Financial Conduct Authority – CP 14/13 – Strengthening accountability in banking: a new regulatory framework for individuals

A response from the Association of British Credit Unions Limited (ABCUL)

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Executive Summary

As a general point we are concerned and alarmed by the divergent approaches that PRA and FCA have adopted in this consultation. In relation to credit unions we have one regulator taking steps to apply the regime proportionately (though not going far enough) while the other fails entirely to recognise the burden that these proposals are likely to have on credit unions (in spite of its own cost-benefit analysis). We would like to see both regulators extend their measures in support of proportionality and to devise a regime which is consistent between the two regulators. At present the proposals are messy and do not take sufficient account of the burden that they will impose upon our members.

We strongly prefer the PRA's approach to the implementation of the Senior Managers Regime and Certification Regime to that of FCA – we have however argued for this to be extended to *all* credit unions. As such, we would like to query why the FCA has declined to utilise the flexibility it has available to it in applying the requirements more proportionately. While PRA propose to make special arrangements for smaller credit unions, including a simplified framework for prescribed responsibilities and a specialised SMF category, the FCA intend to apply the proposals to credit unions in the same way as other firms. This is despite concerns expressed by the independent cost-benefit analysis undertaken by Europe Economics which stated clearly that the cost-benefit case for these proposals in the credit union context is weak and that they are likely to cost credit unions and small institutions disproportionately.

We urge FCA to reconsider its proposals and do more to accommodate credit unions within the framework. Most notably, we have significant concerns as to the potential for these proposals to present difficulties in recruiting, training and retaining senior staff and volunteers without compensation packages which many credit unions can ill afford. In particular we suggest that FCA:

- Consider the case for a simplified SMF framework for smaller credit unions and whether this can be extended to all credit unions.
- Within the current proposals, make it more explicit that the SMF structure should be applied in a way which fits the size and complexity of a firm and only require SMF approvals where they are materially-required.
- Consider what guidance can be provided to credit unions as to how the new SMF structure ought to be applied in a credit union context.
- Develop a set of simplified prescribed responsibilities for all credit unions, since the complexity and granularity of the proposed framework is excessive.
- Develop guidance as to how the Statements of Responsibilities and Responsibilities Maps ought to be implemented in a credit union context.
- Develop standardised formats for Statements of Responsibilities and Responsibilities Maps.
- Remove requirements around handover meetings between successive SMF holders.
- Provide further guidance and clarity as to the application of conditional approvals, particularly in relation to competition and proportionality.
- Consider whether regulatory references should be limited to only SMF applicants, as criminal record checks are.
- Provide guidance as to how regulatory references and criminal record check results should be

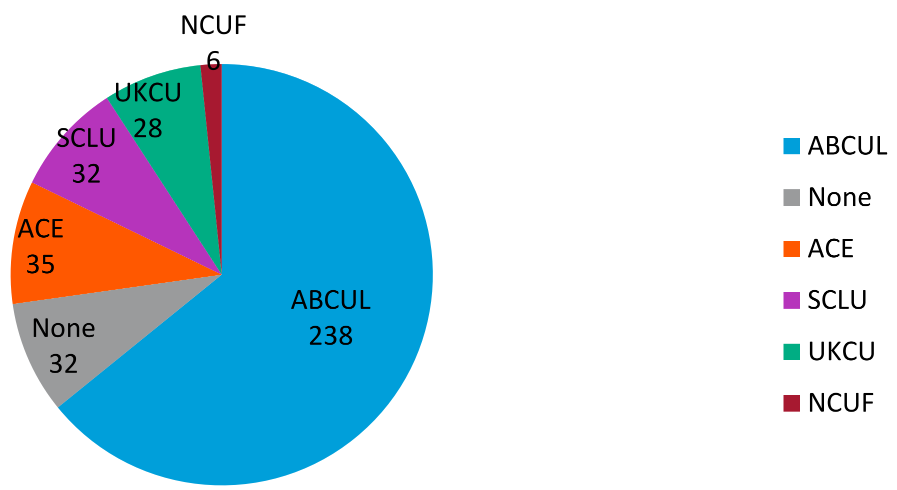
used by credit unions in assessing candidates for approval.

- Develop provisions for grandfathering which take account of the conceptual clash that occurs in relation to standing guidance at CREDS 8.3.4G and offer similar guidance material for how the SMF regime should apply in the credit union context.
- Extend the transitional period for SMR, CR and Conduct Rules to 12 months.

ABCUL is keen to work with FCA to develop the framework to enable its successful and proportionate application in the credit union context.

Introduction

We appreciate the opportunity to respond to this consultation. The Association of British Credit Unions Limited (ABCUL) is the main trade association for credit unions in England, Scotland and Wales. Out of the 338 credit unions which choose to be a member of a trade association, 70% choose to be a member of ABCUL. The following chart shows the breakdown of credit union trade association affiliation.



Credit unions are not-for-profit, financial co-operatives owned and controlled by their members. They provide safe savings and affordable loans. Some credit unions offer more sophisticated products such as current accounts, ISAs and mortgages.

At 31 December 2013, credit unions in Great Britain were providing financial services to 1,122,461 people, including 126,217 junior savers. The sector held more than £1.1 billion in assets with more than £676 million out on loan to members and £949 million in deposits.[1]

[1] Figures from unaudited quarterly returns provided to the Prudential Regulation Authority

Credit unions work to provide inclusive financial services has been valued by successive Governments. Credit unions' participation in the Growth Fund from 2006 – 2011 saw over 400,000 affordable loans made with funding from the Financial Inclusion Fund. The DWP has contracted ABCUL to lead a consortium of credit unions under the Credit Union Expansion Project, which will invest up to £38 million in the sector and aims to make significant steps towards sustainability.

The credit union sector has also enjoyed the support of the Coalition Government specifically as part of its commitment to promote mutuals and competition and diversity in financial services. This was most-recently illustrated by the HM Treasury Call for Evidence *British Credit Unions at 50* which sought views on what Government and wider society can do to support the expansion and development of credit unions in order to provide more competition in financial services.

More widely, this agenda of promoting diversity and competition in financial services has been extended through legislation to form part of the statutory remits of both PRA and FCA. This also provides benefits in terms of the core statutory responsibilities of financial stability – since a diverse industry presents less contagion risk – and consumer protection – since wider choice and competition should drive better outcomes for consumers. This was echoed in recent remarks for Martin Wheatley as well as efforts by PRA to reduce the regulatory barriers to entry in banking.

Therefore, the promotion of a flexible and proportionate regulatory regime for credit unions should be at the heart of the proposals to implement the SMR and Certification Regime. It is clear that the scandals and poor performance which has given rise to the proposals has not arisen in the credit union sector and indeed the promotion of the growth of credit unions is clearly seen by policymakers as part of the remedy for some of these issues. As such we urge both PRA and FCA to implement the proposals in a way which is appropriate to and sensitive of the needs of credit unions.

Consultation questions

Q6: [FCA] Does the proposed list of FCA SMFs capture the appropriate set of roles? If not, a. are there any other roles which the FCA should consider specifying as SMFs? b. are there any proposed SMFs which the FCA should consider excluding?

We would like to question why the FCA has decided to adopt a different approach to SMF allocation compared with PRA. While PRA has made provision for smaller credit unions (under £25 million in assets) to have one or a number of specialised "credit union Senior Mangers" between whom the relevant (simplified) prescribed responsibilities are to be allocated, the FCA has opted instead to apply its provisions in the same manner as all other firms.

While we take on board the point that these will not be applied in the same way to credit unions as to other firms and it is here that proportionality will be provided, we also note the concerns expressed by Europe Economics in its cost-benefit exercise which specifically cite the potential detrimental and disproportionate effect of these proposals upon smaller credit unions. Furthermore, we note that while the PRA has produced a simplified list of prescribed responsibilities for credit unions to further apply proportionality, the FCA requires the same list to be adhered to by credit union SMFs. We would like to see a simplified list of responsibilities produced by FCA in order to embed proportionality into the application of the framework to credit unions. We would also like FCA to consider whether it may tailor the regime for smaller credit unions in the manner proposed by PRA. We have argued to PRA that its smaller credit union regime should be applied to all credit unions since we do not accept that the cost-benefit case stacks up for not doing so. Therefore we would like to see FCA do the same. PRA's regime, in allowing one or a number to adopt the "credit union Senior Manager" function, provides flexibility and proportionality which the FCA's currently does not.

Our ultimate concern is that the effect of these proposals will be to drive up the cots of employing key staff and of recruiting and retaining skilled directors (who are often volunteers) since it imposes a significantly enhanced level of personal responsibility upon them. This is likely to be a problem disproportionately faced by credit unions despite their considerably lower risk in terms of potential customer detriment and their absence from responsibility for any of the scandals and breakdowns of integrity which led to the proposals in the first place.

Q7: [FCA] Does the proposed list of Key Functions adequately cover those likely to be carried out by relevant firms? Which functions should be added or removed?

To reiterate the point above, we feel the list of Key Functions for all credit unions is inappropriate and overly complex stemming, as it does, from the experience of the banking sector and the structures that are apparent there. In reality for all credit unions there are likely to be a very limited number of people with responsibility for the range of Key Functions set out and therefore we would appreciate if FCA would consider developing a simplified list of Key Functions for all credit unions order to create a framework which makes more sense in a credit union context.

Once more, we would also like to make the point that the inappropriateness of the list of Key Functions speaks to the fact that this framework is designed without the needs of smaller institutions which present limited risk of detriment – i.e. credit unions – in mind. Therefore they impose a level of complexity and granularity which does not fit the credit union model and presents all sorts of new costs and expectations for credit unions *vis-a-vis* their staff and volunteer directors. This presents significant challenges which we do not feel the consultation sufficiently acknowledges and we feel strongly that there is no regulatory case for imposing this level of complexity on credit unions.

Q8: [PRA/FCA] Do the combined FCA and PRA proposed SMFs cover the key decision-makers in relevant firms?

Yes. Our concern is that they also extend far beyond key decision-makers and also present a much greater level of responsibility and obligation than we feel is appropriate in a credit union context. In particular, the prescribed responsibilities in the FCA context (and for PRA for larger credit unions) do not present a realistic view of the workings of a credit union and the functioning of their management structure. Nor do they represent a sufficient attempt to apply the legislation's requirements proportionately. It is clear from the PRA's proposals for smaller credit unions that the legislation provides sufficient flexibility to make more appropriate arrangements for credit unions but we are disappointed by the lack of commitment in finding an appropriate application to credit unions.

Key measures to alleviate some of this burden would involve:

- A simplified list of responsibilities and Key Functions for *all* credit unions
- Consideration of whether the full simplified regime can be extended to *all* credit unions
- Guidance on the application of SMFs in a credit union context
- Guidance as to the application of responsibilities / Key Functions in a credit union context

Q9: [FCA] Do you agree with the FCA's proposed approach to the allocation of responsibilities?

We are broadly satisfied that the FCA's approach to the allocation of responsibilities seeks to provide flexibility in order to allow firms to fit the Key Functions into its own business plan. However, we are concerned that the list of Key Functions, as set out above, is very inappropriate, overly-complex and granular to fit with credit union business models. We would instead like to see a simplified set of Key Functions for all credit unions which takes better account of their particular business models and is proportionate in its application noting the concerns around the potential for disproportionate impact set out in the independent cost-benefit analysis.

Q10: [PRA/FCA] Do you agree with the PRA's and FCA's proposals on Statements of Responsibility?

We have concerns relating to Statements of Responsibilities and connected Responsibilities Maps which generally stem from the overly-complex and disproportionate SMF framework and list of prescribed responsibilities / Key Functions. Given the lack of relevance of many of the required responsibilities, statements of responsibilities will suffer from the same lack of relevance in a credit union setting. This will only compound the bureaucratic nature of the SoRs and the impact on credit unions' ability to recruit and retain sufficiently skilled and experiences senior staff and volunteer directors. This demonstrates the likely enhanced impact of these proposals and, therefore, disproportionate effect resulting from the proposals overall as identified in the cost-benefit analysis.

Ideally we would like to see both regulators create a simplified framework for SMFs (for *all* credit unions) and simplified prescribed responsibilities / Key Functions which would apply to all credit unions. At the very least, though, a template and guidance for the Statement of Responsibilities and Responsibilities Map in a credit union context would assist credit unions in managing this costly and time-consuming exercise.

Q11: [PRA/FCA] Do you agree with the PRA's and FCA's proposal to require firms to produce a Responsibilities Map?

As in our response to the question above, we would like to see guidance and template documentation be provided for credit unions applying the Responsibilities Map requirement. Alongside this we would also like to see a wider application of simplified responsibilities / Key Functions for SMFs in a credit union context. This should apply regardless of size since a great deal of the responsibilities and Key Functions set out do not correspond to a simple credit union business model. Otherwise the Responsibilities Map will become a bureaucratic exercise of limited usefulness to the regulators' statutory objectives and in direct conflict with the responsibilities to apply regulation proportionately and to promote competition.

Q12: [PRA/FCA] Do you agree with the PRA's and FCA's proposed approach to handover arrangements?

Once more, we feel that this requirement presents an excessive burden upon credit unions given their generally simple business model and the lack of threat of detriment or financial instability or consumer detriment arising from their operations. It also presents practical difficulties in terms of the frankness and openness which SMFs will be able to display to their successors in handover meetings. We do not see what benefit this requirement is going to have in a credit union context and we therefore suggest that it is withdrawn, at least in the case of credit unions.

Q14: [FCA] Do you agree with the proposals set out in the FCA's proposed statements of policy contained in draft chapters SUP 10C and DEPP 8?

We have some concerns here based on the wide-ranging discretion that both regulators seem to have provided by the legislation. While we accept that there are unlikely to be many instances where these powers are activated in relation to a credit union, we would also urge transparency in their use and clear published reasoning given where conditions and limits are placed on a credit union SMF's approval. We wonder whether further clarity could be provided in the FCA's draft handbook chapters on how these powers will be applied with regards to proportionality and competition.

Q16: [FCA] Do you agree with the proposed approach to defining certification functions?

In general we accept the FCA's approach to defining the scope of the certification regime although this may be affected by any adjustment that FCA may make to the scope of its SMF regime following our comments above.

Q17: [FCA] Do you agree with the FCA's proposed approach to rules and guidance on fitness and propriety?

We are in broad agreement with the FCA's approach. Amendment and refinement of the FIT guidance would be helpful.

Q19: [PRA/FCA] Do you agree with the FCA and PRA proposed requirements on:

a. criminal record checks

We are broadly supportive of this but note some potential sensitivities in certain parts of the country and the particular difficulties that this may present to credit unions which, as local organisations which close links to the community, may be put in a difficult position if they are required to run criminal records checks in certain circumstances. In general, however, we feel this is good practice and we do not object.

There are questions about the capacity of the DBS to fulfil the extra demand and we would urge both regulators to explore this. It is possible that trade bodies such as ABCUL may be able to assist in addressing some of these potential barriers.

b. the provision of references?

We believe there are a number of flaws with the proposals around regulatory references whereby they make unrealistic assumptions about the level of detail furnished by such references and the reliability or otherwise of that information. Similarly, we are concerned that there is potential, with the extension of this requirement to the certification regime, for a huge administrative burden to arise from these references. Finally, it is not clear how far firms are required to take the material provided by references into account and the degree to which they have discretion to discount a previous instance of misconduct.

We would suggest guidance is provided to firms to enable them to better understand how they can appropriately use references and, furthermore, for its requirement to be limited – as criminal record checks are – to only those applying for an SMF.

Q21: [FCA] Is this the best possible definition of scope that fulfils the objectives set out in paragraph 5.11? Are there alternatives that would better meet these objectives?

No. We believe that the conduct of junior, front-line staff not subject to the SMF or Certification Regime, should have their conduct monitored by their line managers as an internal disciplinary matter and these individuals should not be burdened with a regulatory requirement in this way. Our key concern is the potential impact of this on the recruitment of volunteers in smaller credit unions. We are also concerned that even in larger credit unions, customer-facing staff are very closely monitored by responsible certified and SMF individuals and therefore it does not strike us as necessary to impose this kind of requirement in addition to the requirements already incumbent upon senior accountable persons.

Q22: [FCA] Do you believe that rules should apply to all people in the firm who are directly involved in financial services business?

No. We refer to our comments made above in response to Q21.

Q23: [FCA] Are there any functions that you believe should be added or removed from the list at 5.13 because they are roles that are, or are not, the same as roles performed by those working in non-financial services firms?

Our position is that we do not believe this is a good distinction and that the Conduct Rules should only apply to SMF and Certified individuals as is proposed by PRA.

Q24: [PRA/FCA] Do you agree that these are the right Conduct Rules for both regulators to introduce, taking into account the objectives set out in paragraph 5.16?

We are satisfied with the Conduct Rules as set out and their application between the regulators. Credit unions pride themselves on their high standards and would not find difficulty in fulfilling the requirements laid out. We do, however, have concerns as to the administrative burden of demonstrating compliance with the Conduct Rules in terms of training and other documentary evidence. We suggest, therefore, that the Rules are limited only to those falling under the SMF or Certification Regime and that guidance is provided as to how adherence is to be assured.

Q25: [FCA] Do you agree that these are the right additional FCA-specific rules?

We are broadly satisfied that these are the right additional rules.

Q26: [FCA] Does the guidance attached at Annex 6 give helpful clarity on the behaviours the FCA expects under each of the rules?

We are pleased with the FCA's provision of guidance on the Conduct Rules which is very helpful, particularly for small firms. However, we believe it could be presented in a more accessible format and we also believe it could go much further than it does in spelling out the kinds of scenarios which would constitute a breach of the rule and vice versa. Similarly, it would be helpful if the guidance could take a more targeted view of the needs of smaller firms, such as credit unions.

Q27: [PRA/FCA] Do you agree that individuals already performing the relevant controlled functions within their existing approvals should be grandfathered to the new SMF?

We strongly agree with this proposal but would like to highlight a potential conceptual clash between the existing framework as it applies to credit unions and the grandfathering schema proposed in the consultation.

Under the CREDS 8.3.4G guidance on approved persons in a credit union context, credit unions are advised to apply for CF1 (Director) for members of the credit unions' board and CF2 (NED) for members of the internal audit committee (often known as the supervisory committee). This arises from the fact that the framework is designed with plc / commercial structures in mind and therefore does not neatly correspond to the co-operative governance structure operated by credit unions. Similarly, particularly very small credit unions, can often see their board members take an active operational role in the credit union. However, as the sector grows, this is becoming less common and credit union boards tend to take a stronger focus on governance only. Similarly, many credit unions are reforming their internal audit structures and reviewing the role of the elected supervisory committee in this.

As such, most credit unions today will have CF1-approved individuals performing functions which the joint proposals envisage would be now occupied by the equivalents under the CF2 categories. For example, a credit union chairman would currently be approved as CF1 rather than CF2 and therefore provision needs to be made to allow credit union grandfathering between categories which are currently separate – so, in our example, to allow a CF1 to become SMF9 (for a larger credit union under the PRA proposals) or for other directors the SMF15 NED category under FCA proposals. This is provided in the case of smaller credit unions (which we would like to see extended) already whereby the SMF8 category appears as a grandfathering option for both CF1 and CF2-approved individuals, therefore, it should be possible to make similar allowances for other credit unions (notwithstanding our comments on the SMF structures more generally).

Furthermore, we would appreciate if both PRA and FCA could offer guidance similar to that appearing currently within CREDS which clarifies which functions are considered executive director functions and which are considered NED functions. This will assist credit unions to think through how their evolving governance and executive structures can be accommodated within the SMF schema. ABCUL would be happy to play a role in devising any such guidance and communicating the general principles of this to its members.

Q28: [PRA/FCA] How much time do you think is necessary to implement the new SMR rules, including the preparations of Statements of Responsibilities and Responsibilities Maps? Please explain what activities would be required to prepare for implementation, and the time required for each activity.

Overall, in the name of proportionality, we would suggest that a period of 12 months should allow sufficient time for credit unions to implement the proposals. Processes involved here would be first, identifying how the credit unions' structures fit within the SMR framework and identifying which individuals need approval for which SMF – this could take several months given some of the challenges we outlined above in terms of the clash between the current application of APR and the proposals under SMR.

Alongside this, there will also be an issue of training and development to be addressed in order to make sure SMR individuals are entirely up to speed with the way the regime changes their personal accountability, conduct rules and Statements of Responsibilities. As our concerns above also highlight, we anticipate that this may also present issues of recruitment as some board members and senior staff may not wish to be subject to the new levels of accountability either at all or without compensation which credit unions may struggle to provide. Therefore, we suggest a period of upwards of six months for this process to be completed with the added complication that board recruitment is subject to the cycle of Annual General Meetings which could further delay matters.

Finally we anticipate some challenges for credit unions in devising and agreeing Statements of Responsibilities and Responsibilities Maps especially if the proposals are pursued as they are currently devised without any provision made for simplified prescribed responsibilities and Key Functions. This also has raises related questions to the issue above re: potential recruitment processes. Therefore we would anticipate a further process of several months before this can be realistically completed for most credit unions.

Q29: [PRA/FCA] How much time do you think is necessary to implement the new Certification Regime? Please explain what activities would be required to prepare for implementation, and the time required for each activity.

As above, we feel that this process should be given a period of 12 months for implementation. We think there is a clear case for phasing implementation alongside SMR with the same time table since the processes around identifying, training and potential issues of recruitment will all apply more or less equally.

Q30: [PRA/FCA] In relation to the Conduct Rules, how much time do you think is necessary for implementation? Please explain what activities would be required to prepare for implementation, and the time required for each.

As above, we feel 12 months should be sufficient though this is contingent to some extent on whether the FCA persists in its position that all non-ancillary staff will be required to comply. The main question here is one of training staff in the rules and the implications of a breach. For some credit unions this may also present issues of recruitment too, especially in the case of volunteer operatives in very small credit unions.

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