future consideration may be to ensure that access to providers across Europe comes with minimum standards. The Deposit Guarantee Scheme Directive (DGSD), for example, does not cover saving through peer-to-peer platforms. This leaves deposits at risk of loss in a future financial crisis – which would have incredibly damaging effects on the nascent fintech industry. We argue that the extension of DGSD to all innovative finance sectors would ensure a level playing field between different types of provider.

Do customers have access to safe, simple and understandable financial products throughout the European Union? If not, what can be done to allow this access? Please specify if it should be by regulation or self-regulation or both

40. The UK has experience of such an initiative under the FCA's Sergeant Review. The focus of this Review was on four products: Easy Access savings accounts, 30 day notice savings accounts, Regular Savings Accounts and Fixed Term Life Insurance. These will be badged as Simple Financial Products and subject to consistent language, terms and conditions, product features, pricing transparency, purchasing process, and regular information and product updates. The BSA was involved in this project, welcomes the recommendations and continues to be involved in its implementation.

41. However, we would be reticent about any proposal to make wider-suites of products 'simpler' through regulation. The FCA's review focuses on products which are relatively simple by their nature. Such an exercise for mortgages, for example, would be far more difficult given the wide range of rates, product features, fees, charges and other elements. We are aware that there are significant cultural differences in the various mortgage markets across Europe. In Germany it is typical for mortgage borrowers to fix their rate for upwards of ten years. This is rare in the UK – where fixing for two to five years is the norm.

42. For products such as annuities or other pension products a 'simple financial products' exercise would be even more difficult. We believe that some products are inherently 'complex' due to the complexity of the underlying financial transactions, and instead the Commission's focus should be on providing sound advice to consumers rather than applying a veneer of simplicity through regulation.

What can be done at the EU level to facilitate access for service providers to mandatory professional indemnity insurance and its cross-border recognition?

43. In the UK lenders and deposit takers deal with a range of professional sectors covered by professional indemnity insurance. Each of these schemes tends to be monitored by a different professional body, including the Solicitors Regulation Authority, the Financial Reporting Council, the Architects Registration Board and the Royal Institute of Chartered Surveyors. We find it difficult to envisage how all of these bodies could be brought under one EU-wide umbrella across all member states given the range of jurisdictions and professional standards.

In your opinion, what kind of data is necessary for credit-worthiness assessments?

44. For mortgages in the UK a lender will assess a customer's credit worthiness by looking at their proof of identity, information on their income from independent sources, their expenditure and any outstanding credit obligations. They will also look at credit rating data – some use this to automatically provide a 'credit score' for the customer whereas others underwrite manually.

45. Three credit ratings agencies (CRAs) provide credit data to lenders in the UK. This details information on a range of things such as how much credit the customer currently has outstanding, their address history, whether they make repayments for loans, credit cards, utilities, leases and other debts on time and any County Court Judgements found against them.

46. In order to create a Europe-wide credit rating scheme, commercial CRAs would need to be compelled to share their data with those of other member states. There would need to be strong principles of reciprocity. Currently this takes place in the UK under the Steering Committee on Reciprocity of which the BSA is a member. There are other practical issues however – address history, for example, is facilitated by the Royal Mail's address database which includes postcodes. Postcodes and address formats are unlikely to be uniform across member states.

Is further action necessary to encourage lenders to provide mortgage or loans cross-border?

47. Please see 'mortgages' section above and the EBIC comments on this question.

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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.

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