Building Societies in the Financial Services Industry

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FOREWORD

Building societies and, indeed, the mutual concept itself were written off by many in the late 1990s. Those societies that saw themselves as innovative, risk-taking, and entrepreneurial had proudly cast away what they saw as the constraints of their mutual status. By 2000, they were ready to take their full and rightful role in the new, free, globalised financial markets that had been created by new technology and regulatory reform over the previous two decades.

A decade later, the ambition, excitement, and sense of self-belief among those who led this change had disappeared. By 2009, not a single one of the ten building societies that had turned themselves into banks retained their individual existence, and a number had been rescued by the taxpayer. In contrast, most of those societies that remained mutual, and fought to reinvent and enhance the meaning of mutuality, survived the financial crisis, and came out of it stronger. One of the most remarkable statistics in this welcome new book by Barbara Casu and Andrew Gall is that between 2011 and 2014, mutual building societies accounted for 90% of net new mortgage lending.

The history of this period is fascinating, and Casu and Gall provide a range of insights. The wealth of data in this book means it is set to become a standard statistical text on developments in this area. However, the authors go further, with helpful interpretations and analysis of market developments, financial performance, and customer views. The impact of regulatory change is not ignored; indeed, it is explained in some detail. It is interesting to reflect that, to some extent, the country chose to go down a route that led to such ruin.

Vince Cable, Liberal Democrat Business Secretary in the 2010–2015 coalition government, said that the demutualisations had been “one of the great acts of economic vandalism in modern times.” That statement deserves sustained reflection by policymakers and those who drive market behaviour. The huge and costly experiment to determine whether mutual or stock-based ownership models are best designed to provide customers with basic financial products has been comprehensively answered in mutuals’ favour in recent years. Those wanting to understand “how” and “why” should spend a few hours with “Building Societies in the Financial Services Industry.”

Adrian Coles
Director General, The Building Societies
Association, 1993–2013

PREFACE

The UK financial services industry has been severely impacted by the financial crisis of 2007–2008, which resulted in UK banks suffering big losses. The financial turmoil resulted in significant government intervention in the sector. State aid was then followed by wide-ranging regulatory reforms, aimed at making the financial industry more resilient to shocks, by limiting risk-taking and improving bank conduct. As a consequence, the industry is undergoing a period of deep transformation, which affects all industry participants.

The implications of the global financial crisis on the banking sector have been widely analysed, less so the consequences on other financial intermediaries. Not all types of financial institutions were affected in the same way by the crisis.

Although the building society sector was not immune to the effects of the global financial crisis, on average, it managed to overcome it in better health than the banking industry.

An analysis of the key characteristics of the UK building society sector is therefore interesting to understand how different types of financial institutions have evolved during the deregulation era of the 1990s, when activity restrictions were abolished and banks and building societies started competing in the mortgage and savings markets, and how this affected the range of activities undertaken in the run-up to the financial crisis.

Building societies are mutual organisations, owned by their customers, or members. Although technically they are not “banks” and do not offer the full range of banking services, as mutuals they are a subset of stakeholder-based financial institutions. Understanding the key features of

their business models and analysing their strengths and weaknesses compared to banks are particularly interesting as policymakers are seeking to foster a more diverse financial sector. In recent years, building societies have enjoyed political support as the importance of mutuals within a more diverse financial sector has been highlighted by policymakers and regulators. This support is also recognised by customers, as indicated by the high levels of satisfaction and trust.

This book aims to describe the performance of UK building societies since the large-scale demutualisation process ended in the year 2000. Chapter 1 offers an overview of the UK financial services industry and reviews the impact of the global financial crisis on UK banking. It also provides an analysis of the changing structure of the UK banking sector: from increased concentration, which resulted in the sector being dominated by few, very large, banking groups to the recent entrance of new “challenger” banks. The entrance of new banks, with new banking licences being issued for the first time in a century, is likely to increase competition, particularly in the retail banking sector. This increased competition, in addition to the effect of regulatory reforms, as well as far-reaching technological innovations, presents new challenges for the building society sector. Chapter 2 presents a brief summary of UK building societies’ 250 years of history. We focus in particular on the demutualisation process that saw the largest building societies becoming banks. We then assess the impact of the financial crisis on the sector; we analyse the consolidation process that took place as larger and more sound building societies took over troubled ones. Chapter 3 reviews the legal and regulatory framework with respect to building societies’ permissible activities and discusses recent developments. In addition, we consider the strengths and weaknesses of the building society model, with a particular focus on capital and governance. Chapter 4 presents an analysis of the key issues faced by building societies in today’s financial markets. We discuss the key changes in the structure of the industry and how these have impacted on margins and profitability and have resulted in restructuring and consolidation in the sector. Finally, Chapter 5 presents an empirical analysis of the comparative performance of UK banks and building societies since the year 2000. When comparing societies against standard bank performance metrics, we have been careful in the interpretation of the results not to provide a biased view of the sector’s performance. We believe this analysis to be informative to demonstrate the differences between types of organisations competing in

the market and therefore helpful to policymakers weighing up the future shape of the banking sector.

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ACRONYMS AND ABBREVIATIONS

AGM	Annual General Meeting
APPG	All-Party Parliamentary Group
AT1	Additional Tier 1
ATM	Automated Teller Machine
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BOE	Bank of England
BSA	Building Societies Association
C/I	Cost-to-Income
CCDS	Core Capital Deferred Shares
CET1	Common Equity Tier 1
CRR	Capital Requirements Regulation
DBS	Dunfermline Building Society
DTI	Debt-to-Income
ECB	European Central Bank
EU	European Union
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FOS	Financial Ombudsman Service
FPC	Financial Policy Committee
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
HBOS	Halifax Bank of Scotland
ICB	Independent Commission on Banking
IFS	Institute for Fiscal Studies
IT	Information Technology
KRBS	Kent Reliance Building Society

LIBOR	London Interbank Offered Rate
LTi	Loan-to-Income
LTV	Loan-to-Value
M&S	Marks and Spencer
MBBGs	Major British Banking Groups
MPC	Monetary Policy Committee
NAB	National Australia Bank
NIM	Net Interest Margin
NS&I	National Savings & Investments
OBS	Off-Balance Sheet
ONS	Office for National Statistics
PIBS	Permanent Interest Bearing Shares
plc	Public Limited Company
PPDS	Profit Participating Deferred Shares
PPI	Payment Protection Insurance
PRA	Prudential Regulatory Authority
RBS	Royal Bank of Scotland
ROA	Return on Assets
ROE	Return on Equity
SFTs	Securities Financing Transactions
TBTF	Too-Big-To-Fail
UK	United Kingdom
UKAR	UK Asset Resolution
UKFI	UK Financial Investments Ltd
US	United States of America
YoY	Year on Year

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