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**EBA Consultation Paper on Draft Guidelines on methods for calculating contributions to Deposit Guarantee Schemes**

**A response from the Building Societies Association**

**Introduction**

The Building Societies Association (BSA) represents all 44 UK building societies. Building societies are mutual deposit takers which have total assets of over £330 billion and together with their subsidiaries, hold residential mortgages of more than £240 billion, 19% of the total outstanding in the UK. They also hold over £240 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies employ approximately 39,000 full and part-time staff and operate through approximately 1,550 branches.

We welcome the opportunity to comment on the draft guidance set out in the EBA’s consultation paper. The BSA is a member of the European Association of Cooperative Banks and we have been involved in the development of their response to the EBA’s Consultation Paper.

**Comments on the metric proposed by EBA for the calculation of risk-based contributions to DGSs**

The BSA has, since the onset of the financial crisis, advocated the introduction of risk-based levies for the UK DGS, the Financial Services Compensation Scheme. We consider that building societies, having pursued more prudent business models than many of the PLC banks, have contributed a disproportionately large share of the costs borne by the UK DGS in respect of the bank failures of 2008. Accordingly, in considering the EBA’s proposals we are looking for a calculation method for DGS contributions which allows for the lower risk nature of the building society sector to be appropriately reflected.

The rationale for the development of a metric for the calculation of risk-based contributions to DGSs is that it should be predictive of the likelihood of failure of a credit institution and the probability of a call on the DGS. As such, it would have been helpful if the EBA had been able to present empirical evidence demonstrating the extent to which the metric, which it is now proposing, would have predicted past banking failures. For example, it would be instructive to know whether, had the metric been applied to DGS levies prior to 2008, the credit institutions which would have paid the highest risk-based levies, were those which actually failed.

In the absence of such evidence we must assess the EBA’s proposals on the basis of their reasonableness. On this basis, we consider the EBA’s approach to be generally appropriate. Notably, the EBA’s choice of core components of the proposed metric would appear to be broadly correct. Capital and liquidity are key measures of the prudential strength of a credit institution, Asset quality is clearly another important risk factor, although we would observe that the non-performing loans ratio is something of a blunt indicator of the risk of credit losses.

Also, we strongly support the idea of including business model and management as a risk category, representing, as we do, a sector which has an ownership model distinct from that of the proprietary banks and a business model which is more risk averse than that of the generality of banks.

However, there are two aspects of the risk category for business model which we consider need to be amended in the draft guidelines.

The first relates to the earnings component of the risk category for business model. This needs to reflect more explicitly the position of institutions which are not profit-maximising. Building societies, as mutual institutions which do not need to make distributions to external shareholders, are not required to maximise profits, although they do need to be consistently profitable, as retained earnings are their primary source of capital formation. Building societies balance the interests of their saving and borrowing members and they typically pay higher interest rates on cash savings and charge lower interest rates on loans than do the banks. In combination, this leads to building societies having a lower net interest margin than the banks.

We are very encouraged that the EBA draft guidance recognises, in Annex 2, that member states should apply the earnings metric in a way that does not penalise credit institutions which have non-profit maximising business models. At the hearing on 8 January, the EBA suggested that this could be achieved by member states promulgating a dual calibration approach to the calculation of the earnings component of the metric and that this could be made clear in the EBA guidelines. We would very much support this as it would help to reinforce to member states the need to ensure that mutual businesses are not unfairly discriminated against in determining risk-based levies.

The second relates to the inclusion, within the business model component, of a ratio of the return of risk-weighted assets over total assets. As the EBA acknowledged at its January hearing, this approach would discriminate against those credit institutions - including a majority of building societies - which are subject to the standardised approach to credit risk modelling compared to those which have adopted an internal model-based approach. Accordingly, the EBA suggested that a dual-calibration method be adopted by member states for the RoA/TA ratio to promote fair treatment of those on the standardised approach. We strongly agree with that and would urge that the guidelines be amended accordingly.

The Building Societies Association
11 February 2015