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Our response to the FSA's consultation paper, "Regulated fees and levies: Rates proposals 2012/13", CP 12/3

Introduction

The Building Societies Association 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 over £235 billion, 19% 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 34% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

Executive summary

We express our members' concern at another significant increase in the FSA's annual funding requirement. - over five years it has risen 92.7%. The building society sector, by contrast, has reduced its management expense ratio by more than a third over the past fifteen years.

We are particularly concerned at the cost of the Money Advice Service. Not only has the budget for the money advice part of the service risen by an above inflation 5.9%, but also the costs for the debt advice part have been passed on to deposit takers and home finance providers <u>without consultation</u>. Problem debts arise from many additional sources including utility charges, and personal tax and council tax, as well as from mortgages, credit cards and current accounts. **Why are these other creditors not sharing the burden of financing debt advice ?** We find loading the entire cost on to fee-blocks A1 and A2 disproportionate and unacceptable.

Adding to BSA members' financial burden is the move to recover a greater proportion of overall expenditure from the deposit taker category which affects all of our members. In 2007/08, the A1 category contributed 18.9% of the annual funding requirement; by 2012/13 this has risen to 30.6%. We understand that enhanced supervision is targeted at the larger and systemic firms and note that the premium fee is designed to capture that – which we support. But mutuals still appear to be paying for the mistakes made by the now nationalised big banks and failed demutualisers.

Chapter 6

Q1: *Do you have any comments on the proposed FSA 2012/13 minimum fees and periodic fee rates for authorised firms?*

We note yet again the appreciable increase in regulatory fees and levies. While we recognise effective regulation is not cheap, the proposed increases are, as in previous years, significantly over the rate of inflation.

The FSA's supervisory enhancement process has already significantly boosted its budget baseline. While we support that process, it does mean that the new regulatory arrangements will start from an already high cost base. That is why we question further increases. Regulators should also play their part by controlling costs, especially in a difficult economic climate.

In 2012/13, the FSA's annual funding requirement has risen to £578.4 million, an average increase of 15.6% over the previous year. But the share falling on deposit acceptors – fee block A1 - rises by £35.6 million, or 25.2%, from last year - when deposit acceptors already met 28.2% of the total AFR. Higher impact firms will bear more of the increase due to the premium (25% or 65%), introduced last year, and this benefits most of our members. But we should still not lose sight of the greater burden being placed on deposit takers as a whole, at a time when their profitability already faces other threats.

Less than a year ago (June 2011) the government was assuming[1] "*that the FCA's and PRA's combined ongoing running costs should not be materially different (in real terms) in aggregate from the current FSA budget of about £500 million.*" While the budgets of the two new regulators are not part of this consultation, we nonetheless wish to make clear that they must continue to plan using the £500 million figure and not re-set the baseline to the higher figure proposed in CP 12/3.

In 2011/12, the overall increase[2] in the AFR was 10.1%, in 2010/11 3.9%, in 2009/10[3] 36.5% and in 2008/09[4] it was 6.9%. In monetary terms, the FSA's annual funding requirement has risen from £300.1 million in 2008/09 to £578.4 million in 2012/13. That is a compound increase of **92.7 %** over just five years – clearly this cannot continue.

We therefore welcome the statement[5] by the FSA's outgoing chief executive that: *"The FSA recognises that given the economic circumstances the industry faces, it is not realistic that the cost of regulation continues to rise at this rate in the long term, and therefore the new authorities will be very focused on controlling costs."* But past performance, and the rising estimates of the transition costs of the new regime, give us grounds for scepticism as to the actual outcome.

At the same time, our members must cope not only with the business challenge of a low interest rate environment engineered by the authorities, but also with increasing costs of regulation – some designed with globally systemic banks in mind – and do so with fewer resources. Indeed building societies have been reducing their management expenses, not just in the past few years but for the past fifteen years[6]. As a sector, the management expenses ratio has fallen by more than a third in that period.

We also draw particular attention to two significant recurring items of additional expenditure in the FSA's budget: staff and IT.

Staff. One of the reasons behind the higher annual funding requirement in 2012/13 is the core work programme including more intensive supervisory costs (and a 3.5% salary increase for FSA staff). This has led to an increase in the AFR of £29.1 million, or 5.9%. Compare this with the previous year when it was announced that there was no plan to increase the overall FSA headcount [although somewhat confusingly the same consultation says: "Our intensive approach to supervision will complete its implementation *with increased resources*, including prudential risk specialists now assigned to our largest firms."]

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[1] Paragraph 3 of the impact assessment of http://www.hm-treasury.gov.uk/d/consult_finreg__new_approach_blueprint.pdf
[2] We have taken the proposed AFR provided at the fee rate consultations published in February each year. We note the budgets for AFRs of 2009/10 is shown one year with financial capability included but excluded in another (see Feb 2010 fee rate paper).
[3] Includes £21.7 million in respect of financial capability.
[4] The 2008/09 budget was subsequently increased during the year for *inter alia* £13.6 million for supervisory enhancement programme.
[5] Press statement on FSA business plan 2012/13 http://www.fsa.gov.uk/library/communication/pr/2012/031.shtml
[6] See "management expenses as a % of mean assets" column http://www.bsa.org.uk/docs/statisticspdfs/2005fsa2.pdf

But the overall trend is definitely up where staff are concerned. In 2007/08[7], the FSA announced it would spend up to £50 million over three years on a programme of change across the organisation, including upgrading the skills and expertise of its people, staff reorganisation and improving its knowledge management capability. [Two years later the FSA is still confident[8] that: "This investment will lead to benefits that will be realised over a longer period and will contribute to our move to a more outcomes-based regulatory approach."]

The following year, 2008/09, the FSA increased its budget to include an additional £13.6 million for a supervisory enhancement programme that entailed the recruitment of 280 extra staff. In 2009/10, reference is made to the continuation of further expenditure through the year "driven by the enhancement of our supervisory processes". But in 2010/11, the FSA concluded it needed even more staff - another 460[9]. Total headcount appears to have increased from 2,740 (March 2008) to 3,992 (March 2012) - a 46 % increase over four years.

The continuation of such increases in staff expenditure, year on year does lead us to question why the earlier increases – substantial as they were – have not proved sufficient. Our members are concentrating on core business and making economies; why is FSA not able to do the same – by prioritising the most important areas and discontinuing or deprioritising less important activities? That would then release resources - whether cash or staff - to devote to the priority areas. There is a feeling that the FSA loses sight of whose money it is spending – firms', and ultimately consumers' – as the blank cheque mentality takes hold.

IT. The increased expenditure related to IT in CP 12/3 needs to be placed in the context of the previous substantial increases in IT spend, and the explanations given for them, over the last five years.

In 2012/13, systems spend will increase by £22.4 million partly in respect of setting up FSA systems that will be used by FCA. No such figure was provided in 2011/12, yet we note[10] the plans to deliver a large number of "non-negotiable" policies and business initiatives, requiring further investment in the operational platform.

In 2010/11 there was reference[11] to continued investment in IT: "Further investment is also needed to address the increase in Information Services (IS) development work and the growing role of IS solutions in facilitating new initiatives. Funding will also be required for the ongoing development of our IS architecture and Knowledge Information programme, and general demand for IS support on existing projects."

2008/09 saw £12 million in the budget for increased technology and property infrastructure (no split given) for expanded FSA operations.

We support sensible investment in IT that enables FSA to operate more efficiently – e.g. by reducing headcount. But each successive increase in IT spend raises the fear that previous instalments were not well spent and have not delivered value. Yet there is no accountability for any of this. The most egregious example of this problem is the proposal that PRA will need even larger future investment in new IT systems on the grounds that the FSA IT systems, which our members have paid for and continue to pay for, have been rejected by the Bank of England as having relatively high running costs. How have we reached such a ludicrous situation, who is accountable, and how will a repeat of this fiasco be avoided in future procurement ? CP 12/3 – and the latest Business Plan - remains ominously silent on all three points.

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7 See chapter 10.3 of http://www.fsa.gov.uk/pubs/cp/cp07_03.pdf and chapter 3.4 of http://www.fsa.gov.uk/pubs/cp/cp08_02.pdf
8 See page 4 of Annex 1 at http://www.fsa.gov.uk/pubs/cp/cp09_07.pdf
9 Breakdown provided at chapter 5.5 of http://www.fsa.gov.uk/pubs/cp/cp10_05.pdf
10 Chapter 2.24 of http://www.fsa.gov.uk/pubs/cp/cp11_02.pdf
11 Chapter 5.24 of http://www.fsa.gov.uk/pubs/cp/cp10_05.pdf

General

Adding to the mutual sector's financial burden is the clear move to recover a greater proportion of overall expenditure from the A1 deposit taker category, which affects all BSA members. In 2007/08, the A1 category contributed 18.9% of the annual funding requirement; by 2012/13 this has risen to 30.6%. We understand that enhanced supervision is targeted at the largest and systemic banks and note that the premium fee is designed to capture that – which we support. But mutuals still appear to be paying for the mistakes made by the now nationalised big banks or failed demutualisers. Our members estimate rises in FSA fees and other levies in 2012/13 alone of between 14 and 30%, without factoring in the costs of the debt advice part of the Money Advice Service. The addition of debt advice means an additional 20% increase as building societies (and mutual banks) fall in the two categories (A1 and A2) that will bear the cost.

Overall, a more appropriate and fair treatment would be to remove mutually-owned deposit takers such as building societies from the A1 deposit taker category, decoupling them from banks, particularly those systemic ones requiring additional enhanced supervision. We believe this would be far more transparent than the model proposed and would end cross subsidy.

In conclusion, we propose that the FSA – and its successor bodies, the FCA and PRA – first cuts costs as the firms it regulates have, and then removes mutuals from the A1 deposit takers category and gives them their own fee block.

Chapter 8

Q3: *Do you have any comments on which basis we should use to calculate periodic fees for the issuers of regulated covered bonds?*

The changes may affect only the five mutuals that have issued covered bonds, and any other mutual looking to issue regulated covered bonds.

We note that the FSA proposes a new separate fee block (G15) for issuers of RCBs. This fee block will be allocated a proportion of the FSA's annual funding requirement. The periodic fee will be a combination of a minimum charge and a variable periodic fee.

For the minimum charge, the FSA has proposed 75% of the total amount allocated to G15 divided by the number of RCB issuers. An alternative formula for a minimum fee has also been proposed. This works out as 75% of the total amount allocated to G15 divided by the number of programmes, with the first programme of each issuer attracting 100% of the minimum fee and all subsequent programmes attracting 75% of the minimum charge. Although slightly more complex, we believe the alternative formula is fairer and a better reflection of the regulatory work carried out by the FSA.

On the variable fee, the FSA has proposed as a tariff base regulated covered bonds in issue as at 31 December 2011. This results in a fee rate of £3.41 per £ million or part £ million of RCBs in issue. An alternative formula for the tariff base has also been proposed. This works out as RCBs issued in the 12 months ending 31 December 2011. This results in a fee rate of £10.63 per £ million of part £ million of regulated covered bonds issued. Clearly, this favours those issuers that have not been active over the past year. If the FSA believes its regulatory focus is mainly directed at those RCBs issued in the preceding year then we believe the alternative formula should be used.

Chapter 12

Q11: *Do you have any comments on the proposed method of calculating the tariff rates for firms in each fee block towards the CJ levy and our proposals for how the overall CJ levy should be apportioned?*

The FOS general levy is calculated using “industry blocks”, which are similar (but not identical) to the FSA fee blocks. Each industry block has a minimum levy and, in most cases, the levy increases in proportion to the amount of “relevant business” (ie business done with private individuals) each firm does. For 2012/13, the distribution of the CJ levy has increased for industry block 1 (deposit acceptors, home finance providers and administrators) from 39.1% to 49.2%, reflecting the increased use of FOS resources devoted to these cases.

Industry block 1 contains banks and building societies although each has a different level of complaints that are lodged and found in favour of the consumer. We therefore find this increase – not to mention the arrangement itself - most inequitable and unjust. Mutuals such as building societies are conservative and low risk firms, with a strong culture of fairness to consumers, but they are yet again paying for the errors of banks,.

Consumer complaints to the FOS about building societies were just 2% of all new complaints in 2010/11. This figure has remained the same for the past three years, despite the overall number of new complaints to the FOS rising. Complaints about banks were 66% of the FOS caseload, up from 61% last year.

In terms of the financial products that consumers complained about, building societies accounted for just 2% of banking complaints, 2% of payment protection Insurance complaints and 8% of mortgage complaints. Building societies, together with their subsidiaries, hold residential mortgages of almost £210 billion, giving them a 17% share of the total UK market.

The FOS upheld, in favour of consumers, 52% of complaints about banks, 80% of complaints about intermediaries selling payment protection Insurance and 53% of complaints about independent financial advisers. This compares to 22% of complaints made against building societies being upheld.

The foregoing analysis demonstrates the unfairness of the present system - a new way of calculating levies for this sector is clearly needed. In view of these figures, we strongly suggest that mutuals such as building societies are decoupled from banks ie put in a completely separate industry block. That way the mutual sector and its customers would not be burdened by the impact of the banks’ mis-selling scandals. Building societies are not banks: they have different structures, ownerships and cultures, which result in the much lower complaints figures cited.

Chapter 13

Q12: *Do you have any comments on the proposed 2012/13 Money Advice Service levy rates for money advice?*

The Money Advice Service, formerly the Consumer Financial Education Body, has been operating as an independent body since 26 April 2010.

The money advice part is paid for by industry through fee blocks A1 to A19. The increase for the money advice part in 2012/13 is £2.5 million, or 5.7 %. The A1 fee block is to pay 31%, broadly similar to the previous year. In 2011/12 the overall increase for the money advice part was 32.8% and in 2010/11 51.6%. All far above the level of inflation. In the two years of MAS’s existence its requirement from industry for funding has risen 40.7%. Yet again we see no accountability, and few if any tangible results.

Continued above inflation increases in future financial years for this service, particularly given the re-focus of activity towards majority online, will be totally unacceptable to the mutual sector. We expect MAS to live within its means, perform efficiently and deliver against an agreed, measurable and transparent set of success criteria.

We accept that some marketing/ communications is required to establish awareness and trust in MAS. We are concerned however, by the proportion of the 2012/13 budget that has been earmarked for such expenditure. In 2011/12, a total of £5.7 million representing 13% of the overall budget was spent on marketing and communications. In 2012/13, this figure will increase to £21.4 million or 46% of the budget.

In absolute terms, this figure exceeds the per company advertising spend[12] by the personal banking divisions of: Santander, Halifax, NatWest and Lloyds. We are concerned both that the proportion of the total could have an impact the provision of core advice services and that there seems to be little clarity on the milestones or success criteria for this activity, with the risk that levy payers money will be wasted with little positive result.

Q13: *Do you have any comments on the proposed 2012/13 Money Advice Service levy rates for debt advice?*

General

Our members are most surprised, and disappointed, to see that they are now being required to pay for a service formerly underwritten by government (BIS). They consider that the FSA should have at the very least consulted on this issue rather than just imposing the costs on (part of) industry. It is likely that this sudden demand for funding MAS debt advice will have to be met by inter alia a scaling back of BSA members' voluntary support for existing local debt advice initiatives – a clear public policy own goal.

Our members ask why they, part of a regulated and secure sector of the market, are paying for a service that will be supporting, among others, the OFT sector of payday or motor loans.

Problem debts arise from many additional sources including gas, electricity, telephone and water utilities, personal tax and council tax. National Debtline figures reported for January and February this year show that 92.4% and 98.4% of callers respectively reported having debts other than those associated with financial services providers. Indeed The Money Advice Trust reported that water bill related debt rose by 32% in 2011 alone and that National Debtline had received a fuel debt related call every five working minutes throughout last year.

It is our contention therefore that it would be fairer to apportion the costs for debt advice across other sectors in addition to financial services on the basis of "polluter pays" rather than total lending. With appropriate sector level agreements the cost of collecting such levies should not be substantial. Such an approach would also mitigate the real potential that financial firms, presented with substantial compulsory debt advice costs, have to scale back their discretionary support for debt advice agencies such as Citizens Advice and The Money Advice Trust.

Even within the financial services sector, it is manifestly unfair to load the entire burden on fee blocks A1 and A2 when much problem debt relates to unsecured consumer credit providers who are not deposit takers – e.g. providers of home credit, motor loans, payday loans, pawnbrokers, and loan sharks.

We understand that consideration was given to using consumer credit providers to pay their share but the idea was rejected because the information the OFT holds on them is not sufficiently robust and that the OFT is unable to differentiate between large and small providers[13]. That is a poor reason to burden the building societies (and banks) with the costs. We strongly recommend that OFT carries out data cleansing work as soon as

[12] 2010 TGI data
[13] Chapter 5.2 of http://www.moneyadviceservice.org.uk/_assets/downloads/pdfs/funding_debt_advice_a_proposed_model.pdf

possible as a step to identifying likely fee payers in the future. It is entirely unacceptable to tax building society members more, simply because basic information is not held on the consumer credit sector to enable the burden to be properly and fairly shared.

Yet again, we note how the cost of the debt advice part of the Money Advice Service has spiralled. In 2012/13, the cost is £40.5 million, yet in 2010/11 – when the credit crisis had already taken hold – the cost[14] was £12.5 million. How can the costs have risen by 224% in two years? Is it empire-building? Why is this spending so far out of control - and, we suspect, mostly wasted on marketing? We see this as another example of the blank cheque mentality.

Calculation of levy rates

The FSA proposes to allocate the costs of the debt advice part of the Money Advice Service to the A1 (deposit acceptors) and A2 (home finance providers and administrators) fee blocks only. It says that this approach "targets the recovery costs to the lenders who are beneficiaries of the debt advice".

It is using MAS research that shows household debt is 15% unsecured (£6.1 million) and 85% (£34.4 million) secured. A1 will therefore pay the unsecured part and A2 the secured part. The FSA is proposing to use this split as the basis for allocating the £40.5 million debt. The tariff is therefore "outstanding debt", not MELS (A1) or annual mortgage transactions (A2). The fees calculator does not, unfortunately, include this element.

The source of the funding model comes from London Economics. As we say earlier, we consider the basis of its arguments for the apportionment of costs unconvincing. In the absence of evidence that customers of the largest mutual deposit takers are more likely to use the debt part of MAS, we challenge their inclusion among the ten largest deposit takers who are to pay 80% of the costs.

[14] Chapter 13.8 of http://www.fsa.gov.uk/pubs/cp/cp10_05.pdf