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BoE Transitioning to a repo-led operating framework- discussion paper

About the Building Societies Association

The Building Societies Association (BSA) represents all 42 UK building societies, including both mutual-owned banks, as well as 7 of the largest credit unions. Building societies have total assets of almost £525 billion and, together with their subsidiaries, hold residential mortgages of over £395 billion, 24% of the total outstanding in the UK. They also hold £399 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 40% of all cash ISA balances. With all their headquarters outside London, building societies employ around 52,300 full and part-time staff. In addition to digital services, they operate through approximately 1,300 branches, holding a 30% share of branches across the UK.

BSA building societies regularly access Bank of England (BoE) facilities and in particular the BoE reserve account as well as other facilities. The BSA also represents 7 of the largest credit unions. Credit unions do not currently have access to the Sterling Monetary Framework (SMF) despite the fact that they perform maturity transformation (including offering long-term mortgages financed by short term retail deposits). Some credit unions are larger in size than the smallest banks and building societies, and have been established and trading profitably with embedded risk management processes for many more years than new startup banks that are offered access to the SMF as soon as they are authorised. As such, the denial of access to credit unions is anti-competitive and creates potential financial stability risks within the credit union sector. However, given that credit unions do not currently have access, our comments relate to the impact on building societies.

Building society usage of SMF

The BSA welcomes the opportunity to respond to this discussion paper on the important transition to a repo-led, demand-driven approach to accessing the BoE's SMF. We understand the BoE's strategy to evolve the approach to encourage greater utilisation of the ILTR in particular, and the need for this to happen in normal times such that its use does not create any stigma.

The majority of building societies currently only tend to use the STR and ILTR occasionally and for testing purposes to ensure that they are operationally ready ahead of any liquidity stress. As such it is important to note the operational costs, in particular for smaller societies to ensure that these facilities are set up and operational. This will evolve over time as more of our members choose to use the ILTR more regularly if the price isn't prohibitive.

Flexibility

The BSA notes that the ILTR has a maturity of six months. This gives societies a choice between using the one week STR facility (with level A collateral) and the six month ILTR facility (with level A, B or C collateral). We believe these two options do not give sufficient flexibility to market participants and this could therefore be more costly. We propose that the BoE considers two options to increase flexibility for market participants:

- Allow early repayment of the ILTR without this impacting the cost
- Increase the range of maturities available e.g. one month, two month, three month, six months

Encumberance and unintended consequences

When societies pre-position collateral with the BoE, they are required to assume that the whole pool of assets is encumbered rather than the utilised amount. We do not believe that this is a logical approach and can lead to firms setting up multiple pools to reduce the level of encumbrance. It could also lead firms to pre-position smaller amounts of collateral than might otherwise be the case, thereby reducing the firm's capacity and flexibility during a liquidity stress. This creates additional operational work both for firms and for the BoE. A better approach would be to only treat collateral that is in use as encumbered.

Operational costs and timelines

BSA members have noted that it can take the BoE around 6-12months to conduct due diligence on level C mortgage assets for approval to place with the BoE as collateral. As such, we are concerned about the BoE's readiness to transition to this new approach, if increasing numbers of firms are utilising the scheme then this could put further pressure on the BoE's ability to conduct its due diligence in a reasonable timescale.