Commission on Economic Justice

Wealth and ownership in the UK
Call for evidence

Restricted
21 September 2017

Building Societies Association

A submission by the Building Societies Association

Introduction

The Building Societies Association (BSA) represents all 44 UK building societies and four of the largest credit unions in the UK. Building societies have total assets of just under £375 billion and, together with their subsidiaries, hold residential mortgages of over £292 billion, 22% of the total outstanding in the UK. They hold over £265 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies employ over 42,000 full and part-time staff and operate through approximately 1,550 branches.

Building societies provide a home for people's savings, and use these to provide mortgages to help people buy their own homes. Credit unions encourage the habit of small regular saving, and provide shorter term credit for household needs. The fundamental factor that shapes how building societies and credit unions operate is that they are owned by the customers who save with and borrow from them. This has a profound effect on how their conduct and performance.

Many of the aspirations of the IPPR's Commission on Economic Justice chime with the core tenets of the building society sector: businesses that treat customers fairly, and are mindful of their role in wider society, and that operate for and invest for the long-term. These objectives form an important part of building societies' heritage, but remain as relevant as ever today.

In this brief submission we set out why government should support plural forms of ownership and refer to supporting evidence from the financial services sector. We then address the Commission's question of what can be done to promote diverse forms of ownership. We explain some of the achievements in our sector on this front as these might be more widely applicable, and describe what further steps could be taken.

Why should government support the expansion of cooperatives, mutuals, and plural forms of ownership at the firm level?

Supporting the plurality of ownership is important in retail financial services because it makes **competition more effective** and makes the **system as a whole more resilient** to shocks.

Both of these benefits come from people working in firms with different ownership structures and business models working towards different purposes, and therefore facing different incentives. Different types of organisation therefore demonstrate radically different cultures and behaviours. Sometimes mutual and cooperatives address major market failures that leave groups of citizens unserved or underserved. This is true both of the origins of building societies, and more recently of the development of credit unions.

Some evidence from our sector demonstrating the difference in approach that stems from customer-ownership is set out under these headings below.

More effective competition

- Better interest rates: Building societies do not have to pay dividends to shareholders, giving them a cost advantage that they can pass on to savers and borrowers in better interest rates. https://www.bsa.org.uk/information/consumer-factsheets/the-difference/better-interest-rates
- Better customer service: Building societies consistently outscore banks on various measures of customer service, and receive fewer complaints. https://www.bsa.org.uk/information/consumer-factsheets/the-difference/customer-service
- Better conduct**:** From 2010 to 2017 building societies accounted for 0.2% of conduct fines levied by the Financial Conduct Authority. https://www.bsa.org.uk/information/consumer-factsheets/the-difference/conduct-fines

Greater inclusion

- Credit unions, including several that are BSA members, have been at the forefront of providing fair and affordable credit to less well-off citizens within their common bond, who are otherwise neglected by the mainstream and in danger of exploitation by predatory lenders (loan sharks etc)

A more resilient financial system

- Better capitalised: high quality capital gives a financial institution a buffer so that it can sustain unexpected losses. This is disclosed in the CET1 ratio, which at the end of 2016 averaged 20.6% of risk weighted assets for building societies and 12.3% for the big banks.
- Support for the real economy through the cycle: mortgage lending by building societies recovered faster than other providers after the financial crisis so that since 2012 societies have accounted for two thirds of the growth in mortgage lending. https://www.bsa.org.uk/information/consumer-factsheets/the-difference/supporting-homebuyers-through-the-recovery
- More risk averse: Building societies tend to have lower, but more stable, levels of profitability, and lower levels of mortgage arrears. https://www.bsa.org.uk/information/publications/industry-publications/an-analysis-of-the-relative-performance-of-uk-bank

How can government support the expansion of cooperatives, mutuals, and plural forms of ownership at the firm level?

The BSA has long campaigned for an increased recognition of the benefits that different organisations and models can bring to consumers.

- **Support the development of metrics that indicate how diverse different markets are, and how this diversity is evolving.** The BSA has supported the development of a Diversity Index by academics at the University of Oxford and SOAS University of London. https://www.cefims.ac.uk/cgi-bin/research.cgi?id=109
- **Put structures and steps in policymaking processes to reduce the dominance of the plc mindset.** To avoid alternative approaches being treated as an afterthought or aberration, the policymaking process should require a consideration of other approaches at the outset. This would help to avoid one-approach-fits-all, which risks having unintended consequences, ultimately potentially squeezing out alternative well-functioning models. These considerations of other approaches should be articulated in policy statements and impact assessments. Policymakers should be trained on standard types of alternative models, such as co-operatives, mutuals and not-for-profits, and how these models have different purposes that influence how they operate. This would help to rebalance the default model of large plcs in standard business school and university training.
- **Apply the principle of proportionality**: in a regulated industry the costs of regulation must be proportionate to the benefits. This should seek to avoid burdensome compliance, particularly for small institutions or those with simple business models, as the costs of complying with regulations are often essentially fixed, so fall disproportionately on smaller firms. A pertinent example is regulatory reporting, which if applied across the board would mean the same disclosures having to be made by the largest and the smallest firms alike. Consideration of proportionality should not be limited to size, however, but to all relevant dimensions in each industry, which could include complexity, ownership and business model.
- **Increase scrutiny on the *cumulative* impact on plurality from regulations and policy changes.** For example by parliamentarians in the House and in Select Committees. This was enhanced in our industry in 2016 when the competition objectives of the financial services regulators were amended so that the regulators must have regard to the differences between different kinds of business organisation adopted by financial services firms, such as mutuals.
http://www.legislation.gov.uk/ukpga/2016/14/section/20
- **Support new entrants of all forms.** The joint PRA-FCA New Bank Start Up unit is focused on encouraging new banks, with the option of starting a new building society a footnote. This may be a response to the demand the regulators are facing, but it may also be indicative of a presumption that a bank is the obvious choice of form. Relatedly, the BSA set out a process for converting the banks that were taken into national ownership during the financial crisis into mutuals. This required a long-term perspective, but was not taken up by the Government.
https://www.bsa.org.uk/BSA/files/82/82189399-9dba-4c2b-8bb9-02df291a6c8e.pdf
- **Support the development of suitable capital instruments.** One feature of mutual models is that the main source of capital generation is from retained profits. This reliance on organic capital growth partly explains why they have a long term outlook. To enable more rapid expansion to take advantage of new opportunities, it is helpful to have the option of supplementary capital instruments that are compatible with the mutual model. In our sector these have been developed by building societies since the financial crisis, in conjunction with the regulators. Two societies have now issued Core Capital Deferred Shares, on which the coupon is capped and discretionary to ensure

distributions are not excessive, and voting rights of holders of the instruments are also limited. The deferred share concept has also been extended to credit unions.

- **Mutuals should better articulate their distinctive features to members, media, regulators and policymakers.** To articulate the benefits of their models, it is incumbent on mutual themselves to educate people on the specificities of the model in different markets, and to present the case for their model being given due consideration.

By Andrew Gall

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

BSA EU Transparency Register No: 924933110421-64

www.bsa.org.uk

The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £345 billion, and account for approximately 20% of both the UK mortgage and savings markets