Title: Building Societies Act 1986 (Amendment Bill) **Lead department or agency:** HM Treasury **Contact for enquiries**: BuildingSocietiesAct@hmtreasury.gov.uk	De minimis assessment **Date: 19/12/2023** **Type of regulation: Domestic** **Date measure comes into force:** Click here to enter a date.
Cost of Preferred (or more likely) Option: £0	**Equivalent Annual Net Direct Cost to Business per year** (EANDCB in 2022 prices)

1. What is the problem under consideration? Why is government intervention necessary?

Summary: This Bill is about putting building societies on a level playing field with other retail deposit-takers (i.e. banks) so that they can compete more effectively in the financial services sector and better support their members.

Building societies are providers of mortgage and savings products, mutually owned by their members (depositors/borrowers). The Building Societies Act 1986 ("the 1986 Act") sets out building societies' distinctive model and other legal requirements. Whilst it is believed that the 1986 Act broadly remains fit for purpose, there is interest and rationale in making further improvements to the 1986 Act to allow building societies to compete on a more level playing field with banks operating as Companies Act 2006 companies. The separate legal framework for companies and building societies has not always been updated at the same time. Unless this is addressed via this Bill, building societies would continue to be disadvantaged in relation to other retail deposit-takers because funding that they are required to hold for regulatory purposes will limit other sources of investment, which thus constrains the ability of building societies to attract additional wholesale funding. It will also mean that building societies continue to operate under more outdated and potentially more burdensome governance practices compared to retail banks.

Detail: Under the 1986 Act, subject to some exemptions, building societies are required to raise at least 50% of their funding from their members' deposits in savings accounts, with funding from other sources called wholesale funding. This is known as "the funding limit".

The funding limit is a key feature of the building society's unique ownership model as it preserves the mutual status of building societies by ensuring they are at least 50% owned by their members, and it complements other financial regulation by ensuring societies are mainly funded by the long-term savings of their members. It is believed that the minimum 50%

requirement for funding from member deposits remains appropriate and there are no plans to change this level.

Whilst the 50% members' rule will remain unchanged, this Bill will provide greater flexibilities for the remaining 50% ("wholesale funding"). This Bill will amend the 1986 Act and provide HM Treasury with the powers to make secondary legislation to exclude from the funding limit calculation for wholesale funding, (i) specified Bank of England liquidity insurance facilities, (ii) specified debt instruments raised to meet MREL requirements (minimum requirements for own funds and eligible liabilities), and (iii) sums received under a repurchase agreement for the purpose of complying with a Prudential Regulation Authority (PRA) rule from counting towards the building society wholesale funding limit calculation.

The Bill also makes an amendment to the 1986 Act to make it clear that attendance and voting at meetings by electronic means is permissible (aligning with flexibilities available to companies) and enables the making of amendments to Part 2 of the 1986 Act to align with corporate governance changes in relation to common seal requirements and execution of documents made to company law.

2. What are the policy objectives and the intended effects?

The policy intent of the Bill is to modernise the legislation to better align with the framework under which companies operate, while still maintaining the building society mutual ownership structure. In December 2021, the government launched a consultation into amendments to the 1986 Act[1]. The Government published a response as part of the Edinburgh Reforms in December 2022, in which all respondents supported the range of proposals outlined[2].

As explained above, additional flexibilities around wholesale funding will allow building societies to operate more competitively within the financial services sector. Additional measures around electronic attendance will modernise the regulatory framework and keep building societies in line with the regulations that apply to banks operating under the Companies Act 2006.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

[1] Amendments to the Building Societies Act 1986- Consultation Consultation - Amendments to the Building Societies Act 1986 .pdf (publishing.service.gov.uk)

[2] Consultation: Amendments to the Building Societies Act 1986 Call for Evidence- Response Sensitive 091222 FINAL Response to Consultation - Amendments to Building Societies Act 1986 final .pdf (publishing.service.gov.uk)

The main alternative policy option we have considered is a ‘do nothing’ scenario which we have determined as the status quo. This would mean that building societies continue to operate under the current 1986 Act, which has not been updated in line with Companies Law. This would limit building societies’ ability to compete on a level playing field with other retail deposit-takers (i.e. banks), disadvantaging these societies and their members. Building societies provide diversity to the UK financial services sector, so ensuring that they can complete on a level-playing field with banks is important in supporting the sustainability and resilience of the UK financial services economy and wider consumer choice.

In the section below, we examine the ‘do nothing’ option in turn for each policy measure in the Bill.

Exclusions from Wholesale Funding Limit

If this ‘do nothing’ approach is adopted, building societies will continue to be disadvantaged in relation to other retail deposit-takers because funding that they are required to hold for regulatory purposes will limit additional investment they may be able to source within the funding limit calculation, i.e. continue to constrain space on their balance sheets under their wholesale funding limit calculations. Instead, this Bill seeks to give Treasury the power to exclude these specified sources of funding from the funding limit calculation, helping building societies scale, grow and compete on a more level playing field to retail banks while retaining their mutual model. Details will be specified in subsequent Statutory Instruments to deliver the Bill, but <u>the overall rationale for excluding these different sources of funding is explained in the **Annex** for each measure</u>**.**

<u>Potential Risks of Exempting the Above from Wholesale Funding Limits</u>

Removing the above funding from the funding limit calculation could have some impacts on financial stability as it would enable building societies to use more of its capital for investment and lending activities, which is inherently riskier activity. However, societies will still have to hold these funds for regulatory purposes, but instead will be provided with greater flexibility on accessing capital. The decision on how to use this extra funding capacity would be an individual commercial decision for each building society, and thus dictated by their own risk appetite. However, this sector is generally very resilient with a lower risk appetite as compared to many retail banks, Furthermore, the PRA will continue to monitor Building Societies’ resilience and will intervene if it detects any issues, as is standard. The PRA has been consulted on the development of this policy and this Bill.

Corporate Governance Amendments

Under a ‘do nothing’ scenario, building societies will continue to operate under outdated law, which does not afford them the same flexibility or more modern practices as companies.

Providing building societies with the explicit option to have real-time virtual member participation at meetings will help to modernise the day-to-day practices for these societies, promoting wider member engagement and bringing building societies in line with flexibilities provided to other retail banks under the Companies Act 2006.

Enabling the modernisation of sealing and document execution requirements will remove an administrative burden and give building societies the same flexibility as companies, who may choose to have a seal and either affix a seal to documents or obtain the signatures of directors. Currently, building societies are not afforded this same flexibility which puts them at a disadvantage compared to other retail deposit-takers (e.g. banks). This legislation therefore provides Treasury with the power to make legislative change in relation to the common seal and execution of documents requirements in the Building Societies Act.

4. Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.

Exclusions from Wholesale Funding Limit

What will businesses have to do differently?

Building societies will recalculate their Wholesale Funding Limit as appropriate, which many will do through their normal review process. These revaluations will free up space on the Building Society’s balance sheet which has been held for (i) specified Bank of England liquidity insurance facilities, (ii) debt instruments raised to meet MREL requirements, and (iii) sums received under a repurchase agreement with a view to complying with a specified PRA rule. Multiple building societies highlighted that these exclusions would provide greater capacity to use central bank funding schemes available, resulting in cheaper funding and further risk mitigation under a stress. In turn, this will enable them to finance their operations more efficiently by being able to use more of their capital for investment and lending activities and enable building societies to scale, grow and compete on a level playing field to other retail deposit-takers.

- How many businesses will this impact per year?

There are currently **42 building societies in the UK** who will be impacted by the exclusions to the wholesale funding limit in the Building Societies Act 1986.

- What is the direct cost/benefit per business per year?

HM Treasury requested data from the sector regarding the costs and benefits of this change. The requested was submitted by HM Treasury to the Building Societies Association, who gathered data from a representative selection of their members. This informal consultation, which took place in December 2023, forms the core evidence base for this impact assessment. The response provided to the data request is commercially sensitive and cannot be published in full. However, aggregated summaries of responses have been included throughout the assessment.

As the Bill is giving HM Treasury the power to specify further types of funding within named categories that can be excluded from the wholesale funding limit calculation, there will be a subsequent SI to enact the changes. Therefore a more detailed impact assessment, with quantifiable figures, will be produced along with the subsequent SI.

From qualitative survey data received from the sector, there was consensus from the sector that there would be immaterial costs (both one-off and continuing) to implement these changes as changes would only require minor updates to existing processes and reporting. This would be namely updating the funding calculations that they report to reflect the exclusions by re-classification on internal Treasury systems and accounting ledgers as well as re-modelling in Asset Liability Management and Financial Planning systems. Due to the negligible potential costs involved, given these systems are already in place and regularly reviewed, the sector did not provide any quantifiable figures.

The survey data also showed that the benefit of the changes would directly benefit societies by providing greater headroom and flexibility for their lending activities, meaning they can compete more effectively against retail banks that are not subject to the same constraints. Multiple building societies highlighted that the exclusions would provide greater capacity to use central bank funding schemes available, resulting in cheaper funding and further risk mitigation under a stress. In the event that a stress has occurred, this would enable building societies to fund themselves using the exempt funding tools without concern for breaching the funding limit by accessing them. Building societies may not have to increase the rates on their retail savings book or issue bonds at in wholesale markets, also at a high cost, if they have the capability of doing so. These funding tools could be more costly than the proposed exempt funding tools.

Most firms provided their data in qualitative form. However, there are no immediate direct financial benefits to firms through the exemptions as these will unlock money already on building societies' books. There will be expected indirect financial benefits as firms will be able to decide how to use that freed-up funding and can, for example, benefit from choosing to use more for investment and their lending activity, subject to each firm's review and its governance and risk appetite.

Corporate Governance Changes

- What will businesses have to do differently?

The changes to the corporate governance requirements will explicitly allow the option of real-time virtual member participation in building societies' meetings. It will also give HM Treasury the power to assimilate requirements of the common seal and execution of documents to that of Companies law, which does not require companies to affix a seal when executing a deed. This will be subject to further Statutory Instruments. These changes are intended to provide building societies with greater flexibility, aligning corporate governance requirements with changes made to Companies law. As building societies will not be required to make these changes, but instead will be given greater choice in how they can operate, **there is no required cost to the sector**. However, the expected cost incurred if building societies were to make these changes has been calculated in the annex below.

- How many businesses will this impact per year?

There are currently **42 building societies in the UK** who will be impacted by changes to the Building Societies Act 1986. As previously stated, there is no requirement for building societies to implement these corporate governance changes, meaning the impact will only be sustained should a building society determine it is in their society and its members' best interest to make use of these flexibilities.

- What is the direct cost/benefit per business per year?

As the legislation will allow the option for real-time virtual participation and will not require building societies to make these changes, there are no direct, mandated costs. Additionally, as the legislation will provide Treasury with the power to make regulation around the requirements of the common seal and execution of documents to align with company law, which will be introduced via Statutory Instrument, and as these will be optional to adopt, there are again no direct, mandated costs.

However, HM Treasury requested data from the sector regarding the costs and benefits of the changes should building societies choose to implement these, outlined in the annex below.

5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**
   No
b) **Disproportionate burdens on micro, small, and medium businesses (below 500 employees).**
   No
c) **Significant gross effects despite small net impacts**
   No
d) **Significant wider social, environmental, financial or economic impacts**
   No
e) **Significant novel or contentious elements**
   No

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Banking and Credit

Signed: ***Alanna Barber*** Date: 15/12/2023

SCS of Better Regulation Unit

Signed: ***Phil Witcherley*** Date: 14/12/2023

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***Bim Afolami, Economic Secretary to the Treasury*** Date: 19/12/2023

Annex: Further information sheet

Wholesale Funding Limit

Bank of England Liquidity Insurance Facilities

Currently, building society boards manage the maximum amount of non-member funding well below the 50% funding limit in normal times, such that, in the event of a severe liquidity stress event, sufficient head room remains to access the Bank's facilities without breaching the limit. Excluding this source of funding from the funding limit would enable building societies to operate closer to the 50% limit in normal times, whilst not constraining the usage of these emergency facilities in times of exceptional stress because of a statutory limit.

Debt Instruments raised to meet minimum requirements for own funds and eligible liabilities (MREL)

To meet the Bank of England's Resolvability requirements, larger building societies need to hold a minimum amount of liabilities that can be used to create new capital during a resolution. This requirement is set out in MREL regulations. Whilst capital issuance is already excluded from the funding limit calculation, excluding loss absorbing debt instruments that are held for MREL purposes would further help create a more level playing field with banks who also have MREL requirements.

Repurchase agreements with a view to complying with a specified PRA rule

To meet the liquid coverage ratio (LCR), building societies are required to hold a stock of high-quality liquid assets (HQLA) that can be used to meet unexpected cash outflows in a stress. This LCR ratio is a metric which measures the value of a bank's most liquid assets against the volume of its short-term liabilities[3]. To monetise HQLA assets, building societies use a sale and repurchase agreement (repo), a form of short-term borrowing where bonds are pledged with a third party in exchange for cash. Building societies regularly repo bonds in normal conditions to demonstrate the liquidity of their HQLA portfolios and to avoid negative signalling in a stress scenario. When a HQLA bond is used in a repo transaction, it is included in the funding limit calculation, but no additional funding is raised. Excluding this from the wholesale funding limit

[3] The Prudential Liquidity Framework, Bank of England DP1/22 – The prudential liquidity framework: Supporting liquid asset usability | Bank of England

will mean that this funding will not essentially be counted twice on the balance sheet, freeing up space.

Potential Risks of Exempting the Above from Wholesale Funding Limits

Removing the above funding from the funding limit calculation could have some impacts on financial stability as it would enable building societies to use more of its capital for investment and lending activities, which is inherently riskier activity. However, societies will still have to hold these funds for regulatory purposes, but instead will be provided with greater flexibility on accessing capital. The decision on how to use this extra funding capacity would be an individual commercial decision for each building society, and thus dictated by their own risk appetite. However, this sector is generally very resilient with a lower risk appetite as compared to many retail banks, Furthermore, the PRA will continue to monitor Building Societies' resilience and will intervene if it detects any issues, as is standard. The PRA has been consulted on the development of this policy and this Bill.

Corporate Governance

Real-time virtual member participation

As building societies will not be required to make these changes, but instead will be given greater choice in how they can operate, **there is no required cost to the sector**. However, the expected cost incurred if building societies were to make these changes has been calculated below.

From the data request received from the sector, there was consensus that for some of those who would choose to implement the changes, there would be some one-off costs. These costs would stem from third-party cost to purchase and install the appropriate equipment which includes additional video/audio and broadcasting software. No quantitative data was provided on what this cost may be, with one firm noting the difficulty in quantifying the cost.

However, the data also highlighted that many building societies have already invested in equipment to make virtual meetings possible due to the coronavirus pandemic. Therefore, many building societies already have the existing required equipment, reducing the potential number of firms who would be required to undertake this one-off cost.

The data also noted that cost of legal advice to ensure compliance is estimated to be up to £5,000. The qualitative data survey highlighted that most firms noted this would be a one-off, however one firm suggested that the cost could ongoing.

Data also highlighted there would be continuing costs. Survey data from building societies estimated that to enable virtual participation, there would be direct costs of £10,000-13,000 per firm per year. This includes cost of access to online platform to support broadcast and onsite support of IT equipment. The smallest building societies noted that there would be a greater proportional cost, but the qualitative evidence gathered suggests that they would be unlikely to implement the change as it is not in their business interests, with previous trials of running virtual participation in meetings receiving limited uptake.

Most firms noted qualitatively that expected benefit of increased participation in meetings by members who are unable to join physically, and may support building societies in creating a more accessible and inclusive engagement approach.

Therefore, based on the above figures, for those firms which undertake the changes and move to a hybrid model, there would be a net direct cost of £10,000-13,000 per firm per year, excluding one-off implementation costs.

<u>Removal of the requirement to have a seal or to fix a seal when executing a document</u>

From qualitative survey data provided by the sector, there was a consensus across the sector that if they chose to implement removing the requirement to have a seal or affix a seal when executing a document, there would be a small, one-off cost per firm. It was noted by firms that the process would be minimal and carried out as part of routine reviews. However, an estimated cost was provided of less than £1,000.

There was consensus across the sector that there would be no ongoing costs to implement this change.

The sector noted numerous benefits if they chose to implement the change, namely that there would be logistical benefits: the need to use a seal requires designated staff who have authority and access to the seal to be physical present and available to seal the document. Removing the requirement would simplify the process and give greater flexibility to execute documents. A quantified estimate of savings was provided on the basis of a society having 3 members of staff with the authority to use the seal. It was estimated that £15,000 p.a. savings on the basis of average number of sealings across most of the areas of the business that do sealings. This is on the basis of approximately 950 sealings a year on an admin salary basis at 15 minutes per sealing.

Therefore, with the data provided by firms, it is estimated that there would be a net benefit of £14,000 for the first year of implementation, with an estimated net benefit of £15,000 afterwards should a building society take up this flexibility.

Summary of cost/benefit per business per year for corporate governance amendments

Building societies who choose to implement all the changes may incur some small, one-off costs for investing in the appropriate technological equipment to enable virtual participation in meetings, seeking legal advice on implementing the new changes and updating their policies and procedures to remove the need to use a seal to execute documents. There would also be some ongoing costs to support the provision of virtual participation in meetings. With the data provided by the sector, HM Treasury estimates this to be £10,000-13,000, reducing to £10,000 per firm per year ongoing.

However, this minimal cost is outweighed by the benefits these changes would have on supporting the inclusion of members and future growth and success of the sector.

Overall, it must be noted that as the Bill is designed to give building societies more flexibility by giving the option to remove the use of a seal to execute documents and the option of enable real-time participation in meetings virtually, there **is no requirement for building societies to make these changes** and thus face any costs. Therefore, the expected mandated cost to firms is £0.