

**HM TREASURY CONSULTATION - SPECIAL RESOLUTION REGIME: THE FSMA  
(CONTRIBUTION TO COSTS OF SPECIAL RESOLUTION REGIME) REGULATIONS  
2009****A Response by The Building Societies Association****Introduction**

The Building Societies Association welcomes the opportunity to contribute to HM Treasury's consultation on the FSMA (Contribution to costs of Special Resolution Regime) Regulations 2009 ('the Regulations').

The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 52 UK building societies. Building societies have total assets of over £370 billion and, together with their subsidiaries, hold residential mortgages of over £245 billion, more than 20% of the total outstanding in the UK. Societies hold nearly £240 billion of retail deposits, accounting for more than 20% of all such deposits in the UK. Building societies also account for about 36% of all cash ISA balances. Building societies employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

We note the consultation is post hoc - in that the Regulations are already in place - and that this reflects the need for the authorities to have reacted quickly in their resolution of Dunfermline Building Society in March 2009. We hope, nonetheless that the Government will be receptive to the industry's concerns about the Regulations, as they stand, and will be willing to amend the Regulations, as necessary to ensure an equitable approach for the future.

**The Regulations**

In essence, the Regulations provide for any SRR-related costs to be met by the FSCS, subject to a ceiling of the net amount the FSCS would have been liable to pay out had the bank in question been declared in default in the normal way.

**Lack of incentive on the Tripartite to control costs**

We understand the rationale for allowing any cost relating to the use of SRR tools to be met by the FSCS. And we acknowledge that this approach would provide an element of certainty to the industry about the extent of its total liability in the event of SRR deployment. However, we are concerned about the lack of incentive on the part of the Government to control its SRR-related costs that is implicit in this arrangement. There will, naturally, be a tendency for the Government to ensure it recoups the maximum amount possible from the FSCS and this will not promote a robust cost-control ethos within the Tripartite. Indeed, quite the opposite. We consider there to be a strong argument in favour of an obligation on the Tripartite authorities to pursue the least cost resolution. At the very least, we would want to see guarantees from the Tripartite that any action taken under the SRR will be subject to effective controls on cost. It would be appropriate for the Tripartite's costs to be subject to rigorous audit. The National Audit Office is likely to be best placed to conduct such an audit - the Regulations should provide explicitly for this.

**Lack of accountability**

We are concerned, too, about the lack of accountability of the Tripartite to key stakeholders. In particular, there is no provision for the FSCS - and in turn the deposit takers responsible for funding the FSCS liability - to challenge the propriety of costs

incurred by the Tripartite in connection with its deployment of the SRR. This is tantamount to taxation without representation.

To address this, we would like to see the establishment of a creditors committee of building societies and banks, which would have representation in the arrangements for the management of the assets of the resolved institution.

### **Recoveries**

The lack of detail in the Regulations about what might constitute legitimate SRR costs is acknowledged in the Consultation Paper and, as noted above, that is a concern to us because of the attendant absence of incentive for the Tripartite to control costs. Also significant is the absence of any definition concerning what might constitute 'recoveries', as these are subtracted from costs to give a net figure. For example, we consider that where there is a transfer or partial transfer of the bank's business to a new private sector owner, which involves a payment by the new owner in respect of the assets of the resolved institution it has acquired, that payment will be treated as a recovery in calculating the net cost of the SRR. Similarly, we expect interest earned by the Treasury on the assets of the resolved institution to be taken into account in the calculation of its SRR-related costs. It would be helpful to have confirmation within the Regulations that such payments and interest would be counted as recoveries.

More generally, the FSCS should not be required to meet any costs incurred by the authorities during the course of an SRR which the FSCS would not have been required to meet had the Scheme been deployed conventionally.

### **Notification of the industry**

Building societies - and other deposit takers - stand liable for the costs of SRR, but under current arrangements there is the potential for considerable uncertainty about the costs that they will be required to bear. In the case of Dunfermline, for example, there has, so far as we are aware, been no word from the Tripartite about the cost of the SRR. This creates uncertainty in the context of societies' planning and annual accounting processes. We would, accordingly, like to see a requirement for deposit-takers to be informed at the earliest opportunity of the approximate costs of the SRR and the liability for the FSCS that would be implied.

### **Impact on the wider industry**

Our concerns about the lack of costs control and accountability is exacerbated by the absence of any recognition of the impact of the SRR process on the wider market. For example, (under an arrangement broadly analogous to the SRR) the transfer of Bradford and Bingley liabilities to Santander was accompanied by an £18 billion injection of cash by the Government, £15.75 billion of which is liable to be paid by the FSCS. Whilst the Government's payment was in support of the liabilities which Santander assumed on the transfer (and was reduced by a payment by Santander of £612million in respect of the branches and headquarters offices of B&B) it gave the bank a big boost to its liquidity position and was followed by a considerable expansion of its lending activity in the UK, which saw its market share grow substantially. Competitors of Santander could be forgiven for feeling that they are effectively paying twice for Bradford and Bingley's failure; ie both through their FSCS levy and through the loss of business via unfair competition. This points to the need for the Tripartite to consider - in its future deployment of SRR tools - the full implications for competition in the retail markets of its actions.

Given the potential for distortion of the retail markets described above, we consider that a more sophisticated method for the recovery of SRR-related costs might be considered, which takes account of the benefit to the recipient bank of the transferred business of the failed bank. We recognise that this would need to be structured in such a way - eg spread over a number of years - as to ensure it did not constitute a disincentive to a bank being prepared to take on liabilities of the failed institution, under a partial or full transfer.

More generally, we recognise that the judgement, as to whether a bank is deemed to be in default or is resolved via the SRR, is appropriately one for the Tripartite. However, we are concerned that the knowledge that the industry will pick up the tab – via its funding of the FSCS – could distort decision-making. The Tripartite must always bear in mind that deployment of the FSCS is not a free good. The industry and, ultimately, their customers incur the cost whenever the FSCS is deployed. Priority should be accorded to solutions, such as a private sale of the distressed institution, which as far as possible avoid the use of the FSCS. Whenever the Tripartite is considering triggering deposit protection under the FSCS, either conventionally, or via the SRR, we consider there should be an obligation on the authorities to consider the impact on the wider deposit taking industry and their customers, as well as the impact on the failing institution and its depositors.

### **FSCS Funding review**

The building society sector's share of the costs of SRR that are borne by the FSCS are determined by the rules on FSCS funding and we look forward to the FSA's review of FSCS funding that is scheduled for 2010-11. Building societies are concerned about the disproportionate share of FSCS liabilities that they have been required to contribute, given that the failed banks have generally pursued more risky strategies than those followed by building societies. The BSA has been arguing that there is a strong case in equity for the allocation of the FSCS levies to be modified. We have proposed two ways in which this could be done:

- The contribution groups for deposit takers could be re-cast so that the banks meet in full the first slice of any FSCS levy resulting from a bank failure ie before other firms, including building societies, are required to contribute. Similarly, in the event of a building society-generated call on the FSCS, we would envisage building societies meeting in full the first slice of any FSCS levy, before other firms including banks were required to contribute.
- FSCS levies for deposit takers could remain based wholly on balance sheet quantities, but take account of total balance sheet size, rather than just the retail balance sheet.

Either of these options is likely to produce an outcome that, over time, is more fairly reflective of the relative riskiness of the business models of the building societies and banks.

### **Conclusion**

The Tripartite should never lose sight of the fact that the deployment of the SRR is not cost-free. The Regulations currently provide insufficient safeguards over cost control and accountability. The BSA considers that the Regulations need to be amended in several important respects, so as to introduce robust cost control for the Special Resolution Regime and to provide a forum for building societies' interests to be represented as creditors of a resolved institution.

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