

EBA CP 2012-11 DRAFT RTS ON OWN FUNDS – PART TWO

RESPONSE FROM THE BUILDING SOCIETIES ASSOCIATION (UK)

Introduction

The Building Societies Association (BSA) is pleased to respond to the EBA's Consultation Paper 2012-11 on Part Two of the draft Regulatory Technical Standards on Own Funds, and welcomed the opportunity to attend and participate in the EBA's public hearing on 26 November alongside two of our leading members.

The BSA represents mutual lenders and deposit takers in the UK including all 47 UK building societies. Mutual lenders and deposit takers have total assets of over £375 billion and, together with their subsidiaries, hold residential mortgages of £245 billion, 20% of the total outstanding in the UK. They hold more than £250 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for 31% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

General observations

The modifications for mutuals, cooperatives, savings banks and similar non joint stock institutions in Articles 25 to 27 of CRR recognise and respect necessary differences from the proprietary company model, and represent an important success for the European Union authorities, compared with the highly unsatisfactory "Basel footnote". Building on this consensus, the BSA agrees with the fundamental objective of these RTS – to ensure that the benefit of the modifications is only available to bona fide institutions in each of the permitted categories, and cannot be abused through artificial structures devised by investment banks.

We also recognise that the cooperative and mutual sectors in particular are diverse: there is no harmonisation at EU level, and differences owe much to national and even local traditions. It is not clear that it is possible to devise additional criteria related (for instance) to access to reserves, or to the redemption of shares, that apply to, or cater for, *all* existing bona fide cooperatives or mutuals. The BSA agrees with and supports the important comment made by the European Association of Cooperative Banks at the public hearing : these RTS should *not* become in effect *a further level of regulation* in addition to the Level 1 provisions in Articles 25 to 27.

We illustrate this point with the following example. The ability to redeem cooperative shares in accordance with some national laws and traditions is accepted, subject to prudential conditions, as a permissible feature of those cooperatives' CET 1 instruments – all as set out in Article 27 of CRR. But these provisions are permissive, not prescriptive. In other traditions (including the UK) cooperatives can (also) issue permanent, transferable shares (in which case they would not need to rely on article 27). There is also the distinction between primary and secondary cooperatives. However, the current drafting of Article 3 (c) makes the ability of the CET 1 holders to leave the cooperative and put their instrument back to the cooperative into the defining criterion of being recognised as a cooperative at all. This cannot be right – and the discussion at the public hearing moreover indicated that

the EBA recognises that cooperatives can and do issue permanent, transferable CET 1 instruments.

We also find the approach taken in paragraph (b) in each of Articles 3, 3a, 3b and 3c both indirect and potentially circular. From discussion at the public hearing, we understand that the purpose of these paragraphs is to make clear that institutions (i.e. joint stock banks) that can issue ordinary shares (under Article 26, without benefit of the cooperative /mutual modifications) cannot benefit from Articles 25 and 27. But the reference to “capital instruments referred to in Article 27” becomes almost circular, since Article 27 states that capital instruments issued by mutuals, cooperatives etc shall qualify as CET 1 only if the conditions laid down in Articles 26 and 27 are met. We think it would be simpler and clearer, if such a condition is needed at all, for the RTS to state in each paragraph that the institution cannot issue ordinary shares.

The criteria developed in paragraph (c) of each of Articles 3, 3a,3b,and 3c can be made to work, with some redrafting, for the relevant categories of institution – but in the BSA’s view, these provisions focus too much on secondary characteristics which are then given undue weight as the defining feature of each category. Nor do the RTS need to focus exclusively on elements linked to capital or reserves when defining what qualifies as a cooperative, mutual etc – we consider this is a narrow interpretation of the specific mandate, and we disagree therefore with the final paragraph of Section 3 of the CP (top of page 8). Instead, we suggest the EBA considers a wide ranging criterion along the following lines that would serve to include all bona fide cooperatives, mutuals, and savings banks operating under the specific national laws, while excluding artificial structures: policing of this could then be left to the competent authorities in each member state, as Article 25 envisages :

“The business of the institution is primarily, and demonstrably, carried on for the benefit of the customers and/or members of the institution, and/or as a service to the public, and not primarily in order to generate and pay a financial return to external providers of capital.”

In support of this important general point, we also draw attention to the significant changes in the mandate on which these RTS are based, since the publication of the Commission proposal text. In the latest compromise texts, it appears that the mandate will be more narrowly drawn, so that EBA is to specify *“the national laws of each Member State that govern the establishment and operation of mutuals, co-operative societies and savings institutions”* – i.e. corresponding to paragraph (a) of each Article, while the specification of further conditions – corresponding to (b) and (c) of each Article - is limited to the determination of what qualifies as a *“similar institution”*.

Specific comments

Under the categories of **savings banks** listed in **Article 3a**, the following entry needs to be added :

“ in the United Kingdom: institutions registered as a savings bank under the Savings Bank (Scotland) Act 1819.”

The Airdrie Savings Bank, an associate member of the BSA, continues to operate under this 1819 legislation. Other savings banks in the UK, established under later savings banks legislation, were consolidated into the Trustee Savings Bank group which was privatised in 1985 and later bought by commercial banking interests. The Airdrie Savings Bank, however, remains true to its original legislation and principles and is fully entitled to recognition under Article 3(a). More information about this bank can be found here :

<http://www.airdriesavingsbank.net>

The 1819 legislation also illustrates the difficulty of paragraph (c) : the Act itself does not explicitly state that distribution of capital, reserves etc is not allowed – saying instead that :

The persons depositing money with any institution taking the benefit of this Act, or their heirs, executors or other persons entitled thereto under the provisions of this Act, shall have the sole benefit of such deposits and the produce thereof, in the manner provided by the said rules, orders and regulations;

<http://www.legislation.gov.uk/ukpga/Geo3/59/62/data.pdf>

The BSA's formulation above would cater for this situation, and no doubt others, much better than the EBA's wording.

Turning to draft **Article 3b** on **mutuals**, the wording of paragraph (c) needs to be refined. In any mutual, the members do - in the ordinary course of business - benefit directly from the reserves, for the simple reason that the reserves provide a free source of own funds – the explicit cost of that capital is zero. This means that, other things being equal, a mutual bank or society will offer better savings and lending rates than it would be able to do if it were a joint stock bank and had to pay explicit dividends to shareholders. This is one of the key features and benefits of the mutual model as practised by the BSA's own members. So, as a minimum, paragraph (c) must be further amended to state *“These members do not, in the ordinary course of business, benefit from direct distribution of the reserves.”*

Again, the BSA's formulation addresses the point more simply and clearly.

There is one further omission, in **Article 3 (a)**. The reference to the legislation for cooperatives in the UK as the Industrial and Provident Societies Act 1965 is correct for Great Britain, but there is separate legislation covering Northern Ireland, so the entry should also refer, we think, to the Industrial and Provident Societies Act (Northern Ireland) 1969.

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