# EU regulatory framework for financial services: Call for Evidence

BSA response to the European Commission

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Building Societies Association

# Introduction

We welcome this initiative from Commissioner Hill and his team at the new DG FISMA. In issuing this call for evidence the Commissioner is taking a step back to look at the bigger picture, ask the right questions, and challenge past thinking. We would be very pleased to assist DG FISMA further with follow-up conversations after the close of the initial consultation.

The **Building Societies Association** (BSA) is the voice for the UK's 44 building societies (each of which is a credit institution for EU purposes) and for some large credit unions. Together our members serve over 20 million customers up and down the length of the UK and have total assets above £330 billion. Building societies serve a social purpose – they provide a safe home for the ordinary consumer's savings and in turn lend to consumers on mortgage to buy a home – and have been doing this since the 18th century. But our members vary greatly in size : our largest member, Nationwide Building Society, is a domestic systemic institution - D-SIB or O-SII, while around half of our members have total assets below £ 1 billion. What they all have in common is a legal construct and purpose set out in the UK's Building Societies Act 1986.

The principal differences compared to proprietary (PLC) banks are that building societies are:

- member owned, not shareholder owned. Underpinned by democratic voting rights, in particular, one member one vote.
- required to have the sole statutory purpose of making loans on residential property funded substantially by members' savings
- required to have at least 75% of assets secured on residential property i.e. home mortgages. In fact societies on average hold over 90 % of their assets in this low-risk class.
- required to raise a minimum of 50% of funding from retail deposits i.e. savings accounts. Again, building societies on average raised over 80 % of their funding from retail deposits.
- not permitted to speculate i.e. they cannot create markets or operate as an investment bank ; nor permitted to use derivatives other than to hedge risk positions on their balance sheet.

Including subsidiaries, BSA members hold residential mortgage balances of nearly £260 billion (say € 360 billion) - this equates to 20% of all outstanding mortgages in the UK. They also hold almost £240 billion (say € 330 billion) of retail deposits - 18% of all such deposits in the UK. BSA members employ around 40,000 full and part-time staff and operate through 1,550 branches as well as on line and by telephone.

In responding to this Call for Evidence the BSA has focussed on areas relevant to our members, especially the questions of proportionality and diversity. We congratulate DG FISMA on a systematic approach and a comprehensive set of issues covered in the online survey. We welcome the contributions from other, specialised trade associations who have been able to go into more detail and contribute across the whole spectrum of issues. The BSA is a member of the **European Association of Co-operative Banks** and we particularly support the more comprehensive response being submitted by the EACB, to which we have also contributed. We have provided detailed responses through the online survey on a few issues, and in this overview draw together some general, and cross-cutting observations.

# General comments

We welcome the Commission's readiness to consider improvements in the corpus of existing legislation. In some cases, even where we criticise an original measure as unnecessary or disproportionate, once this has been implemented, we do not necessarily propose that the measure is reversed. Where administrative systems have had to be changed, and substantial irrecoverable costs have been incurred, the least bad outcome may be to continue with the current situation, rather than require further change. In such instances, what we call for is that the lesson learned on one dossier should be generalised and inform consideration of new dossiers, so that similar mistakes are not repeated.

We have provided detail through examples under the issue heading that seems the closest fit with the nature of the issue itself – though a few examples could illustrate more than one issue, we have not repeated them under more than one issue heading (except in one important case). We have one overriding concern which brings together several major issues : we can best describe the concern as **"The cumulative impact of post-crisis regulation, often applied disproportionately, has gone beyond the tipping point at which the net incremental effect on economic welfare turns negative."** This concern brings together the Commission's Issue 1 (unnecessary regulator constraints on financing); Issue 4 (proportionality and preserving the diversity of the EU financial sector ); Thematic Area B ( unnecessary regulatory burdens ); and Issue 10 (Links between individual rules and overall cumulative impact).

# Unnecessary regulatory constraints on financing

In our detailed comments given through the online survey with our example we do say that the CRR provisions and transitionals in themselves were reasonable – but the latter were telescoped by "front-running" at member state level, e.g. insisting immediately on "end-point" definitions of capital. There should perhaps then have been a moratorium on further changes to capital requirements, while the effect of CRR and BRRD was absorbed and understood, so that any further actions would be proposed only in relation to gaps or defects that still remained. But this has not happened – instead, various other parts of the capital requirements regime continue in motion at Basel level, but without any clear discipline to assess interactions and cumulative impact. The introduction of IFRS 9 will lead to major one-off increases in the level of impairment charges, so depressing reported profits and reducing the accrual of reserves to capital – a particular concern for mutuals. With Basel's proposed changes to the credit risk framework affecting the same assets, but proceeding in isolation from this, we suspect there will be another case of double counting in the pipeline.

# Proportionality / preserving diversity in the EU financial sector

Our research[1] has shown that allowing a diverse range of firms, by model and size, to provide financial services brings significant benefits for all concerned. These benefits are both increased competition but also increased resiliency. As firms operate with different incentives and goals, they compete to win and serve customers in different ways. This can improve consumer choice and innovation.

Secondly, it helps the system as a whole to be more resilient: when a shock such as the global financial crisis hits, firms with different approaches to running their business, for example raising funds, and different business models, such as customer owned mutuals, are affected in different ways and will react differently. This avoids group-think, and lemming-like reactions to outside stresses.

On the question of proportionality, the debate has been greatly advanced by the recent contribution[2] from the Bank of England, which we believe is finding resonance in some other member states. We strongly support the key points made by the Bank : in particular

***A "one size fits all" approach of common binding rules for all banks, no matter what their size, complexity or level of cross-border activity, can cause distortions given that the costs of regulation tend to bear more heavily on smaller banks.***

***Often the benefits of regulation are proportionately bigger for larger or more complex banks, while to the extent that regulation imposes fixed costs those will tend to bear more heavily on smaller banks.***

***A differentiated approach** …………**can also recognise the lower benefits, and sometimes higher costs, from regulation of smaller banks. More proportionate rules can help to promote competition and growth.***

***There is a case for ensuring that regulatory reporting requirements do not go beyond what is necessary for effective supervision of smaller banks***.

# Conclusion

We stress again the BSA's appreciation of this opportunity to review what has been done by the EU to regulate financial services, and to remedy, or learn from, any past policy mistakes that may now be identified. We wish Commissioner Hill and DG FISMA well with the task that lies ahead of collating, analysing and assessing the evidence received, and deciding which actions are needed. We remain available to assist DG FISMA further on the matters on which we have contributed comments and evidence.

BSA January 2016

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[1] https://www.bsa.org.uk/getattachment/Information/Publications/Industry-Publications/A-diversity-index-for-financial-services/BSA-Diversity-Summary-Apr2013.pdf.aspx
[2] http://www.bankofengland.co.uk/pra/Documents/crdiv/responsecrrcrdivbankfinancingannex2.pdf

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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