



BUILDING SOCIETIES ASSOCIATION ANNUAL REPORT 2010



# ANNUAL REPORT 2010

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## OFFICERS 2010-2011

**CHAIRMAN:** David Webster  
(Hanley Economic Building Society)

**DEPUTY  
CHAIRMAN:** Peter Griffiths OBE  
(Principality Building Society)

**DIRECTOR-  
GENERAL:** Adrian Coles OBE

SECTION ONE

# CHAIRMAN'S INTRODUCTION



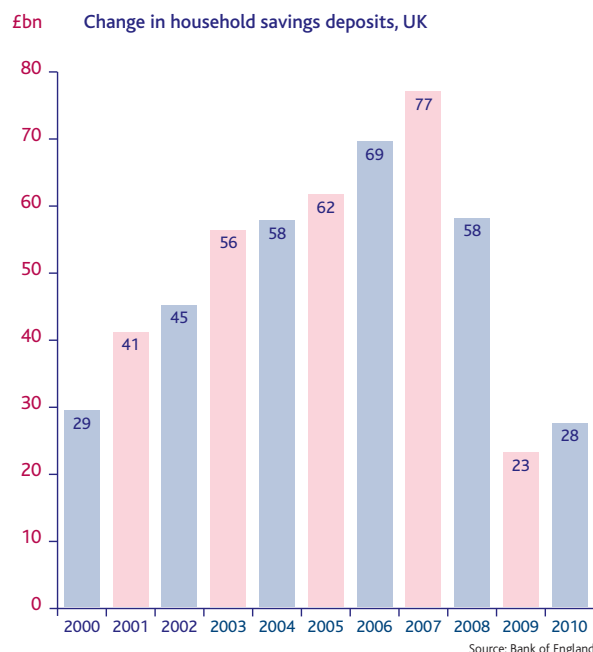
David Webster  
(Hanley Economic Building Society)

## Business Performance

These are tough times in the mortgage and savings markets; indeed there is an austere mood in the wider economy. The financial services markets have faced huge changes over the last few years, not least those markets in which BSA members operate. Net advances in the residential mortgage market have fallen from an annual figure of around £100 billion in the four or five years running up to 2008, to around £9 billion in 2010. Few UK industries will have experienced such a precipitous decline in activity. In the market for savings deposits the figure for new savings across the entire household market of £70-80 billion a year fell to £23 billion in 2009, although it recovered a little, to £28 billion in 2010. These figures reflect really difficult conditions for building societies and other mutuals, the main business of which is, of course, in the mortgage and deposit savings markets.

However, it is important not to become despondent. Business performance in the mutual sector has varied between firms over the last few years, and such has been the highly unusual nature of the markets that even in our sector there have been a few difficulties; some firms have faced significant stresses. Nevertheless, most of our members have had a 'good recession' and are performing well; a few have found it tougher, and were loss making in 2010. It is worth noting however that the majority have remained profitable during the economic downturn, and their collective performance remains impressive compared both to other institutions in the UK and similar institutions overseas.

One notable feature of the recession is that size has not provided any indication of success. The largest mutuals have been successful, as have many of the smaller institutions. One can hardly claim that size has been

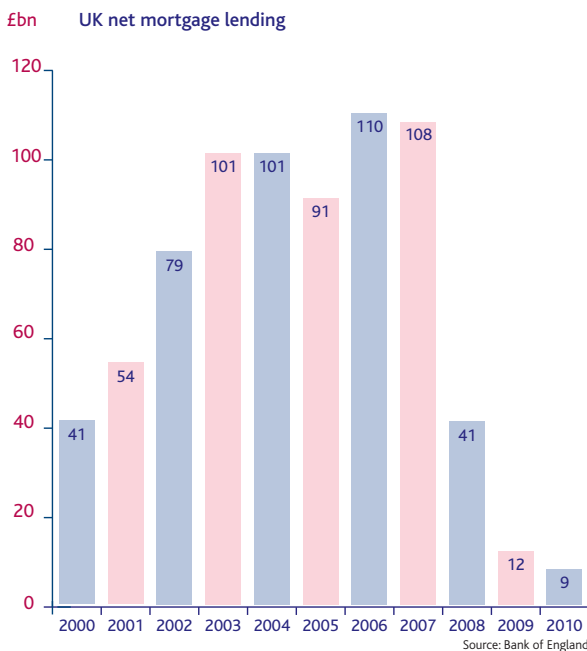


positively correlated with success in the banking sector. What really matters is having a sensible business plan, and the ability to implement it. There is plenty of evidence that many mutuals, of all sizes, possess both of those characteristics.

I am very optimistic about the role of mutuals in general. First, let's be clear – mutual mortgage lenders are open for business. Indeed three of the top ten lenders in 2009 were mutuals, as were nine of the top 20. These figures are likely to be at least matched when the data for 2010 becomes available.

Across the vast majority of our members, capital ratios, a key indicator of financial strength, increased in 2009 and 2010, and reliance on the wholesale funding markets decreased. Cost ratios have been cut in almost every firm, and well over half of our members have cut the absolute level of their costs. Indeed, one of the big firms of auditors, in their September 2010 analysis of the sector, noted that "cost control has been a key plus point in societies' recent performance".

Cost control, however, has not compromised some of the key aspects of what makes mutuals distinctive, and good for the UK's financial services market. In March 2010 the BSA commissioned its latest research into consumer perceptions of service standards in plc banks and mutuals.



*so, we're open for business,  
we're getting more efficient, and  
we're maintaining very high SERVICE  
and lending standards.*

Compared to our previous research we included many more performance indicators. We still failed to identify an area in which mutuals' performance was inferior to that of the banks. Whether it is in relation to overall consumer satisfaction, perceptions of being treated fairly, being trusted to give good advice, offering good value for money, being given help at a time of financial difficulties, being valued as a customer, or having suggestions on improving service listened to by management, mutuals come out better than banks. At a time when there are widespread concerns among many commentators about service levels, charges and trust, building societies and other mutuals clearly have a lot to offer.

And let's not forget that mutuals' record on mortgage arrears is, proportionately, better than that for the mortgage market as a whole. Generally - although in not every single instance - mutuals lent more sensibly in the boom years.

So, we're open for business, we're getting more efficient, and we're maintaining very high service and lending standards. What else do we offer? Linked closely to high levels of service is our democratic structure. We offer our customers - our members - a say in what we do, on such topics as who is on the board of directors, for example. And, importantly, as the debate about bankers' bonuses continues to generate headlines, we offer a vote - voluntarily, not mandated by legislation, as proved to be necessary in the plc sector - on board remuneration policy. I don't believe there are any other institutions in financial services in the UK that give customers a say in that crucial decision.

I could go on for much longer on the benefits of mutuals, and write about the diversity and choice they bring to the market, at a time when there is a danger of the UK market losing these characteristics, and about the advantages of not having all our financial institutions

based in the City of London, but tailoring their products for their localities, or the specific groups they were established to assist. However, many of these aspects are well covered in the Director-General's report, which follows this statement.

### Political Sympathy

As the scale of the disaster in the banking sector became ever more apparent, interest in other forms of business organisation - not least the mutual sector - has grown, especially among politicians. I was delighted to read the commitment to mutual financial institutions contained in the final version of the agreement establishing the Coalition Government, following the May General Election. The words in the agreement bear repetition - **"We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry."**

It is interesting to note that mutuals are associated with diversity and competition - two factors that many would argue have been insufficiently prominent in the UK financial services market in recent years. I am sure that mutuals can make - indeed already do make - a huge contribution in these areas, and can contribute more if the right environment is created to enable them to do so. However, creating that right environment requires more than warm words - it requires action. We wrote to the Financial Secretary to the Treasury with a series of suggestions on how the new government's policy in this area might be implemented; early conversations have been held, but substantive decision-making, if it is to occur, is still ahead of us.

### Regulatory Change

Having said this, there is one area where decision-making on the part of the new government was rapid and revolutionary; the vast programme of regulatory change that affects, or will affect, almost every area of our business. In the mortgage market we've had the Building Societies Sourcebook, we're having the Mortgage Market Review, and we're going to have the EU's Responsible Lending policy. More onerous and expensive liquidity arrangements are already with us, and we're having capital requirements increased, and more tightly defined. The Payments Services Regulations and the Banking Conduct of Business regulations added, in late 2009, to the complexity of offering even simple savings products. The imposition of International Financial Reporting Standards on even our smallest members will add to costs over the next couple of years, but not significantly to the transparency or usefulness of the annual accounts issued by those institutions. And we face a complete overhaul of the regulatory system, as the FSA disappears, and is replaced by a new system with the Bank of England at its heart, and a new series of acronyms to be learnt - the FPC, the PRA, and the FCA, all of which could potentially increase our costs at a time, as I have said, that we are succeeding in becoming more efficient by lowering costs. Indeed the initial Treasury consultation paper on regulatory reform made it clear that smaller institutions should expect an ongoing increase in their annual regulatory costs as a result of the introduction of the new structure.

I would like to emphasise two points: first, given the huge changes in the markets we have already seen, does the regulatory revolution (and what I have listed is little less

*...mutuals are associated with diversity and competition - two factors that many would argue have been insufficiently prominent in the UK financial services market...*

*Let's build in to the new processes a proper respect for,  
and appreciation of mutuals.*

than revolutionary) represent overkill? Certainly in the mortgage market one might reasonably suggest that the MMR represents a regulatory solution to issues the market dealt with many months ago, while making it more difficult for the market to deliver the growth in lending, house purchase, and house building that the economy will require over the next few years. More generally, it would be very helpful if we, those that make up the market, could see the authorities' analysis on the cumulative impact of the whole bundle of measures that I have just mentioned, when combined with the very different market conditions which we are likely to face in the future. Yes there were certainly examples of irrational exuberance on the part of institutions in the run-up to 2007, but there are also currently examples of irrational pessimism on the part of regulators, as they seek to address the problems of recent years in what might be a far too restrictive manner, given the need to create the conditions for continued economic recovery.

My second point is a plea to give the mutuals a level playing field as the reform agenda unfolds - let's ensure that the new political respect for mutuals to which I referred earlier goes further than warm words and delivers real results. Let's build in to the new processes a proper respect for, and appreciation of, mutuals. It is crucially important for the regulators, internationally, in Europe and within what is currently the Tripartite to see mutual forms of institution as at least equal to the equivalent plc structures, and to acknowledge the differences when appropriate, rather than force mutuals into a plc straight-jacket that risks compromising the very advantages that I mentioned earlier. We need a proper appreciation of the

mutual need for a capital instrument that would enable us, to boost capital ratios as necessary, and we need to ensure that the new regulatory structure does not disadvantage mutuals through high costs, or restrictions not placed on others. Also, we need to ensure that those institutions that failed in 2007/08 do not emerge from that failure strengthened, and almost immune to competition, as a result of the tax-payer support that enabled them to ride out the crisis. We look forward with great interest to the report of the Independent Banking Commission and the changes to the structure of banking in the UK that might result from its September 2011 report.

Let me conclude with some thanks. I am extremely grateful to the Council of the Association for offering me the opportunity to be their Chairman, and equally grateful to each member of the Council for the support that I have been shown during my period of office. I passionately believe in the role of the smaller local and regional societies, and it is clear that my colleagues on the Council - whether from large national organisations, or smaller entities, share that passion. Secondly, I would like to thank the Secretariat; they are a small team but they consistently show huge enthusiasm, dedication and expertise that benefits all members of the Association, but not least the Chairman! My particular thanks go to our Director-General Adrian Coles; the whole mutual sector was delighted to learn of Adrian's inclusion in the 2011 New Year's Honours List, and the award of an OBE. I have had first hand experience of Adrian's skill and tenacity over the past 12 months and any success I have had in that period of office has only been possible because of the outstanding team at the BSA.

## SECTION TWO

DIRECTOR  
GENERAL'S  
REVIEW

Adrian Coles OBE

Not surprisingly, given the political and market changes of the last few years, the year was extremely active for the Association. The following paragraphs look at some of the detailed changes announced during the year.

### Regulatory Reform

On 16 June 2010, the Chancellor announced that the Government will abolish the tripartite regime. By 2012, the Financial Services Authority will cease to exist in its current form. In its place, the Government plans to create an independent Financial Policy Committee (FPC) at the Bank of England, which will be responsible for dealing with the macro issues that may threaten economic and financial stability, and a Prudential Regulation Authority (PRA) responsible for the prudential supervision of individual firms.

The Government also plans to establish a new Financial Conduct Authority (FCA) to regulate the conduct of business of every authorised financial firm providing services to consumers.

On 26 July 2010, HM Treasury launched its consultation on the proposed arrangements - *A new approach to financial regulation: judgement, focus and stability* - to which the Association submitted a full response. The Association is in

close contact with the Treasury and all other relevant parties. The Association's key concerns are as follows; the need to build corporate diversity (with due acknowledgement of the role of mutuals) into the new arrangements, the potential complexity and cost of the new arrangements, the proposal for the FCA to act as "consumer champion", and lastly, Bank of England and FPC accountability. The House of Commons Treasury Committee published a preliminary report in February 2011, which supported the need for the industry to be regulated "effectively but proportionately" and described the characterisation of the FCA as consumer champion as "inappropriate, confusing and potentially dangerous" - supporting the Association's oral and written evidence to the Committee. The Government will present more detailed policy and legislative proposals, informed by responses to the 2010 consultation, for further consultation early in 2011.

The Government intends to introduce legislation to implement its proposals in mid-2011 and the passage of legislation is expected to take around a year. The new regulatory framework is anticipated to be in place by the end of 2012.

*I am very happy to confirm the Government's absolute commitment to the concept of mutuality, a form of ownership which has served its members well and has been free from much of the scandal and mischief that we have associated with the plc model in the financial services sector.*

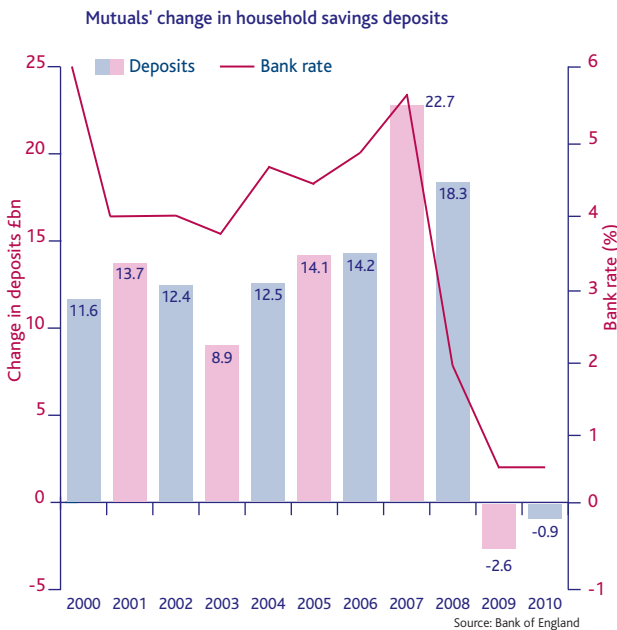
Lord Myners, *Financial Services Secretary to the Treasury*. Speaking in the House of Lords, 24 March 2010.

*The mutual sector is seen as having weathered the storm better than many in the banking industry.*

David Prosser, *The Independent*. 25 January 2010.

## Savings

2010 was another challenging year for mutuals' funding, with total household savings balances falling by £0.9 billion. The main reason for the funding position is the continued very low interest rate environment: the Bank Base Rate for the whole of 2010 was 0.5%, the lowest level for more than 300 years. Competition from banks remained strong - much of it what BSA considers to be unfair competition from nationalised and part-nationalised banks; we were pleased when, in May, the Government removed its 100% deposit guarantee of the nationalised Northern Rock bank.



A resurgent stock market - which in December 2010 saw the FTSE 100 index breaching 6,000 points for the first time for two and a half years, also undermined the attractiveness of holding cash - and substantial amounts (£24 billion) went in to unit trusts.

In the face of such pressures, mutuals' share of the cash savings market remained firm, with mutuals accounting for more than 21% of retail cash balances. With interest rates forecast to rise

only modestly during 2011, and the Coalition's austerity measures set to bite, the challenging market conditions for mutuals are set to continue throughout 2011 - and beyond.

## Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is a key mechanism for engendering consumer confidence in the banking system and promoting financial stability. The FSCS's share of the costs of protecting depositors is, in turn, borne mostly by banks and building societies. In late 2008 the FSCS borrowed from the Government - and paid out - £20 billion to ensure no private individual with a UK deposit in one of the failed banks (Bradford and Bingley, the UK subsidiaries and branches of the Icelandic banks Kaupthing and Landsbanki, and London Scottish Bank) lost any of their money. For the first three years, ie up to September 2011, the FSCS will be required to service only the interest due on the loans from the Government - this has been capped at £1 billion per annum for the first three years. From 2012 the principal of these loans, less any recoveries received in the meantime, will become due for repayment.

The FSCS loans arising from the failure of the banks are to be repaid by the financial services industry. Mutual deposit-takers are being required to pay a substantial proportion - around 20% - of the compensation costs for the years 2008-09 to 2011-12. This is disproportionately very high in relation to their profits and balance sheet size compared to the amounts banks are being required to pay. The BSA has highlighted the unfairness of the FSCS levies and has called upon the Government to introduce a more equitable, risk-based approach to the calculation of the levies. The BSA's campaign attracted considerable support from politicians, the media and mutuals' members. In response, the Government asked the FSA to review the arrangements for FSCS funding - and the review, in which the BSA has participated actively, commenced early in the year.

*The smaller building societies account for half of the best buy places and offer most of the market-leading variable rate [savings] deals.*

Michelle Slade, *Moneyfacts*, *The Daily Telegraph*, 31 July 2010.

*Britain needs building societies not only to survive but to prosper.***Nick Goodway**, *The Evening Standard*, 18 February 2010.

In Brussels, the EU agreed a package of changes to the deposit guarantee schemes directive, including an increase to €100,000 (£85,000) in the level of cover from 31 December 2010. Further changes were proposed in draft amendments to the directive published in July, including a move to pre-funding of deposit protection schemes. The BSA has registered concerns about the changes proposed and, in particular, the affordability of pre-funding at a time when the legacy costs of past banking failures are still having to be paid for by the industry.

A major project for building societies in 2010 was the introduction of systems to facilitate the faster payout of compensation to depositors, within seven days. As part of this, all deposit-takers were required to introduce a, so-called, 'single customer view' by the end of 2010, to aggregate all of a customer's accounts with a particular institution.

**ISAs**

Mutuals' share of the cash ISA market remained stable at 36%. ISAs continue to be an important product for societies and other mutual deposit-takers. In April 2010, following BSA lobbying for a better deal for savers, the Government increased the annual ISA subscription limit to £10,200 - within which, the annual cash ISA limit increased to £5,100.

Whilst the ISA is a successful product, which has become an important part of the savings landscape in the UK, there remains scope for further improvement. The disparity between the annual subscription limits for the cash and stocks & shares components is a source of continuing concern and we would like to see a commitment to equalise these over time. Also, whereas transfers from the cash ISA component to the stocks & shares component are allowed, transfers the other way are not. The BSA has urged the Government to reconsider this policy. That would enable ISA holders to rectify mistakes over transfers without losing their ISA tax exemptions. Also, it would facilitate 'lifestyling' of

portfolios - ie to allow ISA holders to align their assets and liabilities over time - particularly helpful for ISA holders nearing, or in, retirement.

In March 2010, the government-funded group, Consumer Focus, presented to the Office of Fair Trading a so-called 'super complaint' about the operation of the cash ISA market. In response, the industry was able to demonstrate to the OFT's satisfaction that the market in cash ISAs was competitive and that a referral to the Competition Commission was not necessary. But banks and building societies did commit to a package of measures to improve transparency of cash ISA products and to speed up the transfer process - with effect from the end of 2010. Also, the industry agreed to commission a feasibility study into the introduction of an industry-wide system of electronic cash ISA transfers, with a view to further speeding the ISA transfer process.

**Junior ISAs**

In its first six months the Coalition Government announced that it will stop newly born children being eligible for a Child Trust Fund account, and also halted the introduction of the Saving Gateway that had been intended to encourage those on lower incomes to save.

In place of the Child Trust Fund, the Coalition has announced that a new Junior ISA will be introduced in autumn 2011. Mutual deposit takers were the predominant providers of cash CTF accounts, and have a large share of the adult ISA market, so they are likely to be keen to offer Junior ISAs. The BSA and its members have been working with HM Treasury, in conjunction with other provider and consumer bodies, to inform the detailed design of the new accounts. The BSA has stressed that the accounts need to be as simple as possible for savers and providers, and it would make sense for the set-up of the Junior ISA to be closely aligned to that of adult ISAs.

*Mutuals offer some of the most competitive rates, topping the best-buy tables. They are known for treating customers fairly, being transparent in their offering and benefiting their local communities.*

**Melanie Bien**, *Director, Savills Private Finance. The Independent on Sunday*, 18 April 2010.

*Currently, building societies are more able to underwrite on a bespoke basis and impress us.*

Katie Tucker, *Private Finance*, 10 May 2010.

## Dormant Accounts

The Government's plans for the introduction of a Dormant Accounts Scheme continued to take shape during the year, with a BSA member, Co-operative Financial Services, formally submitting to the FSA its application to operate the reclaim fund which will sit at the heart of the scheme.

The Act provides statutory underpinning for the voluntary Dormant Accounts Scheme. Crucially, for customers who have lost touch with their accounts, the money in the account remains their property - available to be reclaimed at any time. Banks and building societies will pay dormant account monies over to the reclaim fund, and are responsible for ensuring customers who come forward to reactivate their account are paid the full balance on the account plus interest. Any surplus monies not needed for reclaims will be made available to the new Big Society Bank.

Reflecting the strong links between mutuals and the communities from which their members are drawn, special arrangements will apply for 43 of the 50 BSA members. This will allow them to direct their dormant account monies to charities local to their branches.

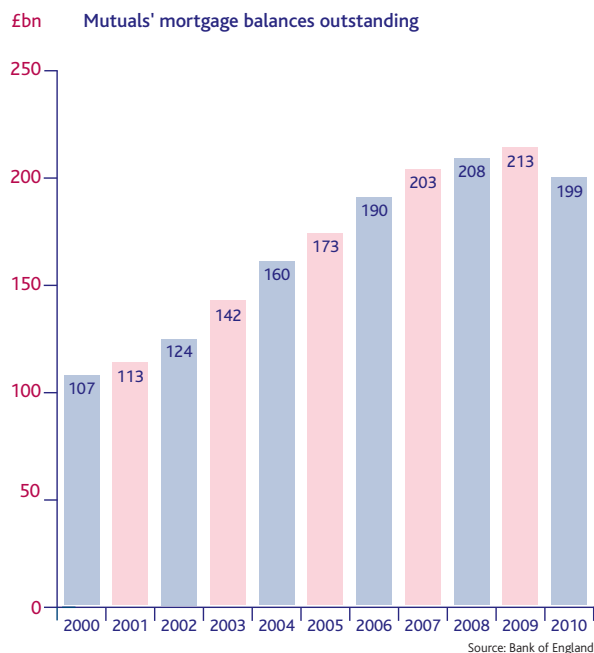
The new scheme is due to be introduced during 2011 and in anticipation of that, building societies and banks have been stepping up their efforts to reunite customers with their lost accounts. An important part of this is the website - [mylostaccount.org.uk](http://mylostaccount.org.uk) - a joint venture between the BSA, the British Bankers' Association and National Savings and Investments - that provides a 'free to the customer' one stop tracing service.

## Mortgages

The UK mortgage market was relatively subdued in 2010. Gross mortgage lending totalled just £136 billion in the year, a 5% reduction on the £144 billion lent in 2009, and considerably

less than the £363 billion lent in 2007 prior to the credit crunch. The low level of gross lending in 2010 reflects, on the supply side, difficulties in raising funds for mortgage lending, regulatory pressure to increase capital and reduce risk and, on the demand side concerns about the affordability of housing, and employment prospects. Mutuals lent £20 billion in 2010, a 15% share of the market. Whilst the level of gross lending has reduced, the repayment of mortgage debt has remained stable, resulting in a reduction of mutuals' mortgage balances from £213 billion in 2009 to £199 billion in 2010.

House prices increased in the first half of 2010 due to a lack of supply of homes on the market. Consumer confidence and demand then began to ease which saw prices fall back and end the year relatively unchanged. Housing market activity and house prices are likely to remain subdued in 2011. The ability to secure mortgage finance will remain challenging, the cost of borrowing is likely to rise, and consumers face added strain on their finances.



Note: Britannia merged with Co-op Bank in August 2009 and ceased to be a building society. The 2009 figure has been adjusted to include the Co-op Bank. The 2010 figure represents all mutual lenders. Figures prior to 2009 are building society only.

*Building societies are leading the mortgage market with innovative products, mortgage brokers say, while state-supported banks have less competitive rates than the rest of the market.*

Tanya Powley, *Financial Times*, 13 March 2010.

## Mortgage Market Review

In January 2010, the FSA published the first Mortgage Market Review (MMR) consultation paper entitled *Arrears and Approved Persons* following the discussion paper in 2009. The consultation addressed two areas - changes to how lenders manage borrowers in difficulty, including restrictions on charges and fees, and the requirements to include mortgage advisers under the approved persons regime.

In June 2010, the FSA published its final rules relating to arrears and possessions following the consultation earlier in the year. A new rule was introduced that obliged firms to record all arrears-handling telephone calls and to keep records for three years. The BSA had argued strongly during the consultation process that this rule may disproportionately affect smaller mutual lenders. Backed up by statistical evidence, our arguments were fair and constructive, and resulted in some small lenders being able to apply successfully for a waiver to this rule.

## Responsible Lending

In July 2010, the FSA published its consultation on responsible lending, which covered, among other items, strengthening requirements on lenders to carry out affordability checks, income verification, interest only mortgages, and product regulation. We have a fundamental concern that many of the proposals transfer responsibility away from the consumer and onto the lender. Whilst we appreciate the lender's responsibility to verify the application information and to have appropriate controls in place, this must be balanced with the capability of the customer to make sound financial decisions for themselves.

## Distribution and Disclosure

In November, the consultation focusing on distribution and disclosure was published. This included proposals to enhance the mortgage sales process, the role of intermediaries and improving disclosure of information for customers. We were disappointed that this consultation did not propose any significant changes to the advising and selling process and instead seeks to make minor changes, which will have no significant impact on consumers, but could have cost and process implications for firms. The BSA engaged with its members and submitted a final response to the consultation on 25 February 2011.

## Treasury Committee Inquiry

In March 2010, the BSA provided written evidence to the Treasury Committee's follow up inquiry into mortgage arrears. The BSA was also invited to give oral evidence to the committee. The inquiry focused on arrears statistics, the treatment by lenders of homeowners in mortgage arrears, the MMR Arrears Consultation, arrears charges and Government support schemes. The BSA's evidence focused on the commitment of mutual lenders to work closely with customers in arrears, offering practical and workable solutions to keep the customer in their home. We also advised the Committee that BSA members work extremely hard to ensure that they charge customers in arrears only where it is necessary to do so and in some cases, operate their arrears department at a loss.

We stated that the BSA is supportive of the principles that the FSA aims to achieve through the proposals detailed in the Arrears Consultation Paper. However, we do not believe

*Building societies are in a stronger financial position than a year ago with many well placed to cope with worsening arrears and funding problems, says Fitch Ratings.*

Natalie Thomas, *Mortgage Strategy*, 22 November 2010.

*One of the lessons of the recent crisis is that many of these kinds of institution [building societies, mutuals, co-operatives and others] are more resilient to shocks, better at handling risks, and better at winning and keeping trust.*

**Geoff Mulgan**, *Chair of the commission of inquiry into the future of civil society in the UK and Ireland.*

Letters to the Editor, *Sunday Times*, 17 March 2010.

that the poor practices identified in the paper are indicative of the industry as a whole. Mutual lenders and the vast majority of other high street lenders follow the stated policy aims of the FSA. This is a view we have continued to convey to the regulator throughout 2010.

In our written evidence we expressed our views on the Government support schemes, Support for Mortgage Interest (SMI), Mortgage Rescue and Homeowner Mortgage Support (HMS). We are supportive of the changes made to SMI and the introduction of Mortgage Rescue, but we remained critical of HMS, as we were from the outset of the scheme.

### Changes to the Home Buying Process

Within the first month of the formation of the Coalition Government, Grant Shapps and Eric Pickles, the relevant Community and Local Government ministers, confirmed the immediate suspension of Home Information Packs (HIPs). Primary legislation will still be needed to achieve permanent abolition. Both the Conservatives and the Liberal Democrats had set out their opposition of HIPs and their intention to scrap them in their election manifestos, so this move came as no surprise.

The BSA supports a transparent and efficient home buying process, with relevant information being made available to the buyer as early as possible in the sale process. Although HIPs did not deliver the full benefits that the previous government originally envisaged, home information can play an important role in helping deliver a sustainable housing market where consumers are empowered to make the right decisions for themselves. The provision of relevant and credible information can also help deliver efficiencies in the home buying process.

In June 2010, the BSA published a short report following an industry wide discussion hosted and chaired by the BSA in April. The BSA intends to continue working with a wide range of stakeholders including lawyers, estate agents, surveyors

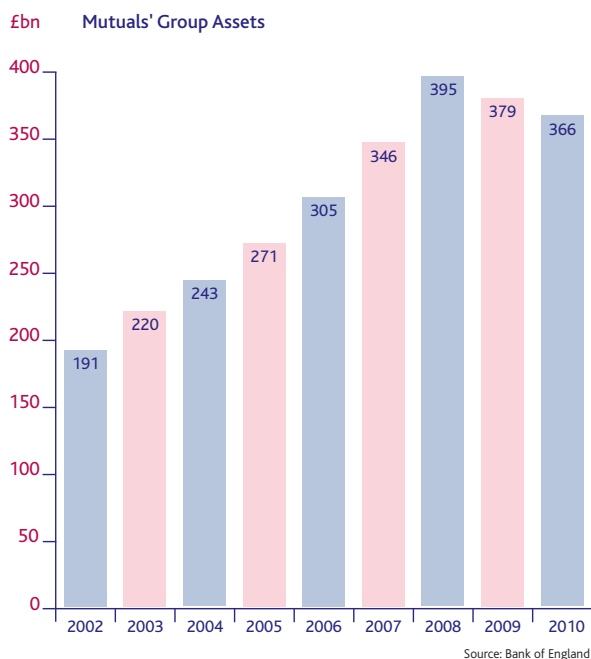
and consumer bodies to consider fully how the industry can improve the process for the benefit of consumers, including delivery of the right information, to the right person, at the right time.

### Liquidity and funding

Ahead of international consensus on liquidity risk management, the Financial Services Authority introduced the first phase of its new liquidity regime in December 2009. This was the implementation of stricter liquidity systems and controls requirements. 2010 was the year in which other requirements were to come on stream. Not all of them did. The regulator announced it would delay quantitative requirements for larger building societies and banks until 1 January 2015. In the meantime, they would adhere to the backstop individual liquidity guidance (the amount of liquidity which the FSA considers is appropriate for an individual institution) they had already been issued.

We queried why the implementation dates for those on the simplified approach to liquidity, including many smaller building societies, were not similarly deferred. They had to keep to the published transitional pathway. This started in October with a requirement to hold a liquid assets buffer (essentially government debt or central bank reserves) of no less than 30% of their simplified buffer requirement moving incrementally to 100% by end September 2013. The FSA then announced that the introduction of the full buffer requirement would be similarly deferred until 1 January 2015 for simplified firms. Longer lead times were given to the steps in between.

Becoming a simplified firm was not easy. Firms had to apply to the FSA for a waiver, which had to be in place by June. Following lobbying by the BSA early in the year, the regulator agreed to amend slightly the eligibility criteria so that those small societies for which the simplified regime was originally designed would be able to take advantage of it.



Note: Britannia merged with Co-op Bank in August 2009 and ceased to be a building society. The 2009 figure has been adjusted to include the Co-op Bank. The 2010 figure represents all mutual lenders and deposit takers. Figures prior to 2009 are building societies only.

An integral part of the new regime is the annual individual liquidity adequacy assessment (ILAA). Under the ILAA process, a firm will assess the adequacy of its liquidity resources and perform stress tests. ILAAs had to be in place by June. A pared-down version, the individual liquidity systems assessment (ILSA), applies to those on the simplified approach. This was to come into force in October. Acting on feedback from members, we questioned the relevance of the ILSA guidance – it seemed to duplicate the ILAA guidance. The FSA took this on board and issued late in the year for comment revised guidance. Unfortunately, this revision was not distinct enough and appeared to suggest simplified firms more or less prepare an ILAA.

### Basel III

The publication of the Basel Committee's final paper on liquidity risk management in December 2010 may well change the FSA's own regime – but how is far from clear.

Although this is the first time there has been a global agreement or harmonisation of liquidity policy, the impact in the UK will be modest because the FSA went ahead with its own new liquidity policy in 2009, hoping that Basel would largely follow suit.

### Pooled funding

Following an initiative from the BSA deputy chairman, plans for pooled funding have progressed, with concrete proposals for a collective issue of retail mortgage backed securities by a range of societies. A meeting was held in February 2011 for societies to learn more.

### Liquidity reporting

New liquidity returns were introduced for all building societies in 2010. There was a delay in some of them becoming available on the FSA's integrated reporting system, GABRIEL. In addition, societies are still completing certain old manual returns for the FSA.

Following warnings from the BSA, the regulator has now recognised that requiring firms to have the capacity for daily reporting in times of stress may not be practical.

### Capital

This year can be seen as very much work in progress with the international accords only starting to take effect from 2013 onwards. There has been much discussion over changes to capital – principally what will count as core tier one for a mutual deposit taker – but until recently been little evident progress. This is partly due to delays in the European directive process, and to some initial resistance on the part of the UK authorities, though the recent approach has been much more helpful.

### Permanent Loss Absorbing Deferred Shares (PLADS)

The Financial Services Authority has indicated that it does not consider permanent interest bearing shares (PIBS) to be sufficiently loss absorbent to count as core tier one capital (reserves or common equity). In response, we have worked with our members to find a suitable alternative form of capital that meets the regulator's requirements while also remaining true to mutuals' ethos. We have long argued that the requirement to have unlimited distribution of profits to holders of capital, to mimic ordinary share dividends, is at odds with the mutual model.

The proposed new form of capital is PLADS. PLADS are designed to be a core tier one instrument with a discretionary but capped distribution which may also include an indication

of likely return, a halfway house between equity and fixed income. There may be scope for these shares to be sold to retail investors too.

Our main challenge over the second half of the year was - and will be over 2011 - to ensure that the next relevant European capital requirements directive, CRD 4, provides for instruments such as PLADS. We rely on HM Treasury to negotiate at European level on our behalf so as to ensure that suitable instruments issued by a mutual or cooperative, or its wholly-owned joint stock subsidiary, can count as core tier one and in particular may be subject to a dividend cap.

### Capital Requirements Directive (CRD) 4

CRD 4 will be the EU version of the Basel III agreement (see below), which was published in December. Although it is supposed to remain consistent with Basel III, it appears there may have to be divergences to deal with European circumstances and concerns. One such area is core capital for mutuals (see above) which the Basel agreement mentions only in a footnote. We lobbied on this very point in our response to the Commission's February consultation. A draft of the CRD 4 text is expected in the summer of 2011.

### Basel III

The text of the final agreement on capital adequacy was published in December 2010 (our comments on calibration and double counting were only partly addressed). It differs little from the outline issued in the summer. How it will affect the UK, and therefore mutuals, will depend on how the European legislators adapt it in the next iteration of the Capital Requirements Directive (CRD 4).

More detail was provided on the leverage ratio, which will have a denominator of tier one capital (not just core tier one). The minimum ratio will be set at 3% for the observation period from 2013 to 2017 and may then change according to the experience gained during the observation period.

The Basel committee has also decided that lower forms of capital (hybrid tier 1 and tier 2) must in future include a mechanism for absorbing losses, known as "bail in" that allows them to be converted into equity or written off. This will apply to PIBS. But an announcement in January 2011 suggests that issues of non-core tier 1 and tier 2 capital,

made up until the end of 2012, will benefit from the limited grandfathering provisions if they comply with the other Basel III criteria. We are talking to the FSA to find out how this latest announcement can benefit societies that need to retire and refinance capital instruments in the near future.

### CRD 2 and 3

In December the FSA also issued final rules to bring into force CRD 2 and some CRD 3 amendments at the end of the year. Throughout the consultative process we have been engaging with the FSA and challenging the regulator on areas that appear to put mutuals at a disadvantage to joint stock banks. The two most important areas of CRD 2 for mutuals are:

#### (i) Core tier one capital

The FSA has decided to proceed with two pieces of superequivalence on CRD 2, as well as to implement the exceptions for mutuals provided in the final guidelines from the Committee of European Banking Supervisors. The superequivalent provisions are:

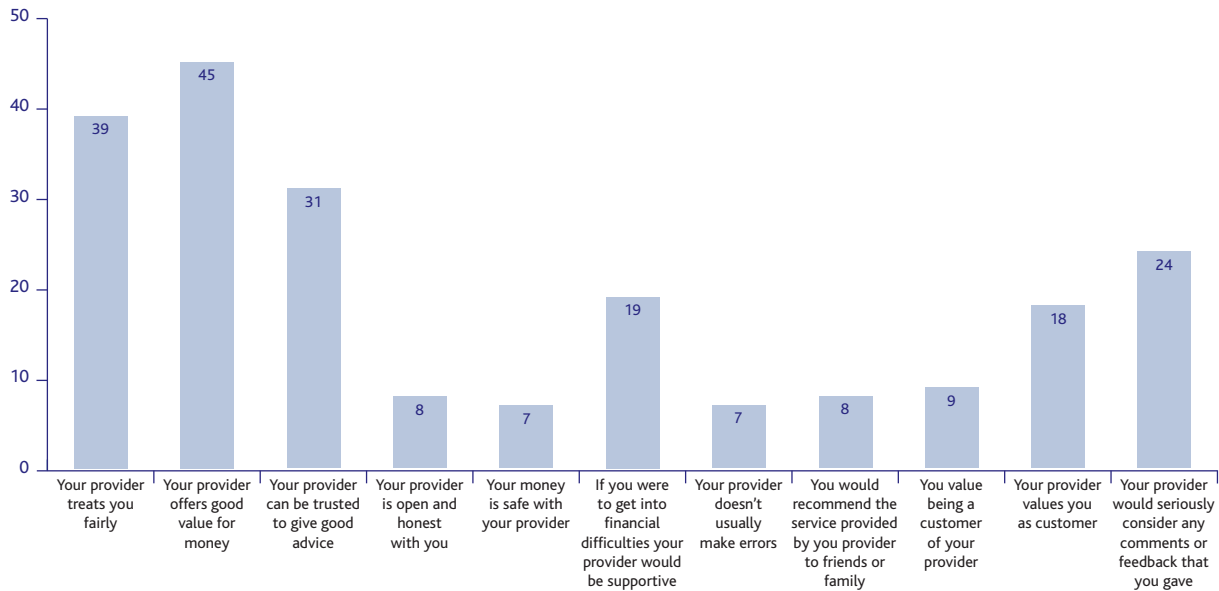
- only ordinary shares qualify as core tier one instruments for joint-stock banks
- instruments with preferential rights to dividend do not qualify as core tier one.

Of greater relevance to mutuals, especially building societies, is the explicit acceptance by FSA, following the publication of the final CEBS guidelines, that mutuals may issue core tier one instruments with capped distributions. Moving forward we aim to improve on the CRD 2 position during the negotiations on CRD 4 in order to facilitate the introduction of our new core tier one instrument, PLADS.

#### (ii) Large exposures

The most important change concerns interbank exposures and is the withdrawal of the exemption of maturities of less than 12 months. Building societies will now not be able to expose more than 25% of own funds to a client or group of clients. Exceeding this threshold will only be possible for exposures between credit institutions and for no more than €150 million so long as the exposure does not exceed 100% of capital.

Mutuals score better in all aspects compared to banks (Difference between net agreements at mutuals and banks, percentage points)



GfK NOP Omnibus Survey, 11-16 March 2010, 1,968 individuals interviewed.

### Treating Customers Fairly

By the start of 2010, a year had passed since the FSA's 'embedding' deadline for treating customers fairly (TCF). Since the deadline, the FSA has been active in monitoring and enforcing TCF and has provided feedback on the exercise. Because members' and customers' interests are at the heart of the mutual sector, building societies and other mutuals took TCF very seriously.

There is ample objective evidence of this commitment. For example, the Financial Ombudsman Service (FOS) annual review 2008-09 contained sector statistics relating to the year when TCF was due to be 'embedded'. They show that 59% of complaints were about banks (the same percentage as the previous year), 13% were about general insurers (11%), 11% related to life insurance and investment product providers (14%), but only 2% about building societies (compared to 4% in the previous year).

In February, FOS published its second six-monthly set of complaints statistics. Data for six building societies was included. The figures were very favourable for the societies when compared to the corresponding results for the main plc bank competitors. The overall average percentage resolved in favour of customers was 53% for all firms. However, the overall figure for the building societies was 24%, compared to 48% for their main plc bank competitors. This means that

FOS upheld the societies' decisions in over three-quarters of the cases, but upheld the banks' decisions in just over half of the complaints.

### The Equality Act 2010

The Equality Bill received Royal Assent in April and is now the Equality Act 2010. Most provisions came into effect on 1 October 2010. The provision of services aspects (which include, for example, age discrimination outside the workplace) are currently not expected to come into force until April 2012. The current timetable - which might change - is for Government guidance to be published in late 2011 and a draft code of practice to be laid before Parliament in early 2012. These aspects are likely to affect certain financial services products eg 'silver saver' accounts and equity release mortgages.

The BSA will remain closely involved in the process - it is important that the Act does not have adverse unintended consequences in respect of products that are designed to provide fair benefits to older people.

### Consumer Law Simplification

In recent years, the Association reached the conclusion that the increasing number, complexity and overlap of 'fair play' mechanisms (including those set out by legislation, regulatory rules, codes of practice etc) were in the best

interest of neither consumers nor businesses. During late 2007/early 2008, the Association consulted members and developed a formal position that there were now ample fair play laws regarding UK savings and lending, and that it was in the best interests of all parties that everyone concerned worked to ensure that the existing arrangements operated sensibly and effectively, rather than seeking to develop new rules in the light of every novel development.

The Association's policy included a 'twelve-point' plan for consumer law simplification. The Association shared the policy with the Economic Secretary in the last Government, Opposition counterparts and certain other interested parties and, over time, took further opportunities to promote it, especially with Department of Business Innovation and Skills and its Better Regulation Unit.

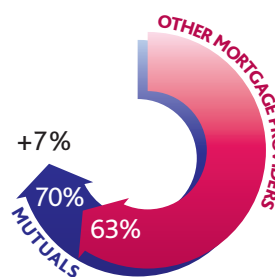
Progress was made in certain areas under the last Government and the Association welcomes the current Government's recent commitment to end 'gold plating' of EU regulations, which was one of the key points in the Association's plan. However, more work needs to be done. For example, there remains a strong case for a radical overhaul and simplification of UK consumer law.

### Claims Management Companies

The Financial Ombudsman Service's annual review 2009/10 confirms that well over a quarter of cases (28%) are brought to FOS by Claims Management Companies (CMCs). These organisations usually charge consumers fees or commissions, sometimes in the order of 35% of the ultimate award (if any).

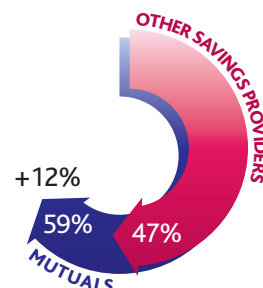
Some members have provided the BSA with evidence of poor practice by certain CMCs; for example, evidence that certain CMCs are taking active steps to prevent their clients from communicating with the firm being complained about and seek to push complaints through to the Ombudsman with no serious commitment to mediation. Such practices would inhibit the effectiveness of the forthcoming guidance in the FSA Handbook on handling PPI complaints.

### Mortgage Satisfaction



GfK NOP FRS, 6 months ending January 2010.  
8,848 individuals interviewed.

### Savings Satisfaction



GfK NOP FRS, 6 months ending January 2010.  
32,573 individuals interviewed.

The current situation is no longer sustainable and the Association is working with other trade bodies towards possible representations in favour of rule changes in respect of CMCs. These might include, for example, the implementation of the Hunt Review recommendation that, as businesses, CMCs - but not consumers - should be required to pay a case fee.

### Lending Code

The Lending Code, a voluntary code that sets standards of good lending practice, celebrated its first anniversary in 2010. It replaced the lending aspects of the Banking Code in November 2009 following the transfer of responsibilities for the conduct of business regulation for deposit and payment products to the FSA.

On 18 June 2010, the Lending Standards Board (LSB) announced that it had appointed Professor Lorne Crerar to conduct the first full independent review of the Lending Code. The independent reviewer received 33 submissions from a variety of stakeholders, including government departments, regulators, Code subscribers and consumer groups. He reported his recommendations to the LSB in November 2010. Since then, the LSB has been working with the Code Sponsors, including the BSA, on amendments to the Code to implement the recommended improvements by the end of March 2011.

*The key attraction about mutuals is that they work on behalf of their members, not to increase profits for shareholders. In other words, they put you as a customer at the heart of their business - which is clearly something to be cherished.*

Simon Read, *The Independent*, 23 October 2010

## Banking Conduct of Business Sourcebook

The FSA's Banking Conduct of Business Sourcebook (BCOBS) also celebrated its first anniversary in 2010. BCOBS applies to firms that carry out the activity of accepting deposits from banking customers in the UK. In May 2010, BCOBS rules requiring firms to notify customers in advance of material disadvantageous changes to interest rates came into force. The financial trade associations, including the BSA, worked with the FSA to develop guidance for firms on what constitutes a material change and a reasonable period of pre-notification. In most cases customers are now informed of material disadvantageous changes to the interest rate at least 14 days before the change comes into effect. The guidance was incorporated into existing industry guidance on BCOBS.

The BSA, together with the BBA and Payments Council, reviewed the industry guidance on BCOBS in the autumn of 2010. We invited submissions from external stakeholders and held two round table discussions with consumer groups to discuss their concerns and proposals for change. Revised industry guidance, incorporating a number of the suggested improvements, was submitted to the FSA for 'confirmation' at the end of 2010. The FSA confirmed the guidance in January 2011, meaning that firms that follow the guidance are regarded by the FSA as complying with the BCOBS requirements.

## Model Rules for Building Societies

Since 1961, the Association has produced Model Rules for Building Societies (the Model Rules) for use or adaptation by societies. The current, 5th edition (published in November 1997) was produced primarily to comply with the changes made to the Building Societies Act 1986 by the Building Societies Act 1997.

In 2010, we instructed Graham Ashurst, a consultant, to review and update the Model Rules. The review was conducted with the help of the BSA Model Rules Working Group which consists of a small number of society secretaries. The Association has published a draft of the 6th edition of the Model Rules. In October 2010, the draft was submitted to the FSA to obtain approval that it is suitable for registration.

## Financial reporting

Further debate on the future of domestic financial reporting standards, known as UK GAAP, continued throughout the year. The Accounting Standards Board regards all mutuals as "publicly accountable" and therefore will require them to prepare their accounts using international financial reporting standards. We have argued, and continue to argue, that full IFRS is not suitable for smaller mutuals. Conversion means higher staff costs, significantly higher ongoing audit costs, more training for board members and loss of comprehension of the annual accounts for individual savings and mortgage members.

October saw the publication of an exposure draft on a new three-tier accounting framework. It also outlined exemptions from full IFRS for very small mutuals and proposed a slightly later implementation date of July 2013. We believe the exemption for very small mutuals is too restrictive. To qualify for the exemption, mutuals must meet all three of the small companies' size criteria rather than two out of the three which is the case for those companies not prudentially regulated.

## Enhancing the auditor's contribution to prudential regulation

We gave a cautious welcome to the FSA's and Financial Reporting Council's proposals for sweeping new powers over auditors of listed institutions. Bank and building society auditors face being forced to blow the whistle on irregularities in their clients' accounts. In February 2011 the FSA and the Bank of England issued a draft code of practice for auditors and supervisors.

## Review of larger building societies' financial statements

In May 2010, we held a useful meeting with the Financial Reporting Review Panel. The panel is responsible for the scrutiny of financial statements of firms which are listed or who have listed instruments (includes PIBS). It conducted a review into the 2007 and 2008 annual reports of nine larger building societies. No significant problems were uncovered.

### Code of practice on taxation

Government pressure was put on those building societies and banks that had not yet signed up to the voluntary code. This applied regardless of the size of the firm, or the relevance of the code (which mainly targets tax-based transactions). The code is designed to encourage financial institutions to comply with the spirit, as well as the letter, of the law. By the end of the year, about half of all mutuals had signed up and the others had either declined or were still making up their minds.

### Foreign Account Tax Compliance Act (FATCA)

This US act, passed in March 2010, requires all foreign financial institutions to enter into disclosure compliance agreements with US Treasury, or be subject to a 30% withholding charge. We continue to argue that British mutuals should be exempt from FATCA's reporting requirements.

### Building societies' legislation

In July 2010, in the course of a letter welcoming the new Financial Secretary to the Treasury, the Director-General mentioned a number of aspects of the Building Societies Act 1986 which could be improved and brought up to date, to give societies more of a level playing field, without either weakening consumer protection or costing any public money. These aspects were: financial trading, including derivatives (section 9A); floating charges in favour of settlements and payments systems (section 9B); electronic communications; summary financial statements (section 76); and the deceased investors' limit (Schedule 7). A very positive meeting was held with Treasury officials in December 2010, and our proposals are being considered further.

### Corporate Governance

Building on the consensus view that deficient corporate governance and management had been contributory to recent bank failures, a number of initiatives in the field of corporate governance were taken forward during the year.

In May, the Financial Reporting Council published an updated version of the UK Code on Corporate Governance (formerly the Combined Code). This incorporated many of the recommendations of Sir David Walker's influential review of 2009. Other Walker recommendations are being implemented by the FSA, which published in September a

policy statement setting out changes to its rules, including those relating to approved persons and significant influence functions. The combination of these implementation vehicles will see the bulk of Walker's recommendations being applied to BSA members.

Standards of corporate governance among BSA members have improved significantly in recent years and compare favourably with those of plcs. The BSA encourages members to follow the Code on Corporate Governance and has issued guidance to assist societies in this. As of 2010 all mutuals now follow the Code. Other indicators of the extent to which building societies have embraced good standards of corporate governance include the very high proportion of societies, 98%, that voluntarily held an advisory vote of their members on the society's directors' remuneration policy and included a report on directors' remuneration with the summary financial statement they send to all members of the society. The BSA encourages all mutuals to build on these achievements by adopting industry best practice in all aspects of their corporate governance.

### Financial Crime

The BSA continues to support members in the fight against financial crime by disseminating intelligence via our secure financial crime alert facility and by facilitating the sharing of information and best practice via the Financial Crime Panel.

Mutuals and their members are targets for a range of frauds. Despite lower lending volumes, there is still a significant level of attempted mortgage fraud. Fraud via the internet is also a major growth area with organised crime using the wealth of personal data available on social networking sites to groom victims and direct them to the most appropriate scenario to attract their money. The BSA is working with the police, the Government and other stakeholders to raise consumer awareness of the risks of fraud and the importance of safeguarding personal information.

Financial crime targeted at the elderly, mentally incapacitated and other vulnerable adults is also on the increase and we are supporting members in their efforts to protect their vulnerable account holders - for example, by supporting regional campaigns against doorstep crime. The BSA and several building societies are supporting Brunel University's research project on vulnerable adults and their research will

help front line employees have a better understanding of the warning signs of individuals suffering financial abuse.

### Mortgage Fraud

Sharp cuts on the budgets for policing in the UK announced in the 2010 Pre-Budget Report will significantly reduce resources deployed to investigate fraud and other crimes against business. As Chief Constables present their adjusted budgets it is clear that fraud investigation, particularly mortgage fraud, has been given even lower priority than currently. This is despite clear recognition of continued fraudster activity and strong links to organised crime.

There is a risk that the gap between actual and required capacity and capability for mortgage fraud investigation - already very evident in some police forces, will become unbridgeable unless it is addressed quickly.

In this context, City of London Police and the National Fraud Authority are working on a proposal to set up an industry funded police unit dedicated to mortgage fraud investigation. While not endorsing such an arrangement at this stage, the BSA has been working with them to ensure that their proposal is comprehensive, commercial and addresses the industry's needs from law enforcement.

On a more positive note, the HMRC mortgage service that ran as a pilot scheme in 2009-10 is to become a full time service to mortgage lenders. The service provides an additional anti-fraud check on suspicious mortgage applications or supporting paper work via a check against HMRC records, paid for by a fee per case submitted. It is currently undergoing a technical pilot of its secure data exchange technology and is scheduled to launch by the end of Q1 2011.

### Physical Security

Physical security is another continuing issue for mutual deposit takers as a target for criminal attacks. These include armed raids on branch premises, burglary, threats of violence to staff, and attacks on cash in transit, in branches and ATMs. We support members by collating and distributing information on incidents as they occur to BSA members, other financial institutions and the police and via the BSA Physical Security Advisory Group. We also maintain strong links with corresponding groups at the BBA, the cash in transit delivery

firms and sectors such as the travel industry where firms also have vulnerable branch networks.

### Operational Risk & Business Continuity

Operational risk involves the risk-management of failure of people, processes and technology resulting in financial loss and/or loss of reputation and customers' willingness to do business. Business continuity management to mitigate the impact of external events is a key part of successful operational risk management as is information governance and maintenance of good customer service.

The BSA set up a Business Contingency Management Panel in 2010 as a forum for members to share issues and best practice which they can then incorporate into their individual business contingency plans. We are also now a member of the City Business Continuity Management Group through which we will receive and distribute information on national contingency planning for events such as the Royal Wedding in 2011 and the 2012 Olympics.

Other areas where the BSA has been involved in highlighting potential operational risk implications include services to attorneys and deputies and management of third parties involved in holding / processing customers' personal data.

### External Affairs

The BSA undertook a full review of its approach to External Affairs in 2010, which included its media relations programme. Our continued participation in the IPSOS Mori annual personal financial journalist survey offers useful insight and information about the media environment in which we operate. The City and Business Journalist survey showed that the mutual sector is the only part of financial services to receive a positive rating from business journalists. When benchmarked with other financial trade associations the BSA press team and spokespeople continue to deliver the level of service that has gained positive feedback from the personal finance journalist community.

To enhance our media relations activity we continued our media contact programme for our Director-General. Paul Broadhead, BSA Head of Mortgage Policy, has also become a regular media spokesperson on housing and mortgage related issues.

We made a concerted effort to ensure that the sector's strategic priorities were articulated to key influencers including Government, media, regulators and consumers. Our commentary and coverage has included the challenges of access to capital, developing a new capital instrument for the sector, the benefits of mutuality, our position on the ISA super complaint, Mortgage Market Review, FSCS and the forthcoming regulatory review.

During the last 12 months our spokespeople have expressed BSA views and policy positions on *BBC Radio 4's Money Box and Today programme*, *BBC TV News*, *Wake up to Money on BBC Radio 5 Live*, *Financial Times*, *Daily Telegraph*, *The Times*, *The Guardian*, *The Independent*, and various specialist trade magazines.

*Society Matters*, our quarterly magazine, continued to comment on key policy issues and showcase members' work in a variety of areas. Policy specials included Savings, Capital & Liquidity and Financial Capability & Education. We also ensured that the BSA was represented at financial capability seminars and conferences for Consumer Focus and the Consumer Financial Education Body.

The Public Relations Forum remains a firm fixture in our annual programme, with a good number of mutuals represented at the quarterly meetings. Principality Building Society hosted the 2010 away meeting, giving a very insightful presentation about their communications, events and marketing commemorating their 150th Anniversary. Also, as an outcome from one of the PR Forums, the BSA held its first Social Media Seminar, which was attended by representatives from 14 different building societies and chaired by Andy Golding, Chief Executive of Saffron Building Society.

The external affairs remit this year has included the introduction of a series of successful BSA thought leadership panel-led

discussions (and publications) on issues that are core to the continuing development of our sector: Home Buying Reform; Capital Raising in the Mutual Sector: Financial Regulation and Provision of Mortgage Long Term Safety Nets.

We have also continued our close association with Mutuo, the mutual sector's think tank, with the *Mutuals Manifesto* and then as the primary sponsors for a significant Mutuo research report '*Promoting Corporate Diversity in the Financial Services Sector*' by The Oxford Centre for Mutual and Employee-Owned Business, Kellogg College, Oxford.

### Political Relations

The 2010 General Election saw the formation of a Coalition Government. The Coalition Agreement setting this in motion included a statement supporting mutuals. The BSA warmly welcomed the statement.

**"We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry."**

*The Coalition: our programme for government*, 20 May 2010.

Prior to the election we worked with Mutuo and other trade associations and mutuals to publish *The Mutuals Manifesto 2010*. The first of its kind, the manifesto was a challenge to the UK's political parties to show how they planned to support and nurture the mutual sector.

The manifesto called upon the Government to commit to ensuring that mutuals are understood and receive equal treatment across all Government departments - this included creating a Government Office for Mutuals with a designated Minister for Mutuals. The manifesto also urged the Government to use its influence with regulators to make sure that they

*One of the most significant lessons of the global financial crisis is surely the need for a strong mutual sector. Many of the banks that got into difficulty were demutualised building societies. Financial mutuals, building and friendly societies, and credit unions were not responsible for the crisis. They do not have a culture of large dividends or excessive bonuses, and research across Europe has shown that a strong mutual sector helps to prevent excessive profits at banks.*

Letter from **Gareth Thomas MP**, Chair, Co-operative Party, *The Guardian*, 26 February 2011.

*Co-operative banks, building societies and credit unions all embody the best of the mutual tradition - meeting the needs of consumers while also promoting a model of ethical, values-led businesses, behaving responsibly in an industry where too many have not. This is driven by a belief that people can achieve most when they work together, and that business should seek to serve wider social ends not short-run profitability. This is why we believe that a strong and vibrant mutual sector must be a key feature of our banking system in the years to come.*

Tessa Jowell MP and David Miliband MP, Progress website, 5 August 2010.

act in a way that respects diverse forms of ownership and to promote mutual ownership as a way of serving the public interest. All three of the main political party manifestos went on to set out plans for mutuals and co-operatives, both within financial services and wider public services.

We had an active party conference season once again, taking part in fringe events at all three of the main political conferences. At a series of events entitled *Mutual Financial Services - how can financial services work in the public interest?* we debated a report (referred to above) from the University of Oxford on promoting corporate diversity in financial services. Political speakers included Mark Hoban MP, the Financial Secretary to the Treasury, Gareth Thomas MP, the then Shadow Treasury Minister, Cathy Jamieson MP and Baroness Maddock.

The All Party Parliamentary Group for Building Societies and Financial Mutuals reformed after the general election and launched an inquiry into corporate diversity in financial services, to which we gave oral evidence.

The remutualisation of Northern Rock began to creep up the political agenda at the end of 2010. Chuka Umunna MP, Treasury Select Committee member, launched a campaign at the beginning of 2011 to urge HM Treasury to consider remutualisation as a viable option. His campaign included an Early Day Motion which gained cross party support. Gareth Thomas MP, Co-operative Party Chair, has also been campaigning on this issue and led a Westminster Hall debate on financial mutuals early in 2011.

The BSA made a number of appearances in front of Parliamentary Committees in 2010. Our views were sought by the Treasury Select Committee on financial regulation and

mortgage arrears and access to mortgage finance. We also attended the Scottish Affairs Committee and the Financial Services Bill, and Child Trust Fund Public Bill Committees. We continued to meet with and brief individual MPs on issues of importance to the mutual sector, including capital, the Mortgage Market Review and reform of the FSCS.

## **BSA annual events, conferences and seminars**

We held our usual range of conferences and seminars in 2010. The financial crime prevention, treasury management, directors', chairmen's and audit committee seminars were held as usual; among the policy areas covered at other events were corporate governance, managing risk in lending, mortgages and arrears, the building societies specialist sourcebook, remuneration, customer relations and complaints, the changing payments systems environment and social media.

Our annual conference held in Manchester in May was a highly successful event. Over 500 delegates attended the show to hear speakers including Philip Collins, Former Chief Speech Writer to the Prime Minister, Hamish McRae, Associate Editor of *The Independent* and Ed Mayo, Secretary General of Co-operatives UK, and visit the business exhibition showcasing the products and services of over 30 exhibitors.

Over 200 people attended the annual lunch hosted by our Chairman, David Webster. We were delighted to welcome principal guest and speaker, Alison Cottrell, Director of Financial Services at HM Treasury.

## SECTION THREE

## INTERNAL MATTERS

**Membership of the Association**

Mutuals have withstood the recessionary trends in the economy more effectively than the banking sector. Nevertheless the difficult market conditions of the last few years have led to some restructuring of the building society and wider mutual sectors, and this trend continued in 2010. There were three mergers of societies in 2010. On 1 April the Chelsea Building Society merged with the Yorkshire Building Society, the largest merger of the year. On 1 June the Chesham Building Society merged with the Skipton Building Society, and on 1 September Stroud & Swindon Building Society merged with Coventry Building Society. At the end of the year there were 49 building societies. In November 2010, the members of the Kent Reliance Building Society voted to support a board proposal that the assets and liabilities of that society be transferred to OneSavings Bank, with membership rights and obligations transferred to Kent Reliance Provident Society which, it was proposed, would own approximately 60% of the new bank. This transaction was concluded in February 2011, with OneSavings Bank retaining its membership of the Association. Following this transaction the Association had 48 building societies in membership, and two mutually owned deposit-taking lenders.

**Associates**

For many years the Association has provided information and networking opportunities to firms with an interest in the mutual sector, through its Associates scheme. In return for an annual fee, Associates receive full access to the members-only section of the BSA's website, entry at members' prices to most BSA seminars, and significant other benefits. In 2010 we held the first of what we would expect to be an annual meeting of Associates, followed by an evening reception,

which appeared to be well received, and worked on plans, which will come to fruition in 2011, to introduce an Associate's newsletter, to facilitate greater contact between Associates and members. Although a number of firms resigned their Associateship in 2010, mostly as a result of significant changes in their business, we recruited a number of new Associates, leaving the overall number broadly unchanged during the year.

**Building Societies Trust**

Building Societies Trust is a charity that makes small grants to institutions concerned with savings, housing, home ownership and building society matters generally. The Trust supports a library on building society matters at the BSA's offices and, during 2010, also made grants to -

- **Crisis** (for its SmartSkills project)
- **Money Advice Trust** (for central administration costs and a specialist support service)
- **The Personal Finance Education Group** (PFEG – for central administration costs)
- **Shelter** (for Shelterline - its telephone helpline service)

The Directors have a policy of making grants valued at £90,000 - £110,000 each year, although this can be raised in exceptional circumstances. Grants totalling £115,000 were made in 2010.

The Trust's Chairman is Graham Kentfield, a former Chief Cashier at the Bank of England. The other Directors in 2010 were Geoffrey Fitchew, a former First Commissioner of the Building Societies Commission and Andy Golding, Chief Executive of the Saffron Building Society.

The affairs of the Trust are administered by BSA Staff.

### Library and information service

We continue to provide a free library and information service to members, associates, researchers and the general public.

We maintain a comprehensive archive of BSA guidance and publications and a specialist collection of reports and articles on the housing and savings markets, many now in electronic format. Over 18,000 items are now catalogued. The earliest documents in the collection are copies of the Building Societies Gazette dating from 1870. We also have a comprehensive collection of the Building Societies Yearbook from its first issue in 1927 and copies of each building society's annual reports going back over twenty years.

The library widened its scope in 2010. To reflect the fact that the BSA now represents mutual lenders and deposit takers and not just building societies the library has ensured that important articles and reports on other forms of financial mutuals are now also added to the collection.

### Human Resources

The Association continued to provide members with guidance, surveys and general information on HR related issues during the year. The surveys, which are available to all participating members, covered executive and senior management remuneration (including details of non-executive directors' fees), labour turnover and sickness absence statistics (on a quarterly and annual basis) and benefits and selected terms and conditions of employment within the sector.

As in previous years Thedata Ltd collated, on behalf of the Association, details of the salaries, fees and other remuneration for chief executives, finance directors and chairmen within the sector. However, in 2010, additional information was provided on the composition of boards of directors at building societies. This information is available to all members on the Association's website.

### BSA Staff

During 2010, the Association appointed two new Mortgage Policy Advisers - Colette Best and Sharon Chapman, who both joined in January 2011. These new staff filled the vacancies created by the departure of Amir Ghani and Neil Johnson, who left the Association in October and November respectively.

Fiona Cornes continued to cover the post of Head of External Affairs on an interim consultancy basis during 2010. Fiona's contract with the Association continues until 30 June 2011.

On 1 January 2010, following the closure to future accrual of the Association's defined benefit pension scheme (with effect from 31 December 2009), all active members of the Scheme as at 31 December 2009 (seven BSA staff in total) joined a Group Personal Pension Plan with Aviva. These staff benefit from enhanced employer contributions for the first three years of their membership of the Aviva Scheme. Thereafter, all members of staff will have identical employer pension contributions for current and future service.

The BSA is delighted that Adrian Coles was awarded an OBE for services to the financial services industry in the New Year's Honours list.

### Financial Position

The Association's surplus for the year, before tax and post Financial Reporting Standard 17 (FRS17) adjustments, was approximately £244,000 (2009: £212,000), almost £83,000 greater than originally budgeted. After FRS17 adjustments, and before tax, the Association's surplus was approximately £1.55 million (2009: a surplus of about £2 million).

Overall income was approximately £15,000 less than originally budgeted. However, expenditure was approximately £98,000 less than originally budgeted. This reduction mainly relates to the savings associated with staff expenditure. Other savings were made on pension administration costs, office expenditure - including website hosting, software and consultancy - expenditure on external functions and staff travel and hotels and VAT charges.

In the second year of the defined benefit pension scheme's five year recovery plan, the Association collected a second payment of £1.3 million from its members in January and February 2010 (the first payment was collected in September 2009). These funds were paid into the pension scheme's fund in March 2010, and have been invested, by the Trustees, in accordance with the Scheme's investment strategy, which was amended to reflect the Scheme's cessation to future accrual as at 31 December 2009. The Association is extremely grateful to its members for the continued support given to improve the financial position of the Scheme.

The Association's share of the Scheme's assets and liabilities showed a surplus of £932,000 as at 31 December 2010 (2009: a deficit of £137,270) - this reflects the significant level of employer contributions made and a higher than assumed return on the Scheme's assets during 2010. However, this surplus can not be recognised as an asset on the balance sheet on the basis that no portion of the surplus can be recovered through reduced contributions in the future, as the Scheme is closed to future accrual of benefits. In addition, no refund from the Scheme to the Association had been agreed by the pension scheme Trustees at the balance sheet date.

The Association is eligible for a repayment of £48,072 in relation to corporation tax for 2010. This compares with a payment of £175,285 for 2009, which related to the increased liability (compared to the previous year) from the special pension payment collected in 2009. Further amounts of tax will be reclaimable in respect of the year ended 31 December 2011.

The Association's unallocated cash reserves as at 31 December 2010 were approximately £1.53 million, equivalent to about five and a half months' expenditure.

### **Membership of the Council 2010**

During 2010 there was just one retirement from the BSA Council - Phil Gray, former chief executive of the Beverley Building Society. Thanks are due to Phil for the time he devoted to BSA affairs and his input on the important policy issues of the last few years.

SECTION FOUR

# DIRECTORY

## The Council

(As at 1 March 2011)

### Chairman

**David Webster**  
(Hanley Economic)

### National

**Andy Golding**  
(Saffron)

**Dick Jenkins**  
(Bath)

**David Webster**  
(Hanley Economic)

**Paul Winter**  
(Ipswich)

Vacancy

Vacancy

### Nominated building society

**Graham Beale**  
(Nationwide)

**Iain Cornish**  
(Yorkshire)

**David Stewart**  
(Coventry)

### Nominated financial mutual

**Neville Richardson**  
(Co-operative Financial Services)

### Regional

**Ian Ward**  
(Northern) (Leeds)

**John Milton**  
(Metropolitan) (National Counties)

**Peter Griffiths**  
(Midlands & West) (Principality)

### Constitution of the Council

The largest three building societies - measured by balance sheet size - have an automatic right to nominate one member each to the Council.

One seat on the Council is reserved for non-building society financial mutuals.

The three regional associations each elect one member to the Council (for a three year term) on a one society, one vote basis.

The remaining six members of the Council are elected for three year terms on a vote of all members at the annual general meeting. The three largest members, by virtue of their ability to nominate to the Council, do not have a vote in this election. Also the largest non-building society financial mutual does not have a vote. The number of votes available to the remaining members is proportional to the annual subscription that they pay to the BSA.

## Staff

(As at 1 March 2011)

### Director-general

Director-general: Adrian Coles

PA to director-general: Keeley Ball

### Commercial activities

Commercial manager: Charlotte Bell

Events officer: Christie Sharp

### External affairs

Interim head of external affairs: Fiona Cornes

Press and public affairs manager: Rachel Wylie

Policy and external affairs officer: Katie Wise

### Financial policy

Head of financial policy: Jeremy Palmer

Policy adviser: Andrea Jeffries

### HR and finance

Head of HR and finance: Louise Thornbury

Personnel officer: Melanie Snelgrove

Accounts consultant: Phil Lickfold

Accounts administrator: Outi Stenroos

Facilities adviser: Barry Smith

Receptionist and telephonist: Lynne Bartlett

Catering assistant: Irene Bastable

### Legal and practice

Head of legal services: Chris Lawrenson

Policy adviser: Andrew Hopkins

Policy adviser: James O'Sullivan

### Library and information

Information services manager: Simon Rex

### Mortgage policy

Head of mortgage policy: Paul Broadhead

Policy adviser: Victoria Barnard

Policy adviser: Colette Best

Policy adviser: Sharon Chapman

### Savings policy

Head of savings policy: Brian Morris

Economist: Andrew Gall

Business economist: Joseph Thompson

SECTION FOUR

# DIRECTORY

## Members of the Association

(As at 1 March 2011)

Bath Investment  
 Beverley  
 Buckinghamshire  
 Cambridge  
 Century  
 Chorley & District, The  
 City of Derry  
 Co-operative Financial Services, The  
 Coventry  
 Cumberland  
 Darlington  
 Dudley  
 Earl Shilton  
 Ecology, The  
 Furness  
 Hanley Economic  
 Harpenden  
 Hinckley & Rugby  
 Holmesdale  
 Ipswich  
 KRBS - a trading name of OneSavings Bank Plc, part of the Kent Reliance Provident Society Group  
 Leeds  
 Leek United  
 Loughborough  
 Manchester  
 Mansfield, The  
 Market Harborough  
 Marsden  
 Melton Mowbray  
 Monmouthshire  
 National Counties

Nationwide  
 Newbury  
 Newcastle  
 Norwich & Peterborough  
 Nottingham  
 Penrith  
 Principality  
 Progressive  
 Saffron  
 Scottish  
 Shepshed  
 Skipton  
 Stafford Railway, The  
 Swansea  
 Teachers  
 Tipton & Coseley  
 Vernon  
 West Bromwich  
 Yorkshire

## Associates of the Association

(As at 1 March 2011)

Addleshaw Goddard  
 Airdrie Savings Bank  
 Allen & Overy LLP  
 Aviva  
 Bank Machine  
 C Hoare & Co  
 Cardif Pinnacle Insurance  
 Clayton Euro Risk  
 Clydesdale Bank PLC  
 CMS Cameron McKenna LLP  
 Co-operatives UK  
 Credit Suisse  
 Crosshill Finance Limited  
 CUNA Mutual Group Limited  
 Deloitte  
 Ernst & Young LLP  
 Family Investments (Family Assurance Friendly Society)  
 Genworth Financial Mortgage Insurance Limited  
 iRed Partnership  
 Joseph & Hepple-Wilson Limited  
 King & Shaxson Asset Management Limited  
 KPMG LLP  
 Legal & General  
 LSL Property Services PLC (e.surv)  
 Mutual One Ltd  
 Mutual Vision Technologies Ltd  
 Norton Rose LLP  
 PricewaterhouseCoopers  
 The TALL Group of Companies (Checkprint Ltd)  
 Thomas Eggar  
 Water Industry Property Information Network  
 WorkSmart Solutions LLP  
 The Wriglesworth Consultancy



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