Financial Services Growth & Competitiveness Strategy–

Call for Evidence

Building Societies Association

Building societies' and credit unions' contribution to UK growth and competitiveness

The BSA welcomes the opportunity to help to shape the plan for financial services set out in HM Treasury's Strategy, alongside the Government's commitment to double the size of the mutual and co-operative economy.

Mutual building societies and credit unions make a valuable contribution to several of the Government's financial services sector objectives as they deliver:

1. **Inclusive growth across the regions, crowding-in investment**
2. **Diversity of provision, creating more effective competition and financial stability**
3. **Serving society's needs, improving access to financial services**

We welcome the Chancellor's call to regulate for growth. In the forty years before the financial crisis, credit to the household sector grew by 11.8% every 12 months, but in the years after the crisis growth has averaged just 2.2%. It is therefore appropriate to ask if we have got the balance between risk and growth right. Building societies and credit unions see this in the challenges many people face in becoming homeowners, and we welcome that the Financial Policy Committee is now required to consider this.

More specifically, the Government should ensure legislation and regulation is proportionate and appropriate, particularly for the distinct, member-focused business models of building societies and credit unions. This will enable them to provide effective competition and offer innovation and choice to consumers.

Building societies and credit unions are often closely embedded in their communities, and are well-placed to improve access and financial inclusion across the country. They will play a key role in supporting the green transition, particularly improving the energy efficiency of homes.

We look forward to working with the Treasury and wider Government to enable financial mutuals, and other cooperatives and mutuals, to grow and contribute significantly to sustainable, inclusive growth for the UK economy.

Question 1: *Stakeholder information:*

The Building Societies Association (BSA) is a **Trade Body** which represents all the UK's building societies and seven of its largest credit unions.

The BSA represents all 42 UK building societies, 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. They employ around 52,300 full and part-time staff and operate through approximately 1,300 branches, a 30% share of branches across the UK.

Objectives and Approach:

Question 3.1: *Do you agree with the proposed objectives set out in paragraph 3.6?*

We broadly agree with the high-level objectives set out for the financial services sector in paragraph 3.6. We would emphasise that HM Treasury's other financial services policy objectives (as set out in paragraph 3.8) overlay and are consistent with these objectives, and that all the above would be subject to ensuring financial stability.

We are particularly keen to ensure that "Doubling the size of the mutuals sector to help drive innovation and inclusive growth throughout the UK" contributes to the Financial Services Growth and Competitiveness Strategy. As such, the second objective should be expanded to "supports the start-up and scale up of innovative new and existing types of financial services, including mutuals".

Mutual building societies and credit unions can contribute to several of the Government's financial services sector objectives as they deliver:

1. **Inclusive growth across the regions, crowding-in investment**
2. **Diversity of provision, creating more effective competition and financial stability**
3. **Serving society's needs, improving access to financial services**

1. **Inclusive growth across the regions, crowding-in investment**

Building societies and our credit union members lend to help people buy their homes, especially to first-time buyers. As well as helping people to achieve their aspirations this helps people move for work, supporting growth. Enabling people to buy and sell property also contributes towards a more efficient use of the housing stock.

Building societies lent 164,500 mortgages to help people buy a new home in 2023. 95,700 of these were to first time buyers, meaning the sector supported a third of all first-time buyers across the country to buy their first home.[1]

At the end of 2023, there were more than 650,000 loans outstanding from credit unions across the UK, in many cases where people might not have been able to obtain loans elsewhere.

Building societies and credit unions help people to build their financial resilience. This prevents economic shocks from scarring an area and enables faster economic recoveries.

[1] BSA Trading Update November 2024

Building societies and credit unions account for almost one in every five pounds saved in the UK, with many accounts that can be opened with as little as £1. They launched the UK Savings Week campaign in 2022, which this year brought together 360 organisations to get people to build their financial resilience and make the most of their savings. Research from Bristol University shows that people who saved regularly not only had better wellbeing, but were less likely to get into debt or to fall behind on bills[2].

Employment by the sector is spread across the regions.

Building societies employ 52,273 people across the UK, with just 5% of their employees located in London. This compares to 41% of bank employees who are based in London[3].

Branches and community partnerships, spurring investment in local economies

Building societies now account for 30% of branches, up from 14% in 2013. Many building societies are maintaining rather than cutting their branch networks, and some are adding new branches. All continue to invest in their branches and to modernise their role so that they can be a part of high streets and town centres now and into the future. Our sector has led innovations in branches including co-locating with community centres and libraries, and opening up spaces for local charities and community groups.

Commercial partnerships, such as with fintechs and green providers

There are numerous partnerships across our sector as societies and credit unions collaborate, innovate and invest with others to leverage technology. For example, Penrith Building Society has collaborated to use Docstribute's Distributed Ledger Technology (DLT) to deliver documents digitally, which is more secure and reduces paper usage. Nationwide is working with Experian to instantly verify a customer's income digitally, speeding up the mortgage decision. Stafford Building Society is assessing its mortgages alongside PropEco, integrating climate risks into financial decision-making and offering insights on energy efficiency to its borrowing members, while Hinckley & Rugby Building Society has partnered with Digital Buildings, a green retrofit specialist, to help property owners to create and finance a plan to improve a property's energy efficiency.

2. Diversity of provision, creating more effective competition and financial stability.

Customer ownership leads to differing purposes, incentives and behaviours.

This is highlighted by employee perceptions at providers with different ownership structures. A survey by YouGov and the BSA found that 82% of employees at banks said that the main aim of the organisation where they worked was to maximise profits, compared to just 23% of employees at building societies[4].

The difference in purpose and incentives at mutuals relative to shareholder owned organisations has profound effects on consumer outcomes.

Evidence shows that mutuals offer better rates over the long term. For example, in the last five years, we estimate that building society savers received over £5.4 billion more in interest payments than they would have received if they had been with the major banks. The FCA also found in its Savings Market Review that societies tended to pay higher rates.

Customer service surveys show that building society customers consistently rate the service they receive higher than customers of other providers.[5] 93% of building society customers say they would recommend their provider to friends and family, compared to 80% of bank customers.

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[2] The role of savings in promoting positive wellbeing
[3] UK Business Register and Employment Survey (BRES)
[4] Financial services with purpose (BSA 2024)
[5] BSA Trading Update November 2024

This is also reflected in a far superior conduct record. Since 2010, building societies have accounted for just 0.1% of FCA conduct fines.

We also see notable examples of innovation in the mutuals sector, particularly around expanding access to the housing market for first time buyers and to those with specific needs. This includes a strong focus on shared ownership which enables those with lower levels of deposit and income to achieve a stake in their property giving them security of tenure, the Track Record mortgage from Skipton Building Society enabling renters to get a mortgage equivalent to their rental payments, the £5,000 deposit mortgage from Yorkshire Building Society meaning that those purchasing a home up to £500,000 can do so with a 1% deposit. In addition, Nationwide will lend 6 times income to first time buyers that choose to fix their mortgage for 5 or 10 years. There are many other examples where societies provide income boost/joint borrower sole proprietor loans from across the sector.

These differences in firms' approaches and incentives make competition in retail banking more effective. Over the long term, better functioning domestic markets will contribute to the UK's international competitiveness.

Financial stability

Because financial mutuals are owned by their customers, they primarily use retained profits as a source of capital, rather than relying on raising capital from external investors. Their member-ownership could be diluted if they were to raise substantial amounts of equity-like capital.

As a result, their risk appetite tends to be conservative, as they cannot raise capital rapidly. This is reflected in relatively higher capital ratios (The average building society CET1 capital ratio at the end of 2023 was 19.8%, compared to 14.1% at the big banks) as well as their lower levels of arrears (0.47% of mortgages were in arrears at building societies at the end of June 2024, compared to a market average of 0.98% (arrears of 1.5% or more of the balance)).

The nature of mutuals' capital also tends to mean that they invest for the long term, as they are not required to maximise short term returns to investors.

As well as tending to be lower risk, building societies and credit unions benefit financial stability by increasing the corporate diversity in the market. Different organisational forms, with different business models, are affected differently by system-wide shocks. This was demonstrated after the financial crisis, when building societies accounted for over three quarters of the growth in mortgage balances across the UK from 2010-2014. They were able to return to lending while the banks repaired their balance sheets.

Corporate diversity in financial services can therefore be conducive to economic growth in the long-term because different firms respond differently at times of stress, giving the system more resilience overall and enabling a swifter economic recovery.

3. **Serving society's needs, improving access**

Mutual providers also support inclusive growth as their wider social purpose means that they are more likely to respond to the needs of the communities in which they operate. This is shown by 72% of building society customers saying they are an important part of their community, compared to 54% of bank customers who think the same.[6]

A number of building societies serve specific segments of the mortgage market, playing a major role in lending to help older borrowers to get mortgages, as well as enabling self and custom build and lending to guest houses, holiday lets and expatriates as well as many other groups that might not be readily catered for by larger lenders.

[6] YouGov for the BSA; Building societies drive three quarters of the growth in mortgage market

As mentioned above, building societies have tended to keep their branches open to a greater extent than banks, more than doubling their share of high street presence since 2013. In addition, several building societies are trialling kiosks that offer access to cash for individuals and small businesses, and access to banking services at major banks via Open Banking. We believe these types of universal banking kiosk should be considered as one of the options when banks exit a local high street, alongside Banking Hubs and the Post Office, and should be funded appropriately by those departing banks.

As well as kiosks as a possible alternative to Banking Hubs, there are also opportunities for these types of kiosk to be additional to current provision. We estimate that there are 142 towns where there is a building society branch, but there is not a bank branch or Banking Hub within 3 miles. In some of these places these types of kiosks could help to increase access to cash and banking services across the UK.

Growth and Competitiveness:

Question 3.2: *[For Financial Services Organisations] For firms operating in more than one jurisdiction, what are the main drivers affecting your decisions on where to invest?*

Building societies and credit unions are all UK based, with their headquarters based across the country and a domestic focus to their business. Therefore, their investment is almost exclusively in the UK economy.

Future of Financial Services:

Question 3.3: *What do you consider to be the most important trends or changes likely to affect the financial services industry over the next 10 years?*

Financial services will be affected substantially by macro trends. These include

- Climate change: financing the transition to green energy in a just and inclusive way, as well as managing climate risks, including operational risks from more frequent extreme climactic events.
- The adoption of technology, which could affect how money is intermediated. AI is yet to be fully adopted, and Big Tech introduces governance issues around data. Care needs to be taken to ensure that technology is introduced in a way that realises the benefits for society while mitigating for unintended consequences.
- An ageing population will require different financial products as people work longer, accumulate and run down assets, and transfer them between generations, in new ways.
- Heightened geopolitical risks could affect financial flows.

These long-term structural changes also entail a heightened risk of shocks and volatility which will have macroeconomic impacts as they are transmitted through the economy.

Question 4.1: *Do you agree with the list of policy pillars that the government intends to focus on? Are there other areas that should be included?*

Question 4.2: *Please rank the list of pillars in order of importance to your business or organisation for i) day-to-day operations and ii) longer-term plans for investing in the UK:*

1. Innovation & Technology

2. Regulatory Environment

3. Regional Growth

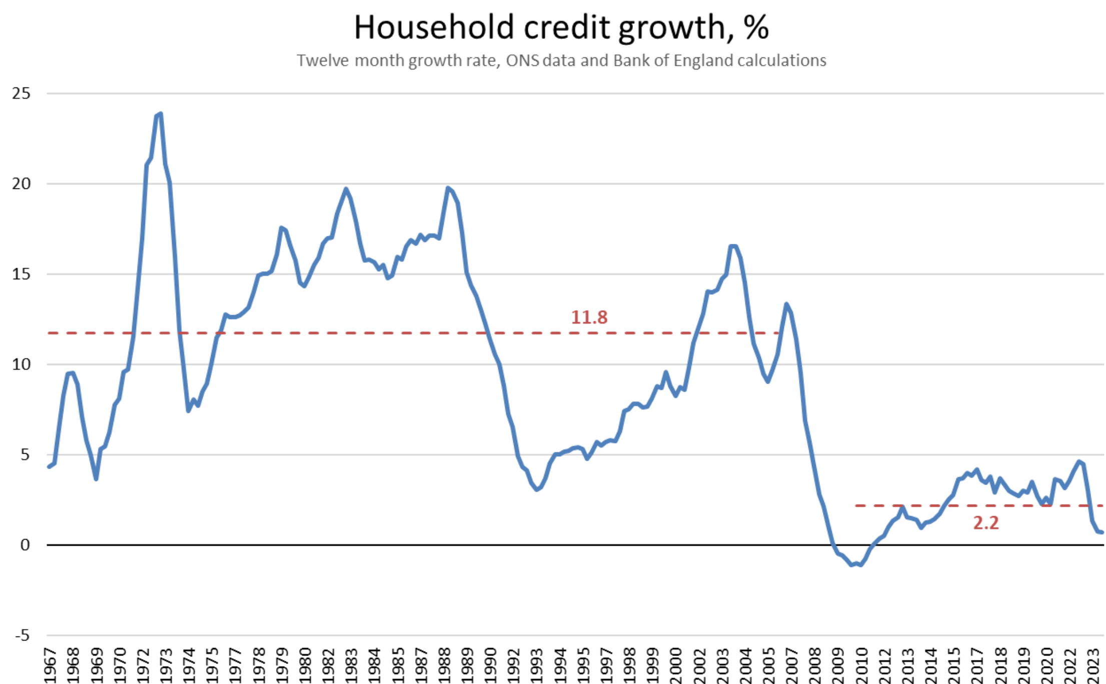
4. Skills & Access to Talent

5. International Partnerships & Trade

We agree with the headline policy pillars.

For our members, the most pressing on a day-to-day basis is the regulatory environment and the legislative arrangements that sit behind that.

We welcomed the Chancellor's acknowledgement in her Mansion House speech that the UK may have gone too far in regulating to eliminate risk, at the cost of growth. As the chart below demonstrates, the period since the financial crisis has seen household credit growth which has been much weaker than the long-term trend.



Over the forty-year period from 1967 to the end of 2006, household credit growth averaged 11.8% over each 12-month period. Since 2010, the average has been just 2.2%.[7]

Of course, some of the past periods of credit growth have proven to be excessive, and we do not wish to see uncontrolled risk-taking. And there are many factors at play so that it is not a simple trade-off to manage. However, the stark difference in trend growth rates over these two extended time periods should at least prompt regulators and society to question if we currently have the overall balance right between financial stability and growth.

A recommendation we have made, based on research into the affordability challenge facing first-time buyers, is for the FPC to amend its lending limits to give more scope to lending to people buying their first home[8]. We were therefore pleased to see that the FPC's remit has now been expanded to explicitly require them to consider how they could support homeownership.

Appropriate and proportionate regulation and legislation for mutuals

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[7] Defined as the four-quarter cumulative net flow of credit divided by the stock of credit 12 months ago. Credit is defined as all liabilities of the household sector except for student loans and financial derivatives. Bank of England June 2024

[8] BSA First-time buyer report 2024

More specifically for our sector, it is important that regulation and legislation is kept up to date to ensure that is it proportionate and appropriate.

We welcomed the amendments made via the Building Societies Act 1986 (Amendment) Act over the last year, and we keenly anticipate the other proposed amendments promised in the Edinburgh reforms and encourage the Government to lay the remaining necessary secondary legislation to complete the reforms as soon as practicable.

We welcome the announced review of credit unions' common bond, as this needs to be examined to ensure that it is fit for the future and doesn't unduly constrain credit unions.

Looking ahead, the Government should commit to regular reviews of building society and credit union legislation to ensure both are kept up to date and their effect is comparable to modernisation of companies' legislation.

We welcome the letters asking PRA and FCA to report on the mutuals landscape in recognition of the importance of effective and proportionate regulation in supporting this.

We believe that the regulators should be required to regularly evaluate their success in fostering corporate diversity including the relative regulatory burden on mutuals. We continue to support the PRA's Strong & Simple initiative as a welcome attempt at a truly proportionate approach. The BSA does not see this as de-regulatory or watering down, but rather that simpler rules that are easy to understand and more straightforward to implement can in fact be stronger. We also encourage the PRA to remove Supervisory Statement 20/15 which applies only to building societies and not to their competitors, is now outdated and inappropriately restrictive. We welcome the FCA's intention to simplify its rulebooks following the introduction of the Consumer Duty.

But proportionality is not a one-off exercise as part of reviewing or forming policy. It requires a change in mindset and approach, entailing continual examination of the interdependencies and interactions of policy, and based on an understanding and appreciation of the different natures of the businesses being supervised. As a broad principle, the cost and burden of cumulative regulation should not result in smaller financial services providers being driven out of the market.

An example of where this proportionate thinking is needed is in relation regulatory thresholds. The framework includes a number of different thresholds that have not been reviewed and this results in 'regulatory drag' whereby more stringent requirements apply to more firms over time simply because they have grown but without increasing the risks they pose to the regulator's statutory objectives. The BSA therefore supports that the PRA's current consultation to index MREL thresholds[9] . However, we would favour a more holistic review of all thresholds in the framework and for the PRA to set principles to guide future regular updates to all thresholds to give firms more certainty and clarity over the rules that will apply to them for the longer term to enable growth. In terms of the MREL thresholds this could have potential knock-on implications specific to building societies because their balance sheets tend to be made up of lower risk assets such as residential mortgages. As a result, the leverage ratio can be their binding capital constraint, as opposed to risk-based capital requirements. For MREL this is significant, as the MREL requirement is then based on double the leverage requirement. So while the MREL threshold (of £15-20 billion) itself is being indexed, the leverage ratio threshold of £50 billion deposits is not. Mutuals approaching the £50 billion threshold therefore face a potentially substantial increase in MREL requirements. A more proportionate approach would recognise these interdependencies and, as suggested, take a more holistic approach to reviewing all the thresholds in the regulatory framework to allow for more growth.

[9] Amendments to the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) | Bank of England

A further significant regulatory impact that is particularly felt by the building society sector is the continued disproportionate and blanket application of Public Interest Entity (PIE) audit scope to all building societies, regardless of their size, nature or complexity. Despite the Financial Reporting Council's core objective to "create a more resilient audit market through greater competition and choice," the FRC's regulatory framework and supervisory approach drives risk aversion by the audit firms and has made the audit market for smaller PIEs unattractive. For building societies, this has resulted in uncompetitive audit tendering processes, fees escalating far more than inflation and audit processes more extensive than helpful to building societies, their members, the greater public or broader financial stability[10]. The BSA welcomes the commitment by the Government to remove unnecessary rules on smaller PIEs and urges this to be done alongside a proportionate supervisory regime by the FRC which will go some ways to improving competition for audit firms, and ultimately make UK markets more attractive. By creating a "Strong and Simple" audit regime for smaller PIEs, audit quality will still be prioritised but audit processes for both PIE and audit firms can be centred on appropriate risk management, freeing up capacity and holding back unnecessary rises in the cost of audit. We note that the issues affecting smaller building societies likely also affect small cap main market listed companies, potentially detracting from London's attractiveness for smaller company IPOs.

Skills & Access to Talent is also important to building societies and credit unions. This is particularly the case for specialist IT and Treasury roles. These are needed in all regions, as societies' headquarters are based across the country. Yorkshire Building Society founded a commission to look at how industry, education providers and local authority could deliver a vision for skills development for finance and professional services in Yorkshire & Humber.

Clear strategy and implementation plans in other policy areas:

Another important part of the operating environment is getting clarity about the Government's policy and how these are going to be implemented. For building societies and credit unions these include:

- Planning reform, delivering 1.5million new homes.
- Green energy transition for housing stock
- Sustainable adoption of technology (AI, Open Finance, CBDC etc)
- Simplifying savings policy and taxation, enabling workplace savings

Question 4.3: *How well is competition currently working in the financial services sector, and how can it be improved?*

As set out above, we believe that competition can be made more effective by enabling a wide range of organisations with different organisational forms to participate in the market. Regulation that pushes, even unintentionally, towards homogeneity is likely to limit consumer choice, reduce innovation and ultimately undermine systemic financial stability.

All too often we see regulations that are designed for large plc banks also applied to mutuals. While the regulators are required to 'have regards' to the impact of their policies on business model diversity and mutuals, this often feels like an afterthought. The continued application of the PRA's Supervisory Statement 20/15 effectively places limits on building societies lending and treasury activities, while competitors are not under the same regulations, a wholly non-competitive policy which negatively impacts only the mutual model. We believe that consideration of the impact on mutuals should be put at the heart of policy making to foster more business model diversity.

[10] BSA audit report, June 2024

We believe that regulation should be simple, agile and straightforward to navigate, and therefore welcome ongoing work to simplify regulatory rulebooks. This will help to reduce duplication or conflicts in the rules.

The recent acquisitions by the two largest building societies of mid-sized banks gives the building society sector a more substantial – and customer-owned – presence in a wider range of markets, including SME banking, credit cards and unsecured lending.

Innovation & Technology

Question 4.4: *What is your assessment of how effectively the UK supports innovation and the adoption of new technology? What could be improved in the financial services sector?*

Question 4.5: *Which technologies do you think have the most potential to transform financial services over the next 10 years? And in which financial services sectors or functions do you see these being applied most effectively?*

Technological innovation is a constant in financial services. Building societies and credit unions adopt new technologies where they offer opportunities to better meet members' needs. They are also conscious that they need to blend digital and physical channels to ensure no members are left behind.

The Government should seek to learn the lessons from episodes such as Open Banking, where take up hasn't developed as had originally been envisaged, but at considerable cost to the largest providers. This is particularly the case as Open Banking is set to be extended to other markets via Open Finance.

Two pieces of research by Frontier Economics indicate that on the one hand there is unlikely to be substantial impact of Open Finance in the case of the savings market because much of the functionality already exists and has not been transformational, while on the other hand, in a scenario where Open Finance is adopted extensively it would make savings balances extremely liquid, with knock-on potential unintended consequences of higher lending interest rates or increased financial exclusion.

Together with the experiences of Open Banking, these pieces of research indicate the difficulties and dangers of being too prescriptive with technology adoption. It is often the integration of technologies in unforeseeable ways that leads to the greatest gains. Rather than pre-judging the data standards and how they will be used, progress would be more sustainable and scalable if it is built out of commercially viable use-cases based on demonstrable consumer demand.

The Government and regulators should use its convening power to work with the industry and other stakeholders to progress digital ID, Open Finance, AI, regulated liability network and central bank digital currencies, and other technologies, and to help the mutual sector to collaborate to adopt new technologies.

Question 5.1: *Do you agree with the priority opportunities that have been identified?*

Co-operatives and mutuals across the economy should be an additional priority opportunity, reflecting the Government's commitment to double the sector. In a wide range of sectors co-operatives and mutuals can deliver inclusive growth, local wealth creation, economic stability and security, social responsibility and wellbeing[11].

Q5.2 - 5.4 not answered

Question 5.5: *In the UK's sustainable finance framework, as set out in the Chancellor's Mansion House package, do you see barriers or gaps that would support the growth and competitiveness of the UK sustainable finance market?*

[11] Co-operative and Mutual Economy Report 2024, Coops UK

***Question 5.6**: What do you think should be the UK's priority when engaging with the global sustainable finance agenda, both bilaterally and at a multilateral level?*
***Question 5.7:** What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition?*
For each opportunity, please provide an indication of the type of intervention required, for example developing guidance, or supporting the development of further capabilities.

We welcome the steps towards a sustainable finance framework, including the green taxonomy, and look forward to this developing further. As a government priority, we need a clear roadmap for energy transition in the housing market. To date, demand for green mortgages offered by our members has been limited. Certainty about the direction of policy is essential to enable this market to grow.

Capital Markets (including retail investment)

***Question 5.8:** Are there any barriers to growth in capital markets that are not being targeted by existing government reforms?*

Access to capital:

Capital markets need to better cater for instruments that are consistent with the mutual model. We want to develop a market for cooperative and mutual capital instruments that is sufficiently deep and liquid so that these instruments become a standard and well-understood form of finance.

Building societies and credit unions should be attractive to investors as they have familiar names, established business models and stable earnings streams in a heavily regulated environment. However, capital raising has been relatively limited so far.

To qualify as CET1, capital instruments are required to be able to absorb losses and, if necessary, be bailed-in in a crisis, and have variable coupons. Further, to be consistent with the mutual model, distributions should be discretionary and capped to limit how much profit can go to investors rather than members. Following the financial crisis, the building society sector developed Core Capital Deferred Shares which have these features.

We are currently undertaking research into the barriers to raising mutual and cooperative capital, from both institutional sources and from members (with appropriate safeguards in place), and seek to reduce these barriers to enable the sector to grow. For substantial growth of mutuals and cooperatives, we need to unlock capital investment in the sector and will set out what is needed to achieve this.

At present it would be practically impossible to found a new building society without relying on philanthropy or public sector support, as capital instruments are not readily available to enable investors to get involved in a way that compensates them for the initial risk.

Retail investment

The Government wants to encourage consumers to participate in capital markets. We support a retail investment market in which consumers can invest with confidence, understanding the risks they are taking and the regulatory protections provided. It is sensible for all consumers to think about how they will achieve their various financial objectives. However, it is important that individual consumers' risk appetites and preferences continue to be sufficiently respected, and risk or complexity can reasonably lead people to prefer the certainty of cash savings.

The Call for Evidence cites industry research which claims that there is £430 billion in cash savings which could be invested. However, this is based on estimates of people who have more than £10,000 in cash savings, which was an arbitrary figure plucked from 2015/16 data and used a proxy for required emergency savings in the FAMR Review. It has never been substantiated, and we have challenged this figure being used as a basis for investable sums[12]. There are valid reasons for holding cash savings for medium term savings objectives, not just as an emergency buffer, and for some people, holding more than £10,000 in cash will be sensible as part of a balanced portfolio. For example, people drawing down pension funds rather than investing in annuities may well wish to hold a sizeable cash buffer to avoid ever being forced sellers of equities. And people aiming to become homeowners within, say, three to five years, may well not want to tolerate even mid-term volatility in the value of the savings for their deposits.

We note that the FCA is now conducting consumer research into cash holdings and investments. We support the Government's aims, but policy in this area should be based on robust evidence rather than rough proxies.

[12] BSA response to FCA CP 22/24

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

www.bsa.org.uk

The Building Societies Association (BSA) is the voice of the UK's building societies and a number of large 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 building society members have total assets of over £525 billion, and account for 24% of the UK mortgage market and 19% of the UK cash savings market. Within this, societies account for 40% of all cash ISA balances.