Financial Services Future Regulatory Framework Review - Call for Evidence on Regulatory Coordination

Response from the BSA

17 October 2019

Introduction

The BSA has always supported fair, effective and proportionate regulation on both prudential and conduct aspects of financial services. The regulatory framework should encourage, not frustrate, the best outcomes for citizens and society. As circumstances change, the detail of the framework needs periodic review. The BSA is therefore pleased to contribute to this process, beginning with our response to this first Call for Evidence. We begin with some general observations, then we respond to the specific questions, along with some more detailed comments grouped thematically – legislation, prudential regulation, conduct and competition regulation. We refer in passing to various earlier BSA responses all of which are available on our website. And we support the individual responses from some of our members, who may address, in greater detail, aspects of particular relevance to their businesses. Important insights from those responses have also been collated and re-emphasised in this collective BSA response.

Context

The BSA represents all 43 building societies and six large credit unions, all of which are dual-regulated by PRA (as deposit takers) and by FCA, while HM Treasury is responsible for their constitutional legislation. BSA members are also subject to the jurisdiction of the Financial Ombudsman Service, which can function as a quasi-regulator. Some building societies and credit unions may also come under the Payment Systems Regulator in respect of payment accounts. BSA members collectively deal with 25 million customers.

General observations

We support the establishment of **design principles** – as outlined in paragraph 1.2 – which can serve as a yardstick to assess whether the current framework is producing the right outcomes. The items in paragraph 1.2 are all sensible and necessary. We think there are two aspects that are, at least implicitly, present but should be reinforced.

First, **parity** of treatment across different corporate forms. Fostering competition and innovation should promote **diversity of corporate form**, provided mutuals are accorded parity of esteem alongside the proprietary company model. Mutuals have a different mission from the shareholder capitalism of the banks: essentially, to make life better for their members. Both building societies and credit unions are driven by social purposes rather than profit, focus on the long term, and are democratically accountable to their members. This diversity will also reduce systemic risks, as a diverse field of providers, mutuals alongside PLCs, will be less prone to herd-or lemming-like behaviours. See our[1], and others'[2][3][4], previous work on this topic.

Second, **proportionality**. The first bullet already mentions that regulatory standards need to be **proportionate to the risks** they address, and the second bullet seeks to avoid **undue regulatory burdens** on firms from the operation of the regime as a whole. We strongly support both of these prescriptions. But our members' experience suggest that most instances of disproportionate or unduly burdensome regulation are accidental or inadvertent – not deliberate – and tend to arise where regulations are designed for large firms and rolled out with little or no modification to small firms too. The remedy is to act in reverse : **"think small first"**. We need, for instance, more differentiation of regimes between large systemic banks and small building societies. The EU with its banking "single rule book" has largely failed to achieve this, despite protestations. We expect the Government, post-Brexit, to do better.

[1] Cass Business School: Building societies are fit for the future – September 2015, BSA

[2] Diversity in European Banking: Why does it matter? – CEPS

[3]"Systemic risk in banking ecosystems" Andrew G. Haldane & Robert M. May, Nature, Volume 469, (2011)

[4]"Organizational Form as a Source of Systemic Risk" David Bholat and Joanna Gray (2013). Economics: The Open-Access, Open-Assessment E-Journal, 7 (2013-27)

Our high-level response to **Question 1** is that on the whole coordination works reasonably well, though there are instances where the various bodies have not appeared joined-up, or seem to engage in landgrabs or turf wars. At the same time, we note that the different bodies have different statutory or other imperatives, and may need to take different stances on certain topics. Turning to **Question 2**, the aggregate impact of regulatory demands, especially reporting, on our members' people resources and IT development programmes is extremely burdensome, often crowding out necessary customer-facing initiatives. Conventional cost-benefit analysis fails to identify the *cumulative* burden of concurrent initiatives – far greater than the sum of the parts. We doubt there are quick fixes, other than more restraint and better coordination on the part of regulators.

Building society and credit union legislation

An important part of the overall regulatory framework for both building societies and credit unions is their governing legislation – the Building Societies Act 1986 and the Credit Unions Act 1979. Managing the operation and evolution of this legislation involves **coordination** between HM Treasury and both PRA and FCA. Experience here has been broadly positive. There has been evolution under both pieces of legislation, for instance :

- for building societies, updates to the Building Societies Act (made by the Financial Services (Banking Reform) Act 2013, Sch.9) inter alia modified the application of the funding nature limit to SME deposits ; and
- for credit unions, several useful modernisations to the Credit Unions Act were made by a Legislative Reform Order in 2011, that facilitated offering new services to members.

But in neither case can this legislation stand still – both credit unions and building societies need to compete and innovate in the real marketplace, not in some Hovis-advert view of the world. We outline below some of the steps which are now necessary, again requiring coordination between HM Treasury, PRA and FCA. **We strongly encourage HM Treasury to take these modest requests, for both building societies and credit unions, forward in the context of the Financial Services Bill announced in the Queen's Speech on 14 October, following the useful 2013 precedent cited above.**

Building Societies

For **building societies**, a range of amendments to the Building Societies Act are called for. While the general framework of the 1986 Act, as amended by the 1997 Act, has stood the test of time, some modifications (often using secondary legislation enabling powers already available in the 1986 Act) are necessary. The most important group (which would need primary legislation) involves further modification of the **funding nature limit**. These would allow societies to serve small businesses better, to innovate in response to the growing prevalence of savings platforms, and to facilitate the operation of Sharesave plans and the holding of tenancy deposits. (There are other unrelated changes, some of which have been called for previously, which are set out in the Annex at the end of this paper.) We, and our affected members, are happy to provide further information / assistance to Treasury officials on any of these items.

In analysing the four individual funding limit modifications below, we first approach along the route already mapped out in 2013[5] for amending section 7 by way of partial disregards. However, we set out at the end a more logical and satisfactory way to amend section 7, to embody the principle of "looking through" (for nature limit purposes) pooled deposit arrangements to the individual customers whose money they are.

1. **Extend special treatment of SME deposits**: in 2013, a change to section 7 of the Building Societies Act introduced a partial disregard for SME deposits when calculating the minimum 50% member funding limit. Deposits from SMEs that are incorporated small businesses each with a turnover of less than £1 million can be disregarded up to an aggregate amount of 10% SDL - see section 7 (3) (aa), (3A) and (10). There are a range of SME thresholds in different areas of legislation, some UK-based, some EU derived. The £1 million turnover is at the lower end. So we advocate raising the section 7 figure to one of the higher existing thresholds - a particularly suitable one, we think, might be the turnover limit of £6.5 million for an SME whose deposits (like those of individuals) must be held within the ring fenced entity of a High St banking group and not in the wholesale/investment bank side. This change would not in fact need primary legislation, if using the partial disregard approach, as there is power in section 7(12) and (13) for the £1 million figure to be raised by negative resolution statutory instrument.

2. **Cater for deposits held through savings platforms**: as intermediation by savings platforms (such as Flagstone, Hargreaves Lansdown and similar) becomes more significant, the question of how the aggregate funds received by a society through the savings platform are treated for section 7 purposes becomes more important. BSA's understanding is that, while there are other structures, a typical structure is for the cash to be held in a kind of omnibus client account, with the society not informed under normal circumstances of the identity of the underlying savers (not surprisingly, the platform wishes to keep the client relationship). Consequently, these clients do not become members, and the aggregate cash cannot be held in a share account, but is held as a non-member deposit and therefore - although the underlying cash is still from individual savers - must be treated as deposits that count against the 50% nature limit. One possible mitigation would be for a partial disregard similar to the SME example above. So, an aggregate amount of savings platform deposits up to, say, 10% SDL that would otherwise count against the 50% limit, could be disregarded. This would require a change to section 7 by primary legislation. As mentioned above, a more logical and thorough reform would be to "look through" to the underlying nature of the funds.

3. **Cater for deposits arising from Sharesave facilities :** Sharesave (previously/also known as Save As You Earn) is a tax-efficient cash saving scheme that encourages employees to save small amounts regularly towards buying shares in their company at a favourable option price. The Sharesave plan providers/administrators are typically the major company registrars, who don't hold banking licences, and therefore need to place the cash savings in a bank or building society account. The current regulations

[5] Financial Services (Banking Reform) Act 2013, Schedule 9

mean that a building society can only hold Sharesave deposits in a member share account whereas banks hold such deposits in 'pooled accounts'. The 'cost to serve' per customer for building societies is thus prohibitive, and in fact Sharesave deposits are highly concentrated in two or three High Street banks – so it is high time to increase competition : this problem was first pointed out in 2016 . Two changes are needed : first, an amendment to the Sharesave regulations to allow a building society to hold Sharesave deposits in a pooled account, and either a similar amendment to section 7 to allow a certain amount of aggregate Sharesave deposits, which are beneficially owned by individuals, to be disregarded for the purposes of the section 7 limit, or – more logically, a "look through" as described above.

4. **Tenancy deposits** : building societies are at similar disadvantage when approached to accept deposits under the statutory Tenancy Deposit Scheme which protects tenants from abuse by landlords retaining such deposits. Equivalent changes are needed to allow building societies both to hold such deposits in pooled deposit accounts, and either for a certain aggregate amount of such deposits to be disregarded for section 7 purposes, or for a "look through" approach.

The "look through" approach would work like this. Whereas the current approach in the section 7 amendments in 2013 disregards a certain amount of one category of funds from the calculation in section 7(2), a different amendment to section 7 could simply aggregate defined categories of SME or pooled deposit accounts with the total of shares (that is, Y in section 7 (2)). This would have the effect of treating these funds – for nature limit purposes only - as being in the same bucket as share accounts.

The common thread running through these items is the need to adapt the detail of the Building Societies Act to cater for a range of situations in everyday life, in a way that benefits ordinary people and businesses by increasing competition and supporting innovation. Such changes should surely find a place in a Bill described in the **Queen's Speech**[6] as follows

*"Steps will be taken to provide certainty, stability and **new opportunities for the financial services** and legal sectors."* (emphasis added).

Credit unions

For **credit unions**, the changes needed are both simpler and more far-reaching and, moreover, **the necessary work has already been started within Government, but appears to have been left unfinished**.

In 2014, HM Treasury carried out an excellent and thorough review of credit union legislation, based on a **Call for Evidence : "British Credit Unions at 50"**. In December 2014, after extensive engagement with the sector, the Treasury published its response[7] and conclusions. In this response, the following point was made in the Key Messages from Government (paragraph 3.3) :

However, the government is concerned that the legislative and regulatory framework may be unnecessarily holding back those that want to expand and innovate.

Later, the response states :

The government recognises the credit union sector's calls for various revisions of the current legislation. In general, these legislative changes require primary legislation and will therefore need to be considered under the next parliament.

[6] https://www.gov.uk/government/speeches/queens-speech-2019
[7] https://www.gov.uk/government/consultations/british-credit-unions-at-50-call-for-evidence

However, the government is today committing to consider potential changes to the legislation on credit unions in the next parliament, subject to the availability of an appropriate legislative vehicle.

The useful work done in the 2014 Call for Evidence, and the sound conclusions drawn by the Government, should not be ignored or discarded, but rather taken up and carried forward. Further consultation on specific measures would be appropriate, but it is unnecessary - indeed counter-productive - to start at the beginning and re-invent the wheel.

The first item on the Government's list for legislative changes in December 2014 was to **broaden credit unions' objects**, to avoid sterile interpretational arguments about whether necessary new products and services fall within the scope of statutory objects and other provisions enacted in 1979. In particular, credit unions need to be clear that they can mediate basic personal or household insurance (e.g. contents cover) to members separately from a loan, and finance cars through hire purchase or personal contract plans, not only through traditional unsecured personal loans.

So, in addressing the future regulatory framework, for credit unions what is needed is to revisit the 2014 work, pick up the conclusions, and finish the job. The item at the top of the list, to broaden credit unions' objects, could readily be accommodated by a few lines in the forthcoming Financial services Bill. Again, referring back to the **Queen's Speech** :

"Steps will be taken to provide **certainty, stability and new opportunities for the financial services** and legal sectors."

Today, on International Credit Unions Day (17th October 2019), our large credit unions and their members deserve no less.

Prudential regulation

The field of prudential regulation illustrates both the importance of future coordination and some past failures and suboptimal outcomes where poor coordination may have played a part.

Proportionality

For a decade or more, the prudential regulation standards for UK building societies have largely been determined at EU level, finally settling-in as the "Single Rule Book" for banking whereby, mistakenly, Basel standards for large banks were rolled out to the smallest building society or local cooperative or savings bank (but not, however, to credit unions, which benefit from an exemption from EU banking legislation). There have been token gestures towards proportionality, but not – at least until CRR 2 and EMIR ReFIT – any worthwhile burden reductions.

The prospect of Basel 4 implementation also means the chance to get this right, at least for the UK (post-Brexit), if not in the EU. Instead of the now- discredited one size fits all "Single Rule Book" approach, the time has come for significant differentiation, in line with many other advanced jurisdictions. Counter-examples include both the recently established "Kleinbankenregime" in Switzerland, and the UK's own domestic regime for large credit unions. Neither should necessarily be adopted as a template, but both show that differentiated approaches are perfectly possible.

Cumulative burden

We support timely action by regulators to support better consumer outcomes. However, where the introduction of regulatory processes has been more difficult to manage, it is not just a question of time. Better coordination and a smarter introduction of complex changes could improve consumer outcomes and result in a smoother process for firms. Below we have sought to give examples where problems caused by introducing changes could have been ameliorated through better coordination and consultation.

The layering of regulatory requirements also creates complex inter-locking changes and planning requirements within firms as the changes will often burden the same underlying systems (as well as people and financial resources). This in turn also creates operational and debugging challenges within the IT infrastructure.

Having this large volume of change also creates opportunity costs : as firms are obliged to deliver regulatory changes, they are also often forced to delay/abandon product or service changes that could create consumer/market benefits. However, estimating these opportunity costs is incredibly complicated as there are too many variables. But we believe that if all UK bodies could agree to only implement a set amount of change together it would significantly benefit firms in order to budget and plan for change. Another helpful approach would be to revive the **earlier Government initiative[8] to curb the proliferation of regulation : *One In, One Out*, and apply it across the financial regulation of each sector whether by Government itself, PRA, FCAS, PSR or others.**

Each society benefits from having a prudential supervisor that is able to bring together a number of prudential requirements across different regulators through a single point of contact, with regular updates provided in a regulatory digest. However, we are conscious that the digest is not exhaustive and a degree of internal horizon scanning and interpretation needs to be maintained. For most firms the most efficient means of communication would be to have a one-stop-shop for obtaining regulatory requirements. This can be made more difficult where there is a high level of firm interpretation. Providing firms with flexibility is welcomed where there is clear and comprehensive guidance around an interpretation but for many new regulatory initiatives this has been lacking (e.g. regulation relating to Recovery and Resolution), and this can lead to a constant tide of evolving activity.

Regulatory reporting

A particular example of poor outcomes and waste of money resulting in part, we suspect, from poor coordination, is the imposition in the UK of the EU common reporting arrangements, COREP and FINREP. In the eventual implementation consultation[9], PRA was forced to admit that COREP/FINREP would be very costly for building societies (the PRA's estimate for the total cost burden falling on the building society sector was £278 million, which was more than 50% of building societies' total retained surplus for the relevant year) and bring no benefits for building societies (PRA could not identify any such benefits, not surprisingly as regulatory reporting for building societies was already adequate). Somehow, this was not spotted in time for COREP to be resisted at EU level. We suspect it fell between the cracks between PRA/FCA (or old FSA) and HM Treasury.

We encounter instances where regulators seeking primarily an overview of a particular market nevertheless insist on collecting data from 100% of firms, when data from the largest 95% or even 90% would suffice. Nor do we think that giving regulators some form of direct electronic access to firms' internal systems is a panacea for reporting burdens – we suspect this idea has not been adequately thought through.

We understand the desire of regulators to see the use of automated reporting in firms which is able to extract core system data into regulatory returns; where in theory a regulator could modify a reporting script, or create a new script, in order to adjust returns to align with changing regulatory requirements. However, there are a number of significant hurdles to such

[8] One-in, One-out: Statement of New Regulation : April 2011

[9] CP 5/13 : Strengthening capital standards: implementing CRD IV August 2013, Chapter 15 Economic Analysis.

a system and approach. The first is the lack of uniformity in core platforms and coding/naming conventions across the industry. This makes a system capable of capturing information consistently quite difficult. Any system that pre-specifies data fields will become out-dated as soon as the requirement extends beyond those data fields, making future proofing very difficult. It also implies that in order to enhance the system's longevity, there would be a need for a substantial starting set of fields. This would suggest the initial cost (both time and money) of implementing such a system would be very significant.

Inappropriate or discriminatory regulation

An area where there should be scope for differentiation from the current EU position is in MREL requirements. The current MREL regime aims to ensure that if a large bank fails it should be capable of being recapitalised in resolution to a level that enables it to remain authorised. For firms that are leverage constrained – which will include many firms with predominantly low risk assets on their books – this appears to result in excessive and therefore inefficient requirements in relation to loss absorption. It would be much more appropriate for MREL to comprise a loss absorption amount based on risk weighted Pillar 1 +2A capital, and a recapitalisation amount equivalent to the higher of Pillar 1+2A or the leverage ratio. We also call for a re-examination (without pre-conceptions) of the lower thresholds at which MREL is required, as evidence mounts that the UK has pitched these far lower than other European jurisdictions (all subject, at present, to the same BRRD provisions).

Paragraph 2.12 of the Call for Evidence discusses regulators' powers to issue guidance, recognising that *"although not binding in the manner of legislation … [guidance] forms part of the material which firms must take into account to meet regulatory requirements."* A specific example of guidance that applies to building societies only is PRA Supervisory Statement 20/15 – "Supervising building societies' treasury and lending activities". This explicitly sets out the regulator's expectations in relation to building societies' risk appetites and management capabilities. While the guidance in SS20/15 may itself be reasonable, it risks breaching the important principle of parity that we highlighted in our opening remarks, as the guidance must strictly be taken into account by building societies, but not necessarily by other firms operating in the same product markets. **It is noteworthy that recent problems seem to have emerged largely at fast-growing banks that are not subject to an equivalent level of prescription as SS 20/15.**

Conduct and competition regulation

General observations

Paragraph 1.1 sets out the scope of the Call for Evidence, which is 'the regulatory framework'. In short, this comprises the institutions that develop, implement and enforce policy and regulatory requirements, and the mechanisms by which they are accountable.

In our view, the fragmentation between 'horizontal' (cross-industry) and 'vertical' (financial services-only) laws, rules and regulations, and the multiplicity of such provisions, greatly hinders the protection of consumers of financial services. The UK has reached a point where it is very difficult for average consumers, especially of financial services, to understand their rights and obligations. This is not because of opaque financial services communications or products, but because of the highly fragmented and uneven nature of UK consumers' rights.

Governments have long recognised the problem and attempted to address it (for example, quite recently with the Consumer Rights Act 2015), but the efforts have consistently fallen short of what was required. Continually adding further laws, rules and regulations, together with numerous modifications, amendments and optimisations, has compounded the problem.

The enforcement dimension is important as well. The FSA's fines for the whole of 2007 amounted to £5.3 million. This was just before the financial crash and when much of the misconduct outlined above was (in practice) well underway, i.e. at the point when much of the damage had already been done. By contrast, in 2014, FCA fines amounted to nearly £1.5 *billion*.

There is a great deal of evidence that this move to robust enforcement, although welcome, came too late. And, even with the advent of more robust enforcement, there was still an almost complete lack of sanctions against senior executives in many of the firms that were heavily responsible for the most serious conduct failings; but we recognise that the *strengthening accountability in banking* (senior managers' and certification regime – SM&CR) changes are designed to address individual accountability.

Therefore, in terms of lessons about regulation, the year 2007 and the period leading up to it were pivotal. It was a time of –

- a great many regulations,
- little enforcement, and
- much misconduct.

Whatever else happens, we must not repeat the '2007 experience'. An alternative expression of this problem is that it can be tempting to opt for *structural* changes – additional layers of laws and regulations, new regulatory bodies and structures – but what might be termed *behavioural* changes – the approach to how the regulator applies and enforces regulation - might be more effective, and certainly merit consideration.

Counterfactuals are of course impossible to prove but, if the FSA had done a better job as a robust and consistent enforcer, we would probably be in a much stronger position now. By the same token, had the regulatory conduct rules been simpler and better-focused, it might have been easier to shine a light on some of the malpractice referred to above, and to avert the need for litigation and so many complaints. For instance, the FSA's ICOB Rules failed specifically to address the underlying elements of the PPI scandal (which were not complicated), although the High Court held that the high-level principles were a sufficient foundation for enforcement purposes.

In the BSA's January 2017 response to the FCA *Mission* consultation, we made the following point in the context of regulation by the FCA's predecessor, the Financial Services Authority –

> *" In 2007 (just before the financial crash), a House of Commons library report described the volume of material emanating from the FSA as "near-legendary" and noted how, in response to complaints of regulatory overload, it had been "reduced now to a mere 8,800 pages". Yet, since the formation of the FSA in 2001 (replaced by the FCA in 2013) we have had many serious conduct issues; for example, in relation to mortgage endowments, PPI, LIBOR, foreign exchange, sales incentives, systems and controls, interest rate hedging etc.*
>
> *The comparison between the size of the regulatory output and the number of major conduct problems is as clear evidence as we are ever likely to see that more regulation is not the same thing as good regulation. Yet some people and organisations, whose*

reaction to problems is usually a call for additional laws or regulations, appear to disregard the clear evidence. We find this 'simplicity-denial' difficult to understand."

Therefore, there was a pre-financial crash base of numerous conduct-related rules and laws, and considerable further strengthening of relevant law and regulation since the crash, for example, through the –

- Mortgage Market Review
- Mortgage Credit Directive
- Retail Distribution Review
- Payment Services Directive 2
- Senior Managers and Certification Regime
- General Data Protection Regulation, etc.

Nonetheless, despite all of the changes outlined above, regulators and others are currently involved in a large number of exercises intended to improve conduct in firms – in some cases, even before recent relevant changes have fully bedded-down or been tested. The initiatives apply either to one side of the book or, in some cases, generally. Some are 'horizontal' and others are 'vertical'. They come from a range of sources and sometimes overlap. Examples include –

- duty of care proposals (FCA)
- financial advice review (FCA)
- loyalty penalty super-complaint (CMA)
- mortgage proposals and research (FCA)
- the 'Breathing Space' exercise (HM Treasury)
- SVR switching (FCA)
- retail banking business models review (FCA)
- savings price discrimination remedies (FCA)
- vulnerable customers (FCA).

We understand the need for serious work in certain areas (such as vulnerable customers), which we have supported, but, overall, this constant legal and regulatory churn is not good for consumers or businesses, yet there seems to be little recognition in government or regulatory circles that it is a serious problem.

In the BSA's response to the FCA *Mission* consultation (please see above), we also made the following plea for stable regulatory structures and arrangements –

> *"Too much change in regulatory bodies and responsibilities, and the requirements regarding senior management frameworks and requirements within firms, is ultimately counter-productive. We have been through a period of great (and, in many ways, understandable) upheaval in these areas, but the best thing now for the UK economy and markets, consumers and firms would be a long period of stability in order to allow the new arrangements to bed down and take effect."*

Whilst general consumer laws and rules are not within the scope of the Call for Evidence, the fragmented nature of the regulatory structures are clearly central to the Call. It would be highly desirable if, post-Brexit, a much more coherent position in the interests of UK consumers could be achieved based on –

- fewer, stronger, more consistent rules and laws,

- closer co-ordination, and indeed demarcation of responsibilities, among the numerous regulators (just as firms must be clear about precise responsibilities, so should regulatory bodies), and

- better, more focused, enforcement.

When conduct regulators see activities and behaviours which they do not like, they have a number of options including market studies, new / additional regulation and active / intrusive supervision. We believe that conduct regulators already have substantially all the tools they need to deal with poor behaviours that endanger good customer outcomes. The FCA should devote more of its effort and resource to active / intrusive supervision rather than resorting to ever more layers of regulation and policy.

We would not draw the current regulatory picture if we were able to start with a blank piece of paper, but we are very cognisant of the fact that, as well as constant churn in laws and rules – and as the Call for Evidence acknowledges – the regulation of the financial services industry has been through considerable upheaval in the last two decades -

Year	Changes
2000	The Financial Ombudsman Service begins operations - although technically not a regulator, its decisions can have considerable implications, eg through provisions for root cause analysis etc
2001	The Financial Services Authority assumes responsibility from the individual sector regulators
2013	'Twin peaks' regulation – the PRA and the FCA – replaces the FSA
2014	The CMA replaces the Office of Fair Trading and the Competition Commission. The OFT's responsibilities for consumer credit pass to the FCA
2015	The FCA acquires full competition powers, concurrently with the CMA
2015	The Payment Systems Regulator becomes operational
2015-9	Other significant changes take place including the establishment of the PRA Rulebook and supervisory statements, and the gradual introduction of the SM&CR rules by both the PRA and the FCA.

Financial services firms are, of course, also subject to regulation by the Information Commissioner's Office, the Advertising Standards Authority and, pending Brexit, EU regulators.

Taking into account the substantial changes in the last twenty years or so, we do not advocate any fundamental change to the UK regulatory architecture. However, the Government could make some modest improvements without disturbing the regulatory framework, as follows.

In order to explain, we need to go back to the existence of horizontal and vertical rules and laws binding financial services firms. The table below provides an overview of the position.

<table>
<tr><th colspan="2">Financial services consumer conduct provisions</th></tr>
<tr><td colspan="2"><u>Principles</u>
• FCA Principles for Business
• FCA conduct rules
• FCA TCF outcomes</td></tr>
<tr><td><u>‘Vertical’ provisions</u>
financial services-only

• FCA Handbook

conduct of business rules and guidance, and
other relevant provisions, which currently include –

o BCOBS - banking
o MCOB - mortgages
o CONC - consumer credit
o ICOBS - insurance
o COBS – investments

o DISP - complaint handling
o UNFCOG, RPPD - fairness guidance
o SYSC - systems and controls
o TC - training

• Consumer Credit Act 1974
• Payment Services Regulations 2017
• FCA competition remit
• Financial Ombudsman Service (not a regulator but an influential part of the retail conduct jigsaw)</td>
<td><u>‘Horizontal’ provisions</u>
cross-sectoral (financial services and others)

Key provisions include –

• Advertising standards
• Competition legislation
• Consumer Rights Act 2015
• Consumer Protection from Unfair Trading Regulations 2008
• General Data Protection Regulation 2016
• Equality Act 2010
• Other statutory, and various common law, provisions</td></tr>
</table>

Each provision is very detailed. There are significant overlaps among the horizontal and vertical provisions; for example, the FCA and the PSR have competition enforcement remits, as does the CMA. The CMA will often engage in an initiative that overlaps the FCA’s competition remit, such as loyalty penalties and SVR switching. This potential for overlap is also true in relation to other areas, such as fairness of consumer contract terms. And there are also, no doubt, personal motivations and organisational rather than policy pressures that lead to dysfunctional land-grabs and turf wars.

Government sometimes introduces horizontal requirements without making sufficient allowance for existing vertical regulation; for example, HM Treasury's Breathing Space exercise covers much the same ground as the FCA Handbook (eg MCOB 13).

All of this means that there is high risk of double jeopardy, and a need for air traffic control.

Furthermore, Government departments and the CMA are not subject to the disciplines set out in the Financial Services and Markets Act. Existing memoranda of understanding do not appear sufficient to ensure logical and effective coordination.

Most important, because of the fragmented and complicated series of legal and regulatory provisions concerning conduct and competition, it is (as noted above) very difficult to see how we can expect average consumers to understand their rights and responsibilities.

Generally (albeit with a few exceptions), non-financial services sectors are not subject to the same level of detailed requirements as financial services firms. In addition, financial services customers have the benefit of being able to escalate complaints to the largest ombudsman service in the world, the Financial Ombudsman Service.

The problems that we described earlier would be much reduced if we had a statutory code of consumer rights, consistent across all sectors (private and public), but regulated at a detailed level by individual sector arrangements. However, we recognise that this is beyond the scope of the Call for Evidence and, in any case, there is clearly little prospect of such a radical transformation in the short or medium-term, even post-Brexit.

Therefore, in view of the fact that the FCA regulates the conduct of financial services firms, including competition requirements, we believe that (within its regulatory perimeter) it should be solely responsible for regulation and enforcement (without concurrent jurisdiction from the CMA). However, because of the specialised nature of its work, and its close association with the FCA, we believe that the PSR should maintain its existing competition responsibilities.

Payment systems

Despite their piecemeal nature, we understand the need for and welcome some of the changes listed in the table above, particularly the creation of the new payments regulator, the Payment Systems Regulator (PSR).

The PSR, operating under the umbrella of the FCA, has set to work at breakneck speed to reform the payment systems landscape; improving competition, breaking down barriers for new entrants and generally making things better for those financial intuitions, including building societies, which rely on agency banking arrangements. While there are significant challenges ahead, the PSR has hit the ground running and much of the changes it has mandated are to be welcomed.

That said, the PSR can be prone, as other financial regulators are, to focus on developing regulatory solutions aimed at large banks to the detriment of smaller players. A recent prime example of this is the development of measures designed to combat Authorised Push Payment (APP) fraud; namely the CRM Code and Confirmation of Payee. While the sector supports the overall aim of these measures, it is clear they were designed primarily with clearing bank current account providers in mind. The majority of building societies do not offer current accounts and the measures as currently drafted simply do not work[10] for building societies or credit unions. As mentioned earlier in this response, problems such as these could

[10] BSA response to PSR consultation CP 19/14 - Confirmation of Payee

be averted if the regulator were to **"think small first"** and ensure regulatory requirements work for deposit-takers other than the larger banks.

Poor consultation outcomes, overlaps, air traffic control problems – other specific instances

Starting with the positives, the current FCA approach to policy development has been generally good, with opportunity to engage policy teams at an early stage (particularly the increasing use of Discussion Papers prior to formal consultation and policy decisions). Embedding this practice as BAU is recommended.

A recurring problem with the current consultation process is that each consultation paper only looks at each regulatory change as a standalone piece. However, over last 24 months the financial sector has been asked to respond to a high volume of regulatory change, including implementing the General Data Protection Regulation, Open Banking, from the CMA - text alerts regarding overdraft charges, future cheque imaging, the Payment Services Directive 2 (including secure customer authentication and confirmation of payee), and with significant requests for information driven by the CMA's Retail Banking Marketing Order and the FCA's Strategic Review of Retail Banking Business Models. While these are changes which taken individually should create benefit for consumers; the changes should be viewed holistically and cumulatively. Delivering overlapping requirements for numerous regulatory agencies often taxes the same people resources within a firm who are simultaneously trying to update legacy systems which would provide the infrastructure needed to provide better services to customers.

Indeed, the volume, complexity and limited implementation timescales of much regulatory change is placing material pressure on firms and their ability to drive strategic/customer propositions forward. We continue to see regulators working across common areas, such as FCA and CMA (treatment of existing customers, payment services), and it is important that a lead regulator is able to take ownership of regulatory change. As an example, while the FCA is properly consulting on the Basic Savings Rate as a retail savings remedy, we are concerned that the CMA appears to be actively promoting its implementation. As mentioned above, the volume of information requests from FCA seems to be on the increase, and although longer periods are generally being provided for their completion, it is important that the regulators understand the disruption on internal resources these can create.

Current Account Competition and Overdraft reviews

The market has been subject to reviews and regulatory interventions over the last four years from both the CMA and FCA with the aim of improving competition and consumer outcomes in the Current Account Market. The FCA has undertaken reviews and published consultation papers and policy statements on - Strategic Review of Retail Banking Business Models, High Cost Credit and Information about Current Account Services. At the same time the CMA concluded its Retail Banking Market Investigation.

The different regulatory mandates, along with staggered implementation deadlines for the remedies and rules resulted in

- increased cost of change,
- potential consumer confusion due to multiple changes being implemented over an elongated period of time,
- delays in implementing propositional change due to regulatory uncertainty, and
- ultimately a delay in the industry implementing simple services to best meet consumer needs and prevent poor customer outcomes.

Anti-Money Laundering (AML)

The last few years have seen significant change in the AML/Counter Terrorist Finance (CTF) regulatory landscape to transpose the EU's 4th Money Laundering Directives (4MLD) and preparedness for a potential UK exit of the EU, such as the Money Laundering Regulations 2017, Criminal Finances Act 2017 and the Sanctions and AML Act 2018. The landscape continues to change at pace as UK develops further law and regulations to transpose the 5MLD and amend further existing UK law in the event of a UK exit from the EU. Other government economic crime initiatives such as the Economic Crime Plan and Subject Access Requests (SARs) Reform are also key elements of the wider framework and are yet to be fully understood and subsequently enacted in legislation. There has also been regulatory and legislative change not directly or solely aimed at AML/CTF but nevertheless impacting AML/CTF frameworks; such as Payments Services Directives, Immigration Act and GDPR. We do not in all cases dispute the necessity for this legislation but effort should be made to rationalise the framework post Brexit. Effective engagement in implementing change is also vital. Recent examples where this has not happened effectively include:

- The EU published 4MLD in the Official Journal in June 2015 for Member States to transpose in respective domestic law by June 2017, however the UK Government did not issue their consultation on the steps it proposed to take on the transposition until September 2016, some 16 months after the 4MLD was officially published. We could have moved forward its consultation and preparedness for domestic transposition far sooner. Unfortunately, implementation of 4MLD was then further disrupted by the 2017 General Election where Government and the FCA were required to suspend consultations for the duration of the campaign. Given the current political climate, this contingency should be built into the transposition of 5MLD.

- The Immigration Act 2017 and its predecessor in 2015 were introduced with the purpose of making the UK a hostile environment for illegal immigrants. They required firms to vet every current account customer against the Government's "list" of disqualified persons and at great cost to the industry as a whole. This was an expensive and complicated implementation for firms, requiring operational and technical change. In the aftremath of the "Windrush" scandal it transpired that the number of "disqualified persons" on the government list was in its 10's and not its 1000's. Although it was not direct AML/CTF regulation it did have Proceeds Of Crime Act (POCA) reporting implications. Also potentially, the effect of the legislation could be to push more people in to the "hidden economy" as opposed to dealing with illegal immigration.

Ombudsman funding models

A recent consultation on funding the Financial Ombudsman Service (FOS), which closed on 13 August 2019, lacked in-depth detailed analysis of the impact of the proposed funding approach across the sector and focused on one proposed new model without further consideration of other options some of which had been initially discussed in the FOS December 2018 consultation. The particular perversity of this single model was to penalise firms with good conduct and fewer complaints. It was also open for a very short period (six weeks) which gave limited time for firms to carry out their own analysis in order to fully assess the potential financial impact of the proposed model. In seeking sustainable funding models for regulatory institutions, we would encourage a range of options and enough time to understand how the changes may impact firms as a whole. A more accurate answer should assist in finding a more sustainable funding model for the institution. The BSA's critique of these FOS proposals is set out in more detail in our[11] specific response. As our Chief Executive Robin Fieth said at the time:

"I recognise the desire of the Financial Ombudsman Service for more stable funding in a post-PPI world, however there is a fundamental mismatch between this and the reality of their operational peaks and troughs. It is perverse that the recommended funding model will benefit firms with poorer customer service at the expense of those with a far better record of fair treatment. This is counter to the principles outlined in the July 2018 independent report into the Service. The BSA is a strong supporter of the Service, which has navigated the troubled waters of mass claims well. However, we see this proposal as a serious misstep and we urge them to drop it."

ANNEX – Building societies legislation

This Annex sets out a brief overview of desirable legislative improvements. More detail is available from the BSA. References below to " the Act" are to the Building Societies Act 1986 as currently in force.

Deceased Investors

Under Schedule 7 to the Act, where a saver dies leaving funds with a building society not exceeding £5,000, the society may pay out to a person claiming to be entitled on producing evidence of the death and a statutory declaration of entitlement, without having to obtain a grant of probate which is not an easy process. Where a society has done this, the payment out is valid with respect to any demand against the society from any other person claiming to be entitled.

HM Treasury has the power to increase the £5,000 amount from time to time. The amount has never been increased since 1986 - so with inflation it ought to be quite a lot higher. The BSA have repeatedly called for this to be increased.

Retirement Age

Section 60(8) of the Act states that the normal retirement age for a director of a building society means 70 years or such lesser age as the rules of the society prescribe. There used to be a retirement age set out in the Companies Act for PLCs but following the Equality Act 2010 which outlawed age discrimination those provisions were deleted from the Companies Act. But the statutory normal retirement age has never been removed from the BSA 1986.

(There is an informal view that because the Equality Act 2010 was made law subsequent to the Building Societies Act 1986, the statutory normal retirement age of 70 is superseded by the

[11] New funding structure for Financial Services Ombudsman penalises firms with fewer complaints

Equality Act 2010 so one can treat the Building Societies Act provisions as no longer applying. That is not how English law works - the standard way is for a subsequent Act of Parliament to specifically set out any earlier legislation which is being repealed or amended. So at present there are two contradictory statutory provisions. It would be much better if the retirement age provisions of the Building Societies Act 1986 were removed as has happened for PLCs under the Companies Act.)

Voting at General Meetings

At some PLC AGMs shareholders vote using hand held voting devices rather than in writing on paper - the result of the electronic voting is then displayed immediately on screen rather than having a delay while paper votes are counted. There is some legal uncertainty as to whether electronic voting at society AGMs is permitted because Schedule 2 paragraphs 34(1), (3) and (3A) to BSA 1986 refer to "voting paper" and "document". To allow the possibility of real time electronic voting at General Meetings it would be better if the Act clarified the position. A lawyer would not want to give an opinion that hand held voting devices can currently be used with the existing uncertainty as this runs the risk of a later legal challenge with the Courts potentially deciding that the entire voting at that AGM was invalid.

Virtual AGMs and/or to allowing members to join online

Some PLCs now hold virtual AGMs with shareholders taking part remotely – though these are much more common in the USA than the UK. Some institutional shareholder groups in the UK say there is more prospect of shareholders holding a Board to account, publicly challenging a Board, at a face to face AGM compared with a virtual AGM with the Board being in one room with no shareholders present but "taking part" over the internet. But some members might not want to travel and would instead prefer to take part over the internet. It might be useful for the Treasury and the BSA to explore the statutory limits on being able to (a) hold a virtual AGM and/or (b) permit members to take part remotely but with there still being a face to face AGM, and for the Act to be amended as necessary.

Execution of Deeds

Building societies should be able to execute Deeds without having to affix a Seal - years ago Companies could only execute Deeds by affixing their Seal. This was repealed allowing Companies to execute Deeds by just Director/Secretary signing. This change has never been made for building societies which makes them look very old fashioned – and is not a contentious change but would make things easier in practice for building societies and their advisers.

Signing of annual report and accounts

The Act requires the balance sheet and SFS to be signed by two directors and the chief executive. The equivalent documents for a company only need to be signed by one director.

Enfranchise second-named and subsequent joint members

The Building Societies Act (Schedule 2, paragraphs 7 and 8) currently vests the exercise of the membership rights of two or more joint members in the first-named account holder as the "representative joint holder" or "representative joint borrower." (In this respect, it essentially parallels the situation under the Companies Acts – currently the Companies Act 2006, section

286 – which reduces the practical administrative burden on companies and their registrars.) This is claimed to give rise to indirect and unintentional gender discrimination, as the default practice for couples' joint accounts is generally to record the husband first, though joint holders are entitled to choose the order in which they are named. A possible change, requiring primary legislation, would be to allow each society to enfranchise all joint holders. (The companies' legislation makes a nod in this direction by stating that the default position in section 286 is "subject to any provision of the company's articles".) While this change may be viewed as desirable, there are also major technical obstacles around whether each joint holder necessarily meets the qualifying shareholding / mortgage debt threshold, and the change would substantially increase the volume and cost of AGM mailings etc. as each joint holder would be entitled to separate member documents, with enormous environmental impact. There is also the risk of further complicating the task of maintaining an accurately de-duplicated register of members. The BSA's view is that, if necessary, the Act could be made permissive on this point – that is, each society could be able, if it wishes, to enfranchise the second-named by changing its rules accordingly, but certainly no society should be compelled to do so. This would put societies in a similar position to companies.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

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 £400 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.