EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES ACT 2012 (MUTUAL SOCIETIES) ORDER 2013

2013 No. [XXXX]

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument allocates the Financial Services Authority's existing responsibilities for the regulation of mutual societies between the two new regulatory bodies, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This instrument is required under the Financial Services Act 2012, which received Royal Assent on 19 December 2012, in advance of the new regulatory system for financial services in the UK being implemented on 1 April 2013.

4.2 The instrument amends the following pieces of legislation in order to facilitate the transfer of mutual societies regulation to the PRA and FCA: the Building Societies Act 1986; the Credit Unions Act 1979; the Friendly and Industrial and Provident Societies Act 1968; the Friendly Societies Act 1974; the Friendly Societies Act 1992; the Industrial and Provident Societies Act 1965; and the Industrial and Provident Societies Act 1967.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services Act 2012 (Mutual Societies) Order 2013 are compatible with the Convention rights.

7. Policy background

7.1 The Financial Services Act 2012 provides for the reform of financial regulation in the UK. In the place of the Financial Services Authority (FSA), it establishes a new system of financial services regulators comprising:

- An expert macro-prudential authority, the Financial Policy Committee (FPC) within the Bank of England to monitor and respond to systemic risks in the financial sector;
- A focused micro-prudential regulator, the Prudential Regulation Authority (PRA), to regulate firms that manage complex risks on their balance sheets - specifically, all deposit takers, insurers and some large investment firms; and
- A focused conduct of business regulator, the Financial Conduct Authority (FCA), to ensure that business across financial services and markets is conducted in a way that advances the interests of all users and participants.

7.2 The FSA exercises two distinct sets of functions in relation to mutual societies. First, it exercises functions under the legislation which governs the establishment and operation of mutual societies; for example, under the Building Societies Act 1986, the FSA registers building societies. Second, under the Financial Services and Markets Act 2000 (FSMA), the FSA regulates those mutual societies that undertake regulated activities such as accepting deposits and entering into a regulated mortgage contract as a lender. The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) are to replace the FSA in exercising functions under FSMA. But this change necessitates amendments to the legislation which governs mutual societies as well.

7.3 In high level terms, the Mutuals Order will:

- replace references to the FSA with references to the FCA or the PRA or both as appropriate, within the various pieces of mutuals legislation; and
- insert co-ordination mechanisms between the PRA and FCA similar to those in the Financial Services Act 2012, to allow for a consistent and effective approach under the new system of dual-regulation.

8. Consultation outcome

8.1 The instrument was subject to full public consultation in the document “A new approach to financial regulation: draft secondary legislation”, which was published on the HM Treasury website on 15 October. The consultation closed on 24 December, in line with Government guidance on public consultation.

8.2 Consultation respondents generally welcomed the provisions. Some respondents raised issues that go beyond the scope of matters that can be addressed in this Order (for

example, issues around the distinction between ‘registration’ and ‘regulation’ by the regulator). Substantively on the Order itself, three points are worth highlighting.

8.3 First, one respondent argued that the PRA should assume responsibility for monitoring the funding sources of a building society, and that therefore sections 6A, 6B and 8 of the Building Societies Act 1986 should be assigned to the PRA. While the Government agrees that the PRA will have an interest in this issue, the FCA will have wider responsibilities for gathering data on funding sources. From a practical point of view, it is therefore more efficient to allow the FCA to undertake this role, and provide information to the PRA as necessary under the general duty to coordinate.

8.4 Second, one respondent argued that the PRA should not be required to consult the FCA regarding confirmation of a merger, because such decisions are taken “against exhaustive criteria” in section 95(4) of the Building Societies Act 1986 “that do not allow for the introduction of extraneous considerations or other discretions”; and similarly that the PRA should not be required to consult the FCA before requiring additional information during the course of an emergency merger, because consultation would “add no value but introduce delay”. The Government agrees that the conditions in section 95(4) are exhaustive. However, there may be limited circumstances where the FCA comes into possession of information relevant to the statutory criteria after the approval of the transfer statement. On balance, it is therefore preferable to retain the consultation requirement. The consultation requirement refers only to the PRA’s assessment of the statutory criteria – it does not imply that extraneous factors may be taken into account in determining whether a merger should be approved.

8.5 Finally, in general respondents supported or did not object to the proposal to apply the PRA’s objectives to its functions. There was a range of views about the proposal not to apply the FCA’s objective. The Government continues to believe where the regulator has significant discretion about how to perform a particular function, it is advantageous to apply the objectives. On this basis, it is right to apply the PRA’s objectives and not the FCA’s. The PRA’s functions under the legislation involve a substantial amount of discretion, and it is appropriate that when carrying out a function such as directing the merger of two building societies, the PRA should be held to account for whether its actions promote its objectives. The FCA, on the other hand, will have little or no discretion in exercising the majority of its functions, as they are mostly administrative in nature, so in the legal sense there is little to which the FCA objectives could be applied. The Government therefore intends to proceed with the proposal not to apply the FCA’s objectives.

9. Guidance

9.1 Further guidance on how the new regulators will fulfil their responsibilities in relation to mutual societies will be made available by the PRA and FCA.

10. Impact

10.1 The instrument, in itself, does not impose any additional regulatory burdens on business, charities or voluntary bodies. The impact of the overall change to the regulatory system on business, charities or voluntary bodies, in so far as they are regulated financial services firms, is set out in the overarching impact assessment for the Financial Services Act 2012.

10.2 The impact on the public sector is set out in the overarching impact assessment for the Financial Services Act 2012.

10.3 An Impact Assessment has not been prepared for this instrument. Instead the overarching Impact Assessment that covers the changes to the regulatory system provided for by the Financial Services Act 2012 is available on the Treasury website as Annex H to the following publication: http://www.hm-treasury.gov.uk./d/condoc_fin_regulation_draft_secondary_leg.pdf.

11. Regulating small business

11.1 The legislation applies to small business, but does not in itself impose any additional regulatory requirements on them.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the PRA and FCA will be required by the Financial Services Act 2012 to 'have regard' to the principle of proportionality when carrying out their general functions through section 3B of the Financial Services and Markets Act 2000; specifically, that any burdens they impose should be proportionate to the benefits that are expected to result. Additionally, the PRA and FCA will be required to carry out and publish cost benefit analyses on any new requirements they impose.

11.3 The Government is committed to supporting the mutuals sector. In the Coalition Agreement, the Government stated its desire to foster diversity in financial services, promote mutuals and create a more competitive banking industry. The PRA and FCA will be required to analyse the impact of proposed rules on mutual societies, and brought relevant provisions of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 into effect.

12. Monitoring & review

12.1 HM Treasury will monitor the practical effects of this instrument to ensure it continues to meet the policy aims.

13. Contact

Chris Goodspeed at HM Treasury Tel: 0207 270 5690 or email: christopher.goodspeed@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.