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May 2025 update:
This letter is historical. See our supervisory correspondence page for more information and current views.

10 March 2022

Dear CEO

FCA strategy for Building Societies

We have reviewed the key risks of harm for Building Societies, their consumers, and the markets in which they operate as part of our approach to supervision. This follows on from our previous review, and our letter to you in December 2018. In this letter, we:

- Provide an updated view of the current key risks of harm and outline our expectations of societies
- Provide an overview of our supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being appropriately remedied

We expect you to consider the degree to which your society presents such risks, review your strategies for mitigating them and be able to demonstrate that you and your senior managers are taking reasonable steps to mitigate these risks.

The building society sector, alongside the rest of the financial services industry, has faced significant challenges in the last 2 years as a result of the coronavirus pandemic (Covid-19). We recognise that the increased coronavirus-related restrictions placed on many areas of the UK over the period has led to heightened financial difficulty for some consumers, and that many will continue to live in financial uncertainty as the impact of pandemic continues. We have acted to help firms and consumers to manage the financial impact of the pandemic and to ensure firms supported their customers who were struggling as a result of the economic impact of coronavirus.

At the same time, the FCA is transforming so that we can respond rapidly and effectively to the rapid changes we see in the markets we regulate, including innovation, digitalisation, and changing consumer needs.

We are becoming more innovative, making greater and more effective use of data and technology so that we can act more quickly and decisively. We are becoming more assertive - making full use of our powers, helping others to use theirs, and playing our part in tackling issues that don’t sit neatly within our regulatory perimeter. We are becoming more adaptive, building on our response to the pandemic and changing our approach more quickly as the world changes around us – for example, quickly publishing guidance which led to 1.8m mortgages having payments deferred during the pandemic. We will report publicly on progress, being clear on what outcomes matter and what metrics we use to measure them.

Our view of the portfolio

We continue to see challenges to the sector in areas such as responsible lending, managing arrears and forbearance, LIBOR transition and IT resilience, many of which were exacerbated during the pandemic. The sector's response during this time has evidenced how well societies are prepared to engage and support consumers, and indeed the FCA as a regulator, when having to react to unprecedented circumstances. Examples of this include input when the FCA was preparing the Tailored Support Guidance and to our review on Mortgage Prisoners.

We remain focused on ensuring firms understand the importance of a customer centric culture to their business model and strategy. Whilst societies have common aims and objectives, they are often diverse in terms of their size and have specific approaches to their business models. We have proactively engaged with several societies to discuss and understand business models, strategies, and cultures, which has proved to be useful for our understanding and future planning.

Our view of the key drivers of harm

Our view of the risks of harm to consumers remain largely unchanged from those identified in our December 2018 letter. In this assessment we have considered the impact of the pandemic, recognising that it has created significant challenges for societies and consumers that could not have been anticipated. Given the unprecedented impact of the pandemic, we expect societies to be aware of the difficult circumstances that some customers find themselves in and to consider very carefully the individual needs of their customers and show flexibility in their treatment of them.

Below we outline what we consider to be the key harms for consumers. In the next section we outline our expectations of societies, alongside our planned supervisory strategy.

Customer treatment

- Societies fail to recognise and address the needs and challenges facing customers in vulnerable circumstances and fail to ensure that they obtain the same fair outcomes as other consumers
- Consumers' needs are not adequately assessed which may result in consumers not receiving appropriate affordability checks at the point of sale or appropriate forbearance that is in their interests and, takes account of their individual circumstances
- Consumers reach the end of the term on interest-only (IO) mortgages without a means to repay, and some are not treated fairly
- Poor product design and governance could lead to consumers in the later life lending market purchasing products they don't fully understand, and which do not meet their demands and needs
- Consumers do not receive clear information about, or resolution to, their dispute/complaint, are incorrectly pursued for debts, or feel harassed or inconvenienced by repeatedly having to contact societies for answers

Operational issues, including resilience

- Societies fail to have adequate systems and controls, processes, and policies in place – and the appropriate governance and oversight - to mitigate the risk of operational events. These include systems failures that result in incorrect notifications or demands for payments being issued to consumers causing distress/financial loss
- Societies don't continue their transition efforts where they have contracts that rely on 'synthetic' LIBOR after end-2021, as it won't be published indefinitely
- Societies fail to implement robust operational resilience to address the growing cyber and IT risk leading to data breaches and/or business continuity issues
- Where societies rely on Intermediaries, they should consider what due diligence they do at the outset of any relationship, and on an ongoing basis, to ensure that they minimise the risk to themselves and consumers in terms of operational resilience, exposure to financial crime and business continuity

Our expectations and areas of focus

Our work is therefore prioritised to focus on the following:

Fair treatment of consumers

We expect societies to place sufficient emphasis on the fair treatment of all consumers, and as reflected in the 6 consumer outcomes. We often see poor treatment of consumers being linked to weak operational oversight, ineffective systems and controls and lack of meaningful management information. Unfair treatment is often reflected in consumer complaints, we expect societies to provide clear resolutions and information to consumers along with clearly defined next steps.

We expect societies to manage these risks and to consider that increasing consumer debt and poor treatment has the potential to increase the prevalence of consumer harm.

Consumer Duty

We have consulted on a new 'Consumer Duty' that would set clearer and higher expectations for societies' standards of care towards consumers, and we are consulting on specific rules in a second consultation paper. We know that, due to the way that financial services markets operate, consumers don't always get the products and services that meet their needs or the outcomes they might reasonably expect. Consumers' ability to make good decisions can be impaired by various factors. These include their weaker bargaining position, asymmetries of information, lack of understanding or behavioural biases. More information on the initial consultation can be found here and details of the second consultation can be found here.

Additionally, we have identified the following 4 areas where we expect societies to pay particular attention to the needs of consumers. We will act where we identify societies causing, or who we consider likely to cause, significant harm to consumers.

1. **Treating customers in vulnerable circumstances fairly**

Our Guidance on the fair treatment of vulnerable customers is clear that, to comply with our Principles for Businesses, societies should embed the fair treatment of customers in vulnerable circumstances in their business models, culture, policies, and processes. Societies' senior leaders should create and maintain a culture that enables and supports staff to take responsibility for reducing the potential for harm to customers in vulnerable circumstances. Societies should be able to evidence to us how they are monitoring outcomes for customers in vulnerable circumstances and what changes they are making as a result of their monitoring to improve outcomes for these customers.

2. Supporting customers in financial difficulty

The pandemic had a significant impact on the finances of many consumers, and some continue to struggle, particularly now the furlough scheme has ended. Rising interest rates and rising prices (e.g. increasing energy prices) may add further pressure to those in financial difficulty.

Given the ongoing coronavirus situation we remind societies of the outcomes we want to see for customers in payment difficulties because of the pandemic. We believe the Tailored Support Guidance (TSG) for mortgages, consumer credit and overdrafts and the findings set out in our March publication continue to provide an appropriate framework for lenders to support these customers. The TSG is designed to enable firms to deliver short and long-term support to customers affected by the pandemic. It is intended to support firms to treat consumers fairly and to help them get back to a more stable financial position. We want firms to deliver the following outcomes:

- Customers receive appropriate forbearance that is in their interests and takes account of their individual circumstances
- Societies support their customers through a period of payment difficulties and uncertainty, including by considering their other debts and essential living costs
- Societies recognise the characteristics of vulnerability and respond to customers' particular needs
- Societies have systems, processes, and adequately trained staff, with any staff incentives aligned with providing customers with the help they need
- Customers receive the support they need in managing their finances, including through self-help and money guidance. Societies signpost or refer them to debt advice if appropriate

Societies should consider the entirety of the TSG and our corresponding Handbook rules and guidance to demonstrate compliance.

3. Responsible lending

Despite the challenging external pressures brought on by the pandemic, the low interest rate environment and intense sector competition, societies should not be seeking to increase mortgage business volumes by lowering the stringency of affordability checks. Additionally, we do not expect these pressures to lead to societies expanding how they approach affordability without appropriate risk assessments. We will be actively monitoring the market for signs of unwarranted loosening in societies' approaches to affordability and will scrutinise outlier societies and their practices where appropriate.

We expect societies operating in the later life lending market to treat older borrowers fairly and to pay attention to signs of vulnerability. It is paramount that, where applicable, lenders ensure they continue to assess affordability appropriately, as inadequate affordability checks could leave older borrowers finding it more difficult to meet their financial obligations as they move into retirement.

4. **Managing maturing interest-only (IO) mortgages**

Given there are a number of borrowers who have IO mortgages maturing each year, peaking in 2032, it is particularly important that firms employ a communication strategy that gives customers enough time to take action where there is doubt about their ability to repay their IO mortgage. This will help customers have a better understanding of their situation, responsibilities, and options. As the potential harm to IO borrowers without repayment plans, some of whom may be customers in vulnerable circumstances, societies should consider their plans, and associated communications, to ensure that they are effective in supporting borrowers in both categories.

Additional areas of consideration

In addition to the above key risks of harm, we would also highlight the following areas that societies should give due consideration to.

Helping Mortgage Prisoners

We understand the difficult circumstances that mortgage prisoners are in. That is why the Government asked us to provide data to help them consider whether there are practical and proportionate solutions to help these borrowers. Our Review provides this data.

We hope that more mortgage prisoners will be able to switch their mortgage. We encourage societies to consider if they can amend their lending criteria to lend to mortgage prisoners who are close to their risk appetite. We have published data so lenders can consider whether they can adapt their lending criteria (or use the flexibility in our rules) to lend to these borrowers.

Cyber risk and operational resilience

In our previous Portfolio Strategy letter, we advised of the risk of harm from more frequent and widespread cyber-attacks being potentially exacerbated when using complex and ageing IT systems, by the outsourcing of operations, and the growing transfer of data between societies.

Ensuring the UK financial sector is operationally resilient is important for consumers, firms, and financial markets, including societies. We believe an operationally resilient financial system is one that can absorb shocks rather than compound them. Operational disruptions and the unavailability of important business services have the potential to cause wide-reaching harm to consumers and/or risk to market integrity, threaten the viability of societies and cause instability in the financial system. The disruption caused by the pandemic has shown why it is critically important for societies to understand the important business services they provide, and to invest in their resilience to protect themselves, consumers, and markets.

Earlier this year, we introduced new operational resilience requirements. We also published a shared policy summary alongside the Bank of England and the Prudential Regulation Authority (PRA).

The rules apply to societies within this portfolio and there are key actions and deadlines that you need to be ready to comply with from 31 March 2022 to 31 March 2025. Further details of these can be found on our operational resilience webpage, which also sets out expectations on reporting operational incidents to us.

Libor transition

Panel Bank LIBOR ceased at the end of 2021 and any firm with LIBOR linked contracts should have transitioned customers to a fair replacement rate by this date. Where societies have contracts that will rely on 'synthetic' LIBOR after end-2021, they should continue their transition efforts as synthetic LIBOR will not be published indefinitely.

Environmental, social and governance (ESG)

Financial services and markets have a central role in the transition to a low carbon economy and a more sustainable future. The Government has committed to achieving a net zero economy by 2050. We will support the financial sector in driving positive change, including the transition to net zero.

We expect societies to play their part in helping the economy adapt to a more sustainable long-term future. We've seen encouraging steps taken by some lenders, for example, providing green mortgages. But ultimately, a firm's own governance and culture will be critical drivers and enablers of its performance on environmental and climate matters. Since wider environmental and social matters are increasingly central to economic and financial decision making, our work too must encompass ESG considerations beyond climate change.

Diversity and inclusion is a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges. As set out in DP21/2, having staff and Board members from diverse background and experiences contributes to this. Diversity and inclusion in regulated firms is a priority for us, and DP21/2 (which closed on 30 September 2021) and the accompanying Literature Review started the conversation on what more can be done to improve diversity and inclusion in financial services and set out the links we see between D&I and conduct risks. We shall be consulting on rules and guidance to promote diversity and inclusion in the financial services sector in 2022.

Building from our work so far, we have developed a refreshed ESG strategy. It sets out our target outcomes and the actions we expect to take to deliver these in the coming months.

Senior Managers and Certificate Regime (SM&CR)

Societies should now have acted on the results of the 2019 banking stocktake. In particular, societies should be sure that they have robust processes in place for certification, including for those in management roles, and that they have adequate training in the conduct rules for all staff to ensure all understand how the rules apply to them in their roles. Breaches of the conduct rules that have led to disciplinary action should be reported.

Societies should also consider the PRA's recent evaluation of SM&CR and in particular, the relationship of renumeration to SM&CR.

Brexit Update: The Temporary Transitional Powers (TPP) are ending soon

To prepare for the end of the Brexit Transition Period, we onshored, and where necessary adapted, EU legislation to ensure it was workable in a UK-only context. Some requirements on firms and other regulated persons changed at the end of the Transition Period and, to avoid disruption, we used our Temporary Transitional Power (TTP) to give firms time to adapt to the new regime. With the end of the TTP fast approaching, we expect firms to be fully compliant with onshored regulatory obligations by 31 March 2022. For more information visit our Brexit website.

Our FCA regulatory strategy

Our Approach to Supervision (published in April 2019) sets out the purpose of, and our approach to, supervising firms and individuals. This builds on Our Mission, explaining how we currently supervise around 50,000 firms serving retail and wholesale customers.
As mentioned earlier, it is of great importance to the FCA that societies treat borrowers in financial difficulty fairly. In our Business Plan we said that we would look at how firms provide tailored support to borrowers and tackle the areas of greatest harm. We are currently working with a number of firms, including some societies, assessing whether they are supporting their customers in line with our guidance and whether outcomes are fair and sustainable. You can read our initial findings here.

Underlying our approach to consumer protection and competition, across all retail markets, is an increased focus on consumer outcomes and needs, particularly for those in vulnerable circumstances. Where firms are not meeting our expectations, we will act.

Regulatory reporting

Principle 11 includes a requirement for firms to disclose to the FCA anything relating to the firm of which the FCA would reasonably expect notice. We expect all firms in this portfolio to be aware of the requirements and guidance in SUP 15, and to submit notifications as required. This should be when an issue or event is identified, and firms should not wait until resolution to notify us. An example of where we expect to be notified is when a firm's business model is subject to change that would have a significant impact on the firm's risk profile, resources, or consumers.

Contact
If you have any questions, please contact your normal supervisory contact on 0300 500 0597. This is the primary point of contact for your firm's interactions with the FCA. You can also email us at firm.queries@fca.org.uk. However, there may be times when your firm faces urgent issues of strategic importance. If this happens, please contact Head of Department Andrew Kay on 0131 301 2052, or at andrew.kay@fca.org.uk. If unavailable, then please contact, Craig Mason, on 0131 301 2060 or at craig.mason@fca.org.uk .

Yours faithfully
Brian Corr

Director of Retail Lending (Interim)
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