Corporate Governance Reform: Green Paper

A response by the Building Societies Association

17 February 2017

Building Societies Association

Introduction

The Building Societies Association (BSA) represents all 44 UK building societies. Building societies have total assets of over £366 billion and, together with their subsidiaries, hold residential mortgages of more than £284 billion, 22% of the total outstanding in the UK. They hold over £262 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 33% of all cash ISA balances. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.

Building societies take matters of corporate governance very seriously. The building society governance model of one member - one vote has proved resilient and engenders a long-term perspective, which is not driven by the vicissitudes of the stock markets or the needs of external shareholders. Building societies have readily embraced higher standards of governance over recent decades. The demutualisation of several building societies in the 1990s caused the rest of the sector to reinvigorate their engagement with their members and this has further evolved in line with market best practice over time.

Most of the Green Paper is focused on raising standards the plc sector and in large private companies, so not directly aimed at building societies, which are neither. Nonetheless, the BSA welcomes the opportunity to engage in the debate as the Green Paper is concerned with themes which are of wider relevance to those, such as our members, who have a keen interest in high standards of corporate governance. In the BSA we have encouraged building societies to adopt corporate governance standards and practices which are both excellent and distinctive – themes which the sector has readily taken on board.

Executive Pay

Building societies, as mutual organisations, are not required to maximise their profits and the way that building societies are run reflects that. Societies operate for the benefit of their members, on both sides of the balance sheet and, on average, building society members enjoy higher interest rates on their savings and lower rates on their mortgages than do customers of plc banks.

Executive pay in building societies reflects this member-focused ethos. Building societies do not indulge in the remuneration excesses which have been a feature of their plc bank counterparts. Nor are share options a feature of executive pay in building societies. While societies need to offer competitive remuneration packages in order to attract and retain talented individuals, executive pay in the sector is markedly lower than in the wider banking sector. Remuneration structures that rewarded excessive risk-taking in banks are widely seen as one of the key causes of the recent financial crisis. Building societies have not engaged in such remuneration structures.

While building societies are not subject to the executive pay regulations which apply to listed companies, societies adhere voluntarily to similar standards so, for example, since 2003 building society members have been able to participate in an annual vote on their society's remuneration report. Building societies have also adopted key parts of the 2013 executive pay regulations, meaning societies now put their pay policy to a vote of their members at least every three years. However, there are limitations to this voluntary approach, for example, the BSA does not advise societies to hold voluntarily a binding vote on their pay report. If a society were to do so it would not enjoy the statutory protections which apply to listed companies and their directors under the regulations. A binding vote could leave the society exposed to legal action and, unlike a company within scope of the 2013 regulations, it would not be able to rely on the regulations to defend itself.

Societies are also required by the Prudential Regulation Authority to have regard to the UK Corporate Governance Code which, as the Green Paper notes, includes provisions on remuneration. To assist societies in applying the Code, the BSA issues guidance to societies in the form of an annotated version of the Code. Most of the Code can readily be applied to building societies, so the guidance concentrates on the relatively small number of matters, such as listed companies' relations with major shareholders, which do not readily translate to building societies, whose individual customers are also their members/shareholders.

We are supportive of the Government's aim of promoting greater stakeholder engagement in executive pay. We think the building society practice of subjecting their remuneration reports to annual votes of their members, ie the societies' customers, provides a discipline to which listed companies are not subject. Members' approval ratings have been consistently high, with between 89% and 94% voting in favour of societies' annual remuneration reports over the past 10 years. Had the personal customers of banks had a similar say in their pay policies, that might conceivably have applied a brake to some of the excesses evident in that sector and which contributed to the financial crisis.

We appreciate that it would be unrealistic to expect banks to cede influence to their customers when their primary accountability is to their shareholders. We do not comment directly on the Government's proposals in the Green Paper for increasing shareholder influence over the executive pay of listed companies. However, consideration of the competing interests of customers and shareholders in a plc model, does at least help to illustrate the potential shortcomings of policies focused on increasing shareholder influence, particularly when a substantial proportion of those shareholders are other City institutions, whose own reward structures are in line with those of the companies they part-own.

Strengthening the employee, customer and wider stakeholder voice

Building societies are experienced in promoting engagement with their customers, who are also their members. Among the member engagement mechanisms used by societies are consultative member panels which serve as sounding boards on matters such as new product development and improvements to services as well as, in some cases, more strategic matters. Regular roadshows where societies reach out to members in various locations are also seen as effective.

Societies generally place a lot of importance on member engagement. Unlike plcs, where the major shareholders enjoy privileged access to boards and senior management, and are often well geared up to exerting an active influence on the company, in a building society the members are individuals who each have one vote. It is therefore incumbent on societies to make special efforts to ensure they hear the voices of their individual members. The BSA regularly surveys building societies' engagement with their members in order to promote best practice and innovation within the sector. See, for example, our 2015 publication, Engaging Conversations – member engagement at building societies. While societies would not claim to have all the answers, their experiences may offer insights which could usefully translate to the plc sector.

Corporate governance in large privately-held businesses

We are, of course, aware of the high-profile concerns which have prompted the review of governance in large private companies and we support the Government's aims of ensuring high levels of governance across a wide spectrum of corporate forms. As such, we are surprised to see 'large mutual organisations' included within the scope of the definition of large privately-held businesses. Although building societies are not explicitly within the scope of this definition, we would like to be reassured that building societies are not in the Government's sights.

The building society governance model has proved resilient since the birth of the sector in the 19th Century. The one member, one vote model, where societies do not have external shareholders, means that in difficult times, societies are able to take a longer-term perspective and are not driven by the short-term expedients of the stock markets. This longer-term sustainable approach has meant that building societies were able to continue lending to homebuyers through the depths of the recent financial crisis, whereas plc banks largely withdrew from the mortgage market. In the five years between 2012 and 2016 net mortgage lending by building societies was £82.8 billion, accounting for 67% of total mortgage lending (£123.5 billion) over the period, ie more than three times more than societies' normal share of this market. Moreover, not having pressure to maximise profits means that societies are able to devote more resources to providing excellent customer service and this is evident in consumer satisfaction surveys. For example, in January 2017 independent research conducted by YouGov found that 92% of building society members agreed that they provided good customer service compared to 85% of customers from banks and other providers. Also, 85% of building society members said they would recommend their society to friends or family compared to 71% of customers from banks and other providers.

Unlike the generality of private companies, building societies are already highly regulated. The sector is subject to a dedicated legislative regime, under the Building Societies Act 1986, which includes requirements for societies' constitutional and governance arrangements. Moreover, societies are subject to authorisation and prudential regulation by the PRA, which also embraces corporate governance requirements, and conduct regulation by the Financial Conduct Authority. Societies are also required to adhere to the same reporting standards, overseen by the FRC, which apply to their plc equivalents. As noted above, the PRA expects societies to have regard to the UK Corporate Governance Code, so the reforms envisaged in the Green Paper for private companies would not appear to have relevance for the building society sector as they already apply.

Conclusion

The BSA and our members support the Government in its aim of raising standards of corporate governance in public and private companies. In the building society sector the mutual model combines with sound regulation, a strict legislative framework and wider best practice to achieve high standards of governance. The BSA is committed to build on this in promoting corporate governance for the sector which is both excellent and distinctive and we are encouraged that the Green Paper, although not aimed specifically at building societies, is pushing in a similar direction and we would be pleased to work with the Government as it takes forward this initiative.

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