Eurofound

Financial services: Challenges and prospects

Case study: Building societies in the UK

Business model

Performance of building societies

Building societies and the financial crisis

Demutualisation of building societies

Customer satisfaction and member engagement

Leek United Building Society

Conclusion

Annex – Interview partners

References

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Business model

Evolution of building societies

Building societies are mutual organisations in the UK, which are owned by their members. The building society sector has changed considerably since the first building societies were founded in the 18th century as 'terminating' societies – organisations designed to be wound up once all their members had been housed. In the 19th century, permanent building societies began to spring up and by 1910 over 1,700 societies existed with more than 600,000 members and assets in excess of €89 million (GBP 75 million as at 16 July, 2010). The number of building societies has in recent years decreased significantly due to demutualisation and mergers. There are 51 building societies in the UK.

For many decades, building societies used to be the main institutions within the housing finance market based on tight regulation and government constraints. In the deregulated financial market after 1980, they were integrated more closely into the overall financial system, even if they still remained highly specialised mutual institutions. Today they play a continuing but relatively limited role in retail deposits and wholesale funding, which they use almost entirely to lend against the security of the dwelling, both owner-occupied and privately rented (Whitehead, 2008).

Legal framework

According to the Building Societies Act 1986, as amended by the 1997 legislation, and set out in the Building Societies Association website, building societies' 'purpose or principal purpose is that of making loans which are secured on residential property and are funded substantially by its members'. Building societies are special legal entities, which are incorporated under their own legislation, the Building Societies Act 1986. The legislation states that:

- at least 75% of the business assets of a building society must be in loans fully secured on residential property;
- at least 50% of the funds of a building society must be raised in the form of shares held by individual members of the society; building societies are prevented from acting as a market maker in securities, commodities or currencies, trading in commodities or currencies, and entering into transactions involving derivatives;
- building societies are allowed to enter derivative transactions in order to buy, for example, an interest rate hedge, but they are not allowed to trade them;
- a building society has to seek the approval of members to the acquisition or establishment by the society or a subsidiary undertaking of a significant 'non-core' business;
- building societies are regulated by the Financial Services Authority (FSA). The FSA has certain powers to step in when a building society fails to comply with the society's principal purpose requirement, the lending limit or the funding limit;
- members of building societies have the right to attend their annual general meetings. They may vote on annual accounts and elect the directors to the board.

Building societies and banks compared

The main trade organisation for building societies, the Building Societies Association (BSA), gives the following clarification on its website of how building societies differ from banks (from BSA website: **http://www.bsa.org.uk**).

> *'As building societies are mutual institutions, most people who have a savings account or mortgage are members and have certain rights to vote and receive information, as well as to attend and speak at meetings. Each member has one vote, independent of how much money they have invested or borrowed or how many accounts they may have. Each building society has a board of directors who run the society and who are responsible for setting up its strategy.'*

In addition, the BSA goes on to say, building societies differ from banks, which are companies (normally listed on the stock market) and are therefore owned by, and run for, their shareholders. Building societies have no external shareholders who could require dividends. This normally enables them to run on lower costs and offer cheaper mortgages, better rates of interest on savings and better services than their competitors.

The other major difference highlighted between building societies and banks is that there is a limit on the proportion of their funds that can be raised from wholesale money markets. Thus, they face lower risks in general. A building society may not raise more than 50% of its funds from wholesale markets. Today the average proportion of funds raised by building societies from wholesale markets is about 25%. Moreover, building societies are legally barred from taking positions in the derivatives, foreign currency or commodities markets as already mentioned above.

Performance of building societies

There are 51 building societies in the UK with about 45,000 employees and about 1,700 branches. The societies are owned by their 24 million members. Altogether they have assets of around €405 billion (GBP 335 billion). Retail mortgages amounting to €272 billion (GBP 225 billion) and retail deposits of €266 billion (GBP 220 billion) account for almost 20% of each of these markets (Building Societies Association, 2010a).

Table 1: *Building societies – performance data*

	2008	2009
Number	55	52
Total assets (GBP billion)	360	335
Mortgage assets (GBP billion)	250	225
Saving balances (GBP billion)	235	220

Source: *BSA*

The number of building societies has decreased in recent years due to mergers, acquisitions by banks and demutualisation. The last demutualisation occurred in 2000.

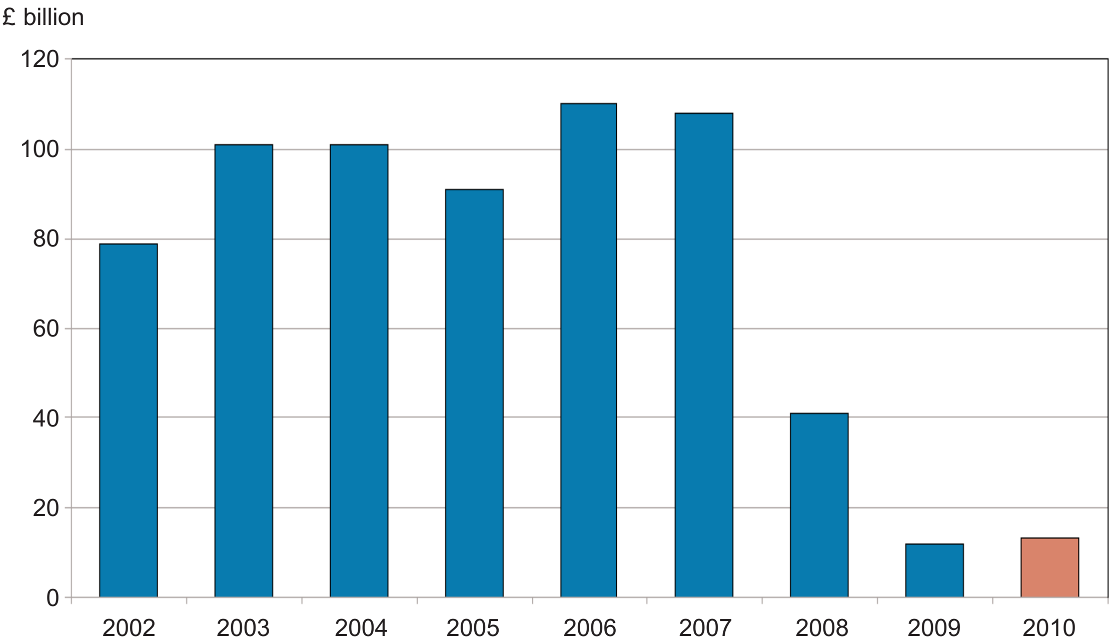
Table 2: *Building societies – operational information*

Year	Number of authorised societies	Branches	Staff		Investors	Depositors	Borrowers
			Full time	Part time			
1996 a)	72	2,571	29,266	8,681	17,033	756,000	2,774
1997 a)	71	2,537	30,632	8,953	19,234	964,000	2,872
1998	71	2,502	33,155	9,996	21,195	909,000	3,136
1999	69	2,384	32,722	10,379	21,774	722,000	3,044
2000	67	2,361	32,334	10,823	22,237	740,000	3,107
2001b)	65	2,126	28,200	9,150	20,310	568,000	2,750
2002	65	2,103	28,982	9,257	20,724	511,000	2,688
2003	63	2,081	32,502	11,440	20,897	520,000	2,679
2004	63	2,074	34,335	11,571	20,734	525,000	2,749
2005	63	2,148	35,615	12,203	22,090	449,000	2,822
2006	60	2,105	37,112	12,839	22,396	472,000	2,857
2007	59	2,016	8,652	12,926	23,038	460,000	2,941
2008	55	1,916	35,331	12,043	24,990	n/a	2,926

Notes: a)Excludes societies demutualised by 31 December 1997; b)excludes Bradford & Bingley
Source: *Building Societies Association, 2009a; FSA*

Building societies and the financial crisis

Figure 1: *UK net mortgage lending by building societies*



Source: *Building Societies Association, 2009a; Bank of England*

In general, building societies performed comparably well during the recession. However, building societies, like other institutions, are finding current market conditions challenging. The UK emerged from recession in the fourth quarter of 2009 with the economy expanding by 0.3%. Overall, economic output has shrunk by 6% since 2007. Deposit flows have strongly declined and there is continued disruption to the wholesale funding markets (Building Societies Association, 2010b).

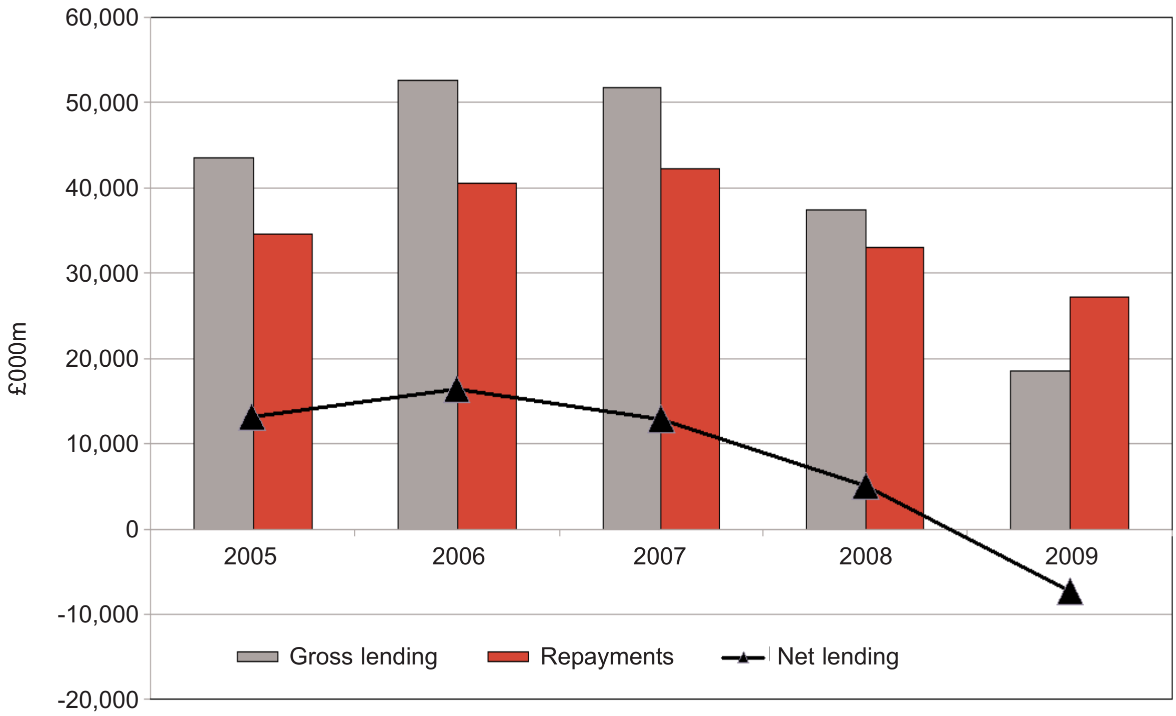
In the UK, according to the BSA, net new mortgage lending during the year fell by almost 90% to just GBP 12 billion in 2009, as shown in the chart below. For 2010, a slight increase to GBP 13 billion is expected. Gross lending of the whole market was GBP 143 billion in 2009, a 44% reduction compared with 2008.

Mergers due to the crisis

Due to the financial crisis, consolidation in the sector intensified with a series of mergers.

- In 2008 Nationwide merged with Derbyshire and Cheshire; Yorkshire merged with Barnsley; and Chelsea merged with Catholic.
- In 2009 Co-operative Bank merged with Britannia Building Society (under new legislation facilitating the transfer of building societies into a group owned by an Industrial and Provident Society); Skipton merged with Scarborough; and Nationwide acquired the deposits, branches and residential mortgages of Dunfermline.
- In 2010 the mergers were announced (subject to member votes), of Yorkshire and Chelsea (effective from 1 April 2010); Skipton and Chesham; and Coventry and Stroud & Swindon.

Figure 2: *Building societies – Sector lending*



Source: *Building Societies Association, 2009a*

Due to increased asset impairments during the crisis, the capital base of very few building societies came under as much pressure as that of the Dunfermline Building Society. According to HM Treasury, these societies were active beyond traditional prime residential lending, a common factor amongst those societies that have either been merged within the sector or (in the case of the Dunfermline) resolved under the Special Resolution Regime.

The collapse of the Dunfermline Building Society in Scotland was caused by its over-exposure to commercial loans. In spite of signs of an impending property market collapse, the building society increased its lending to the sector to €777 million (GBP 650 million) – a sevenfold increase over just three and a half years. In 2009, the Financial Times reported that taxpayers were set to take responsibility for loans at Scotland's largest building society, following disastrous investments in commercial property and mortgage-backed securities (Financial Times, 2009). However, impairments in the sector are low in comparison to the private banking sector.

In order to deal with funding challenges, many building societies have shrunk their balance sheets by reducing new lending more quickly than repayments have decreased. This resulted in negative net lending (as shown in Figure 1).

Current challenges

In terms of their situation in the financial markets, building societies are facing a number of challenges (Building Societies Association 2010d, and HM Treasury 2010).

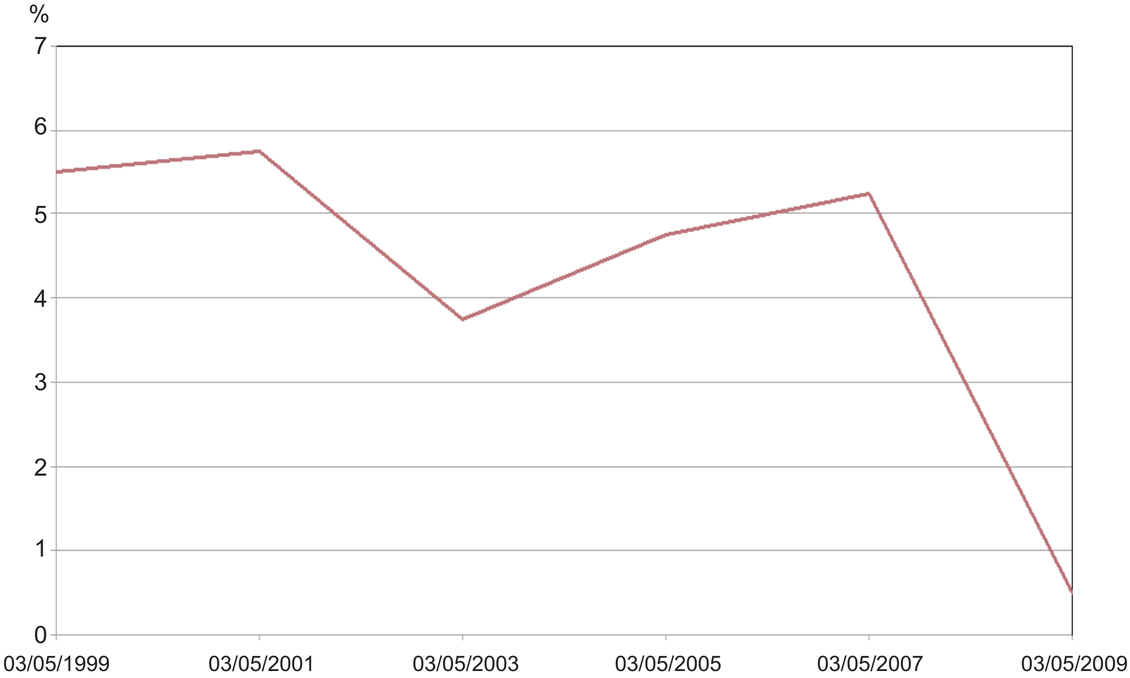
Higher funding costs: The cost of wholesale funding for financial institutions grew significantly during the financial crisis, and building societies also suffered from freezing wholesale markets from which they derive a (declining) part of their funding. Moreover, a re-appraisal of building society credit by investors has contributed to increasing the cost to societies of accessing wholesale funding. This has influenced the cost of funding for building societies in two ways.

- It increased the cost of wholesale funding for those societies engaged in this type of business.
- It led to increased competition for retail deposits, as banks and building societies sought to meet their financing needs by replacing wholesale funding with retail deposits. This caused an increase in costs of retail deposits relative to the bank rate.

According to HM Treasury, this atmosphere of increased competition for funding is likely to remain as the banking sector exits from the extraordinary support given during the crisis – including the Special Liquidity and Credit Guarantee Schemes – and as it adjusts funding structures in response to changes in liquidity regulation.

Increased interest rates: The official bank rate fell from 5% at the beginning of October 2008 to a historical low of 0.5% on 5 March 2009, where it has remained until now. This puts pressure on interest rate margins, particularly for building societies, which earn money on the difference between the interest rate they borrow at from retail depositors and the interest rate they lend at for mortgages and other types of loans.

Figure 3: *Building societies – Bank of England bank rates*



Source: *Building Societies Association, 2009a; Bank of England*

FSCS levies: The cost of failures of certain financial institutions in the UK is met by the Financial Services Compensation Scheme (FSCS). Due to the current funding model for the FSCS, building societies contribute in proportion to their covered deposits (in effect their retail deposit base). Contributions to the FSCS have increased in light of the financial crisis and have impacted on the profitability of those institutions with a high proportion of covered deposits relative to their size. According to the BSA, building societies have to pay a disproportionately high contribution to the FSCS, relative to their size and their level of risk.

Competition from nationalised and semi-nationalised banks: Building societies are suffering a net outflow of funds for the first time since 1955 when their records began. This is mainly caused by strong competition from supported banks. The nationalised and semi-nationalised banks, plus National Savings & Investments, benefited from the taxpayers' support to offer both higher rates of interest and a greater feeling of security amongst potential depositors, which made it more difficult for building societies to compete. Moreover, regulatory and political pressure to increase capital and liquidity, and to lend more, puts building societies under pressure.

According to HM Treasury, the low interest rates, increased funding costs, asset impairments at a few building societies, and high contributions to the FSCS have contributed to a significant reduction of profitability in the sector, with profits for the sector, as a whole, decreasing from around €1.5 billion in 2007 to less than €0.35 billion in 2009 (GBP 1.3 billion and GBP 0.3 billion). According to the BSA, building societies collectively made profits of €0.22 for every €119 managed in 2008 (19 pence for every GBP 100). In previous years this figure was very stable at around €0.39 to €0.43 for every €119 of assets (33 to 36 pence for every GBP 100). Reduced profits – or losses in the case of some societies – limit the amount of retained earnings that societies have to increase their capital base in times of increasing focus on capital adequacy.

However, HM Treasury also concluded that many societies have remained profitable throughout the financial crisis, including a number of societies that have continued to concentrate on traditional business models focusing on prime residential mortgage lending funded by retail deposits. In addition, many societies have strong capital ratios when compared with other credit institutions, which adds to their resilience in times of financial stress.

Demutualisation of building societies

Table 2: *List of demutualised building societies, January 2010*

Bradford & Bingley	Floated 4 December 2000; mortgage book nationalised September 2008; retail savings transferred to Abbey (Banco Santander) September 2008; Abbey rebranded to Santander on 11 January 2010
Birmingham Midshires	Taken over by Halifax, April 1999; now a division of Lloyds Banking Group
Northern Rock	Floated 1 October 1997, currently in temporary public ownership
Bristol & West	Taken over by Bank of Ireland, 28 July 1997; Bristol & West transferred its branch network and savings business to Britannia Building Society on 21 September 2005; Britannia became part of The Cooperative Financial Services on 1 August 2009.
Woolwich	Floated 7 July 1997, taken over by Barclays Bank in October 2000; now exists only as a trading name of Barclays.
Halifax	Floated 2 June 1997, merged with Bank of Scotland to form HBOS in 2001; in September 2008, Lloyds Bank agreed to take over HBOS; it became part of Lloyds Banking Group on 16 January 2009.
Alliance & Leicester	Floated 21 April 1997, acquired by Banco Santander in October 2008; Alliance & Leicester is due to be rebranded to Santander in 2010.
National & Provincial	Taken over by Abbey National, 5 August 1996 (ceased trading under this name)
Cheltenham & Gloucester	Taken over by Lloyds Bank, 1 August 1995; now exists only as a trading name of the Lloyds Banking Group.
Abbey National	Floated 12 July 1989, acquired by Banco Santander in November 2004; Abbey rebranded to Santander on 11 January 2010.

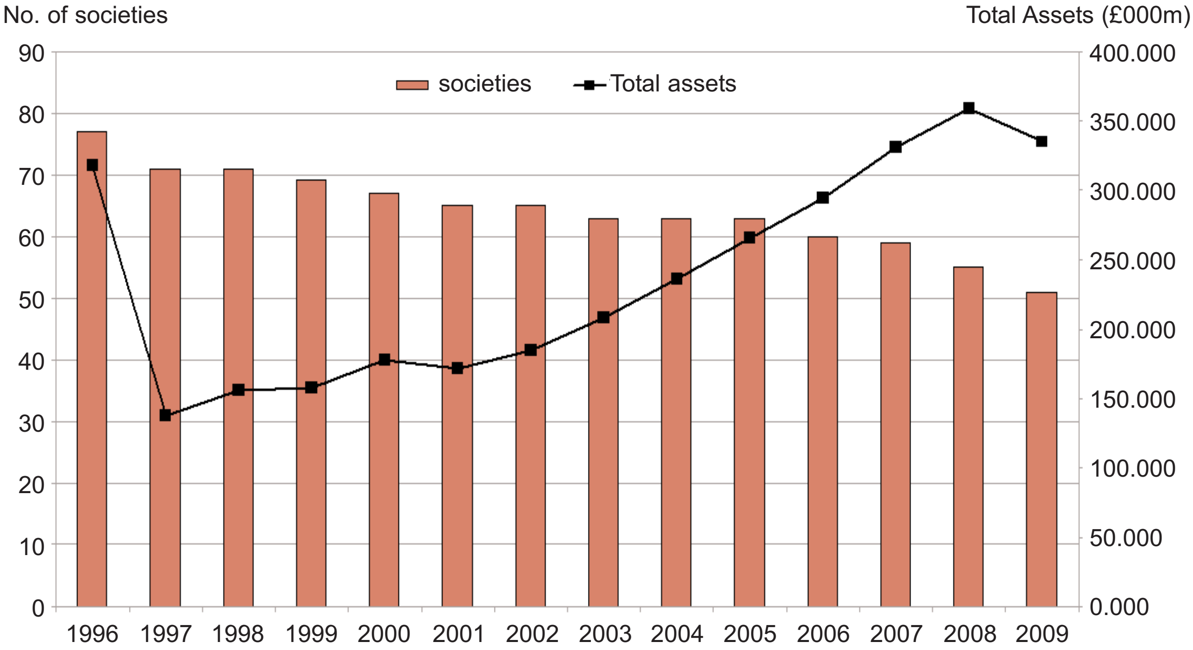
Note: These institutions are no longer building societies and should not be referred to as such.
Source: *BSA*

Due to legislative changes, the shape of the UK financial sector changed considerably in the 1980s and 1990s. The 1986 Act also gave building societies the opportunity to transfer their mutual status to become banks. Because many societies had large reserves, this was seen as desirable by many members. Thus, a number of larger societies demutualised between 1989 and 2000. The first was Abbey National in July 1989, followed by the demutualisation of Cheltenham & Gloucester in 1995, National & Provincial in 1996, Alliance & Leicester, Halifax, Woolwich, Bristol & West and Northern Rock in 1997, and Birmingham Midshires in 1999. The process concluded with Bradford & Bingley in 2000 (Table 3).

As a consequence of the demutualisation, the sector shrank in size, from €384 billion (GBP 318 billion) of assets in 1996 to around €189 billion (GBP 156 billion) in 1998, while the number of societies decreased through consolidation as well as demutualisation, to stand at 52 in 2009 – down from 110 in 1989. The evaluation of assets and the number of societies is shown in Figure 4.

However, none of the demutualised former UK building societies is in independent ownership, since some were nationalised or acquired by other banks. For example, Northern Rock was nationalised in February 2008. Previously, the bank had an aggressive business strategy and about 75% of its funding was obtained from the wholesale market. As explained in Wikipedia, the liquidity problem arose because institutional lenders became nervous about lending to mortgage banks following the US sub-prime crisis.[1]

Figure 4: *Impact of demutualisation on number and assets of building societies*



Source: *FSA Building Societies Statistics 2009* [2]

Customer satisfaction and member engagement

Attitudes towards building societies and banks

The Financial Research Survey conducted in 2008 showed that building society customers were more satisfied with their provider than were customers of other institutions (Building Societies Association, 2009a). GfK NOP, in their omnibus survey of October 2008, asked over 2,000 adults for their views of how banks and building societies treated customers, gave value for money, the quality of their advice, the safety of their deposits, and how they supported those in financial difficulties.

Over two thirds (68%) of building society customers felt that societies treated their customers fairly, while just over half of the bank customers (55%) thought the same about their providers. According to the BSA, these positive results are influenced by the fact that building societies don't have obligations to shareholders and thus have less pressure to squeeze more out of their customers.

[1] http://en.wikipedia.org/wiki/Nationalisation_of_Northern_Rock

[2] http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009/bs_stats.shtml

Moreover, building societies are more trusted by their customers than are banks by their customers when it comes to giving advice: 58% of building society customers would trust their banks to give advice, as against 50% of bank customers. Meanwhile, 32% of bank customers say they would not trust their provider to give advice; however, only 14% of only building society customers felt this way.

About two thirds (67%) of building society customers think their provider offers value for money while fewer than half of the bank customers (48%) agreed with that statement.

According to the 'Moneyfacts consistent saving survey' in January 2010, almost three quarters (72.5%) of the most consistent savings accounts (consistent in terms of the stability of interest rates) were found to be offered by building societies.

Regarding the safety of deposits, it is notable that only 13% of the surveyed building societies' customers were concerned to some extent about the safety of their money, compared with 24% of bank customers. In October 2008 – when the survey was conducted – the banking crisis made the security of deposits a major concern.

The survey also asked people who had a mortgage with a bank or building society whether they thought their provider would be supportive if they got into financial difficulties. Of those building-society mortgage customers interviewed, 47% agreed to some extent that their provider would be supportive, while 15% strongly agreed. For bank customers, the proportions were similar: 15% strongly agreed and 46% agreed to some extent. However, while 24% of bank customers felt that they would not be supported in times of difficulty, only 12% of building society customers felt this.

Two thirds of both bank customers and building society customers stated that they would recommend their services to a friend or family member. However, 22% of bank customers said they would not, compared with just 13% of building society customers.

Member engagement

Member engagement refers to the way in which building society owners participate in the governance of their society. Building societies continually try to improve communication with members (Building Societies Association, 2010). Many societies send newsletters and magazines to members and host sections on their websites to encourage communication. Moreover, 'Meet the directors' sessions are also common and surveys are conducted in order to assess customers' satisfaction with the products and services provided.

Due to the principle of mutuality, members have a vote, receive information and can attend and speak at meetings. The most important channel for members to communicate with their building society is the society's annual general meeting (AGM). There, members elect directors to the board and vote on other resolutions. Given the debate about bankers' pay and bonuses, it is particularly interesting that almost all building societies voluntarily give members the opportunity to vote on directors' remuneration at AGMs. At AGMs, societies regularly receive an approval rating of 90% (that is, 90% of those members who vote – typically around 20% of total membership).

Leek United Building Society

Leek United is a building society with around 120 employees and 12 branches, with its head office in Leek, in Staffordshire. Leek United provides independent, personal financial services for its members and the local community.

Business model

The Leek United Permanent Benefit building society was established in 1863, becoming part of a burgeoning building society movement, which saw hundreds of local mutual savings and loan organisations opening across the country. Many of these were 'terminating' societies, which were wound up when all their members were housed. Of the permanent societies from that time, the vast majority have since merged with other societies or, in more recent times, converted to bank status. Of 51 building societies in the United Kingdom today, Leek United is the 20th largest (rising from 27th place in 2009, due to mergers with and acquisitions of other building societies).

The business strategy of Leek United has been stable in recent years and is committed to traditional mutual values. The society's primary objective is the provision of mortgage finance for purchasing and improving residential property, funded predominantly through the society's personal savings accounts (Leek United Building Society, 2010). So while in the past Leek United may have appeared to be overly cautious, it remained true to the values of a traditional building society by providing mortgages primarily on residential properties and ensuring a responsible approach to lending.

As a building society, the principal business is the production and distribution of financial products and, in particular, mortgages and deposit-based savings accounts. Regulated investment products are supplied by the group via its subsidiary Leek United Financial Services Limited. The group uses wholesale financial instruments in managing its balance sheet, investing funds held as liquidity and rising wholesale funding. The society also makes use of instruments in the wholesale market to manage interest-rate risk, which entails the use of derivative financial instruments. However, the derivatives, as demanded by law, are used solely for this purpose and not for trading or speculation. The principal derivatives used are interest rate swaps.

Leek United also comprises two further subsidiaries: Leek United Home Loans Limited (whose primary function is purchasing and administering mortgage portfolios) and the Mortgage Outlet Limited (which provides mortgage brokering services).

Financial performance

Leek United's conservative business approach was successful during the crisis and is reflected in the company's relatively good performance in 2009. Mortgage lending increased during 2009 without any compromise on quality. The prudent lending policy and individual underwriting, which has been the practice for many years, is an invaluable asset in the current economic downturn. In 2008, there were 8,056 borrowing members and 86,338 investing members (Leek United website).

Table 3: Group performance of Leek United (in GBP millions)

	2007	2008	2009
Profits before tax and FSCS levy	4.2	3.2	4.2
Profits after tax	2.97	1.5	2.75
Assets	799.7	754	735
Reserves	44.18	45.75	47.37
Mortgage lending	172	44	60
Mortgage losses	-	-	-
Management expenses ratio (%)	0.87	0.78	0.80

Source: *Leek United Building Society (2008, 2009 and 2010)*

Competition for retail savings has been fierce throughout 2009, especially from some of the main banks, which received massive taxpayer financial support enabling them to offer otherwise unsustainable interest rates. As a result, the building society sector has experienced a reduction in savings balances with the main beneficiaries being the part-nationalised banks.

Staff numbers

Table 4: *Number of employees at Leek United*

	2007	2008	2009
At head office			
Full-time staff	67	51	46
Part-time staff	17	17	18
At branch offices			
Full-time staff	40	46	44
Part-time staff	26	19	18
Total	**150**	**133**	**126**

Note: Figures refer to the average number of persons (including executive directors) employed during the year
Source: *Leek United Building Society, 2010*

As shown in Table 4, the number of employees at Leek United was reduced after a close examination of the cost structure and improvements in efficiency. Due to these reorganisations, employee productivity increased, costs were rationalised and departments were merged. Moreover, activity duplication has been reduced. Leek United has not made any staff redundant but staff that have left the society have not been replaced. Mr Derek Lyons, non-executive Director at Leek United, said that it was unlikely the society could make any more cuts, and that staff numbers may rise a little again.

Table 5: *Staff costs at Leek United Building Society (GBP thousands)*

	2007	2008	2009
Wages and salaries	2.96	2.71	2.63
Social security costs	247	229	226
Other pension costs	620	304	219
Total staff costs	3.83	3.24	3.07

Source: *Leek United Building Society (2008, 2009 and 2010)*

Employees at Leek United are generally young: some branch managers are in their twenties, for example. Senior management are mainly in the 40–55 year age bracket.

Table 6: *Leek United Building Society, directors' remuneration (GBP thousands)*

	2008	2009
Non-executive directors		
E. W. Hodkinson (Chairman to 22 April 2009)	9	28
P. Marriott (Chairman from 22 April 2009)	28	23
P. W. Kerns (from 21 December 2009)	1	-
D. J. Lyons	24	20
P. A. Stanyer (from 19 December 2008)	19	1
D. A. W. Stevens	24	23
J. Washington	19	19
Executive directors		
K. Wilson	172	158
B. Rimmer (to 31 July 2008)	-	123
K. Griffiths (from 3 November 2008)	109	18
Total directors' remuneration	**413**	**405**

Source: *Leek United Building Society (2010)*

As shown in Table 5, staff costs have decreased slightly in the last three years. Salaries generally rise each year in line with inflation: for example, the pay increase for 2010 was 1.25%, but in 2009 it was closer to 4%. Leek United pays executive directors standard salaries for the industry, their remuneration being published in the annual report. Employees receive pay in line with local levels as well as pensions when they retire.

Vocational education and training

Vocational education and training plays an important role at Leek United, the organisation providing a lot of in-house training. All employees have to participate in training, which is developed either by the Human Resources Department or by staff going on external training courses.

Training expenditures have risen somewhat in the past three years. Generally, in-house training is preferred to external courses. Training includes topics such as money-laundering, compliance, understanding the business and how to handle customers. Depending on the role, training is also provided on the FSA, how to deal with new initiatives for mortgages, and changes to the liquidity regime. For staff selling financial products, there are specific training courses in those areas.

At Leek United there was no extra training needed because of the crisis. According to Mr. Lyons, the awareness of risk and developments in the market is perhaps more important now, but this does not require special training.

Leek United and the financial crisis

The core business of Leek United is lending money to individuals to buy houses. The balance sheet includes money lent to members on one side and borrowed money on the other side. Two years ago, 80% of this money was gained from the retail market and 20% from the wholesale market – primarily from UK local authorities. After the problems surrounding Northern Rock in 2007, these lenders withdrew from the wholesale markets, meaning that building societies had to adjust their funding model towards retail and individuals in particular. Today, Leek United's funding from the wholesale markets is about 4%. The flipside of this is that retail funding is more expensive and hence Leek United's mortgages have to be priced at higher levels. It also means that Leek United is doing less business and selling fewer mortgages because funding sources are less certain.

Two or three years ago the business was slightly different. The priority was to offer attractive mortgage products to borrowers and only afterwards was it considered how Leek United would borrow this money. Today it is the other way round: first Leek United has to make sure of its funding and then it introduces new mortgage products.

Leek United is managing the interest rate gap in a very conservative way with the help of interest rate swaps and exposures. Due to new regulations, the society has to report its interest rate gap to the FSA twice a week.

Leek United – as well as other building societies – performed better during the crisis than did privately owned banks. This can be explained by the following reasons:

- loans were made only to individuals;
- strict underwriting criteria were in place (for instance, loans cannot be more than four times the annual salary of a customer);
- no sub-prime loans or commercial lending took place;
- there were no obligations to shareholders.

However, in recent years, more and more lenders entered the retail market with less strict underwriting criteria, thus squeezing Leek United's margins.

Two years ago, Leek United reduced the number of its employees and cut overheads. This meant that the society was well prepared for difficulties arising in the market. Moreover, constant growth is not a key goal of the business strategy. Mr Lyons said: 'Leek United would like to grow the balance sheet if possible, but that's not the main goal.' He added that the society understood the signs of the market earlier than did other financial bodies.

Although Leek United performed relatively successfully during the crisis, the advantage of being a conservative and reliable business partner with a long-term reputation is not used directly to increase the market share in times after the crisis. Thus, good performance and the conservative business model are not used as a competitive advantage in the mortgage market. Advertising is done mainly through pricing, meaning that Leek United provides financial products that will be listed in 'best-buy' tables, which – it is hoped – will attract more customers.

Customers' deposits

During the crisis, some customers reduced their deposits to GBP 50,000 – the amount secured by the FSCS – while other, new customers opened accounts to spread their assets over different institutions. However, the overall savings in the market did not increase as a whole; they were just moved from one institution to another.

Arrears and customer support

Leek United did not experience severe credit defaults. The rate of arrears is 0.27% (this is the percentage of mortgage accounts in which arrears exceed 2.5% of the mortgage balance) and is one of the lowest in the market. This low figure is due to Leek United's being a low-risk lender, with no 100% loans. During 2009, it had to repossess only one property. The low arrears rate can also be explained by reasonably static unemployment figures and by low interest rates. Moreover, the society gives borrowers a lot of support if they get into difficulties: it discusses any problems with the customer, and might offer a reduced monthly payment, a payment holiday, or an option to add the interest to their loan. The society says it tries at all costs to avoid foreclosure. In general, default risks are higher for commercial property – an area Leek United is not involved in.

FSCS levy

The society says that its customers appreciate its good reputation and security. As in other banks, customer deposits of up to GBP 50,000 were backed by the FSCS. Therefore, like other institutions, building societies have to pay a levy to the FSCS, which is related to retail deposits. Since building societies have many more retail than wholesale deposits, their payments were comparatively high. Some banks paid less than building societies; this could be seen as unfair, since building societies had little involvement in risky assets. Another problem is that the FSA recommends that banks reduce their reliance on wholesale products. Due to an increased demand for retail products, the rates went up, making it more difficult for building societies to compete.

Conclusion

Building societies are an important part of the financial system in the UK. Due to their conservative and less risky business model, they differ from many private banks. Andrew Haldane, Executive Director of Financial Stability at the Bank of England, compared the financial services market to ecological systems, which are naturally diverse. He stressed that diversity within the financial system diminished in the run up to 2007, due to the predominance of the rating agencies, the reliance on the principles of Basel II,[4] the growth of value-at-risk models and associated stress testing as well as the trend of demutualisation. He points to the danger of the financial system becoming more homogeneous and, in turn, less ‘disease resistant’. Against this background, a substantial market share of mutual institutions adds to the diversity of a financial system, while a ‘monoculture’ of private banks increases the danger of herd instincts developing. Thus, the organisational and regional diversity of mutual institutions contribute to the richness of the financial services landscape.

Building societies are traditionally cautious and during the crisis they stuck mainly to a traditional, conservative business model. According to Professor Wood at London’s Cass Business School, building societies were essentially protected from every source of shock that arose during the crisis due to their narrow business model. Any move away from this business model would make them less secure.

Institutions in the cooperative banking sector felt quite comfortable in their position due to their relatively good performance during the crisis and they saw advantages in their business model. However they don’t seem to advertise their competitive advantage. Their usual way of advertising is to provide a loan, which will be listed in the best-buy tables. However, they could, for example, make more of the fact that they didn’t get into difficulties during the crisis.

Adrian Coles, Director-General of BSA, expects that, in five years time, there will be fewer building societies, but that they will provide a valid alternative to banks driven by concerns for shareholders’ profits. While margins will be low, the safe business model will be trusted more than that of banks. Concentrating on customers, low risks and high levels of service will remain very important. Certainly, building societies will not go out of business, but they will grow less rapidly than they did in the boom years. The lower risk model with its long-term nature will be more widely recognised. Whether building societies will be able to take market share from private banks will depend on the market. At the moment though, with very low interest rates and competition from nationalised banks, this can’t be achieved.

Moreover, Adrian Coles has suggested that financial institutions could remutualise: there are advantages in mutual structures, such as reduced risk, increased diversity, improved accountability and better consumer trust. In particular, remutualising failed demutualised institutions would be a strong statement that lessons from the last 10 years are being learned (Coles, 2010).

[3] The Basel II agreement seeks to create an international standard for banking regulation regarding the levels of capital that banks must have.

Annex – Interview partners

Table A1: *Interview partners*

Name	Institution	Position
Derek Lyons	Leek United Building Society	Non-Executive Director, Vice-Chairman
Adrian Coles	Building Societies Association	Director-General
Prof. Geoffrey Wood	Cass Business School	Professor of Economics

Kurt Vogler-Ludwig, **Danielle Kaisergruber**, **Helene Giernalczyk**
with support from **Luisa Stock**, **Simone Poppe**

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EF/10/48/EN 3

