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Research Briefing

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Building Societies Act 1986 (Amendment) Bill 2023-24: Progress of the Bill

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Summary

The Building Societies Act 1986 (Amendment) Bill would enable societies across the UK to raise more funds from sources other than member savings and bring some administrative rules in line with those which apply to banks.

The Bill largely mirrors proposals the Government consulted on during 2022 and has been welcomed by the industry.

Under the Building Societies Act 1986, building societies must raise at least 50% of funds, with some qualifications, from customer savings.

The Bill would exclude some types of funding held for liquidity purposes or accessed in stress scenarios, from this calculation.

What are building societies?

Building societies are financial institutions with the principal purpose, established in law, of making residential mortgages, funded substantially by individual customer savings.

In accordance with this principal purpose, building societies must ensure at least 50% of their funds come from customer savings (subject to some qualifications), while the remainder can come from sources like bonds, called wholesale funds.

Building societies account for around 23% of residential mortgages by value in the UK and 19% of household savings.

Until the mid-1990s building societies accounted for around 60% of residential mortgages, but this fell to around 20% after a number of building societies, including Halifax and Northern Rock, became banks in 1997.

Building societies are owned by their members, which are individual customers with savings in or borrowings from the society. They are not owned by external shareholders, unlike banks.

The funding limit

When the 1986 Act was passed, the funding limit was set at 20%, meaning at least 80% of society funds had to come from customer savings. This was gradually increased and now sits at 50%.

The Bill does not propose changing the 50% figure but does propose excluding three types of funding from the calculation (clause 1):

- Funds accessed from the Bank of England in stress scenarios.
- Types of loss-absorbing debt building societies might hold to ensure that, should the society fail, investors rather than taxpayers bear the loss.
- Sale and repurchase agreements for types of easily-monetised assets building societies must hold for liquidity reasons. Building societies may choose to sell these under repurchase agreements, but this results in the funding being essentially double-counted for the purposes of the funding limit calculation.

The Bill would also give the Treasury the power to further specify these definitions via statutory instrument.

Other Bill provisions

The Bill also proposes changing the 1986 Act in ways that would allow real-time virtual participation in annual general meetings (clause 2) and pave the way for reducing the administrative burden with executing documents (clause 3).

Similar provisions already apply to banks, which are governed by the Companies Act 2006, but not building societies, which are governed by the Building Societies Act 1986.

Progress of the Bill

The Bill passed second reading without division on 19 January 2024. It was reported unamended at committee stage on 7 February 2024. Its report stage is scheduled for 19 April 2024.

Response to the Bill

The Bill is welcomed by the sector which says the proposed changes to the funding limit exclusions will enable societies to access funds in times of difficulty, compete better with banks, and provide more mortgages.

1 Introduction

The Building Societies Act 1986 (Amendment) Bill 2023-24, bill 18 of the 2023-24 session, was introduced on 6 December 2023 by Labour MP Julie Elliott as a Private Member's Bill, presented to Parliament through the ballot procedure.

The Bill's second reading in the Commons was on 19 January 2024 and its committee stage was on 7 February 2024. The Bill was reported unamended with report stage scheduled for 19 April 2024.

The aims of the Bill closely mirror proposals made by the Government in December 2021.[1]

The Bill has extent across the UK. It will come into force two months after the day it is passed.

The explanatory notes for the Bill were drafted by HM Treasury with the consent of Julie Elliott.

[1] HM Treasury, Consultation: Amendments to the Building Societies Act 1986

2 Background

2.1 What are building societies?

Building societies are financial institutions with the principal purpose, established in law, of making residential mortgages, funded substantially by the society's members.[2]

Members are individuals who have a shareholding in the society by virtue of their savings, and/or have a loan from the society which is based on land (such as a mortgage).[3]

By contrast with banks, building societies are owned by their members, rather than by external shareholders.[4] Members are able to participate in general meetings and vote on resolutions.[5]

Not all customers of building societies are members. For example, individuals who only hold other products (for example, credit cards or personal loans) from the society, or business customers are not members.[6]

Statistics

As of January 2024, there are 42 building societies.[7] In 2022 their membership comprised about 23.4 million investors (those with qualifying savings) and 3.5 million borrowers.[8]

Mortgages

Building societies form a significant part of the residential mortgage market, though this has declined over time.

2 Building Societies Act 1986, pt 2, s 5
3 As above
4 HMRC, Corporate Finance Manual, CFM14080 (updated 21 December 2023)
5 Building Societies Association, "Democracy and efficiency: the strengths and weaknesses of one member one vote" (PDF) (accessed 9 January 2024)
6 Nationwide, "What membership means" (accessed 11 January 2024)
7 Building Societies Association, Building Society assets, 24 November 2023.
8 Building Societies Association, Long run historical operational statistics – extract from BSA Yearbook 2023-24, 16 November 2023

In the year to September 2023, building societies accounted for 25% of gross mortgage lending to individuals (£62.2 billion).[9]

As of the end of September 2023, the value of total mortgage balances outstanding to building societies was £376 billion, 23% of the £1.62 trillion total.

By contrast, prior to the 1980s building societies faced relatively little competition in the mortgage market. During the 1980s there was more competition from banks though by the mid-1990s building societies still accounted for around 60% of residential mortgages.[10]

A number of demutualisations (where building societies including Halifax, Northern Rock and Alliance & Leicester converted to banks) in 1997 took that share down to around 20% where it has remained since.[11] [12]

Savings

In September 2023, building societies held 19% of household cash savings in the UK (£371 billion of household savings).[13]

Branches and access to cash

Building societies have around 1,300 branches – down by about a fifth compared with 2015.[14] The number of bank branches has declined faster – more than halving since 2015.[15]

The Building Societies Association estimates that building society branches now make up 38% of bank and building society branches, up from 17% in 2014.[16]

9 Calculated from Building Societies Association, Building society mortgage lending, updated 29 November 2023 and Bank of England data via Building Societies Association, Mortgage lending, 4 January 2024

10 Commons Library research briefing 97/20, Building Societies, p10-12

11 Building Societies Association, "List of demutualised building societies", 1 April 2022

12 Building Societies Association, BSA Yearbook 2023-24, 16 November 2023, p94

13 Calculated from Building Societies Association, Building society deposits, 29 November 2023 and Bank of England data via Building Societies Association, Household savings. 4 January 2024, matching figures in BSA welcomes proposed changes to the Building Societies Act, 6 December 2023

14 Building Societies Association, Long run historical operational statistics – extract from BSA Yearbook 2023-24, 16 November 2023

15 Based on figures in Which? Bank branch closures: is your local bank closing? updated 4 January 2024 and Building Societies Association, Long run historical operational statistics – extract from BSA Yearbook 2023-24, 16 November 2023

16 Building Societies Association, Building Societies Trading Update: January - September 2023, 27 November 2023

2.2 Funding and lending limits

The Financial Conduct Authority (FCA) says:

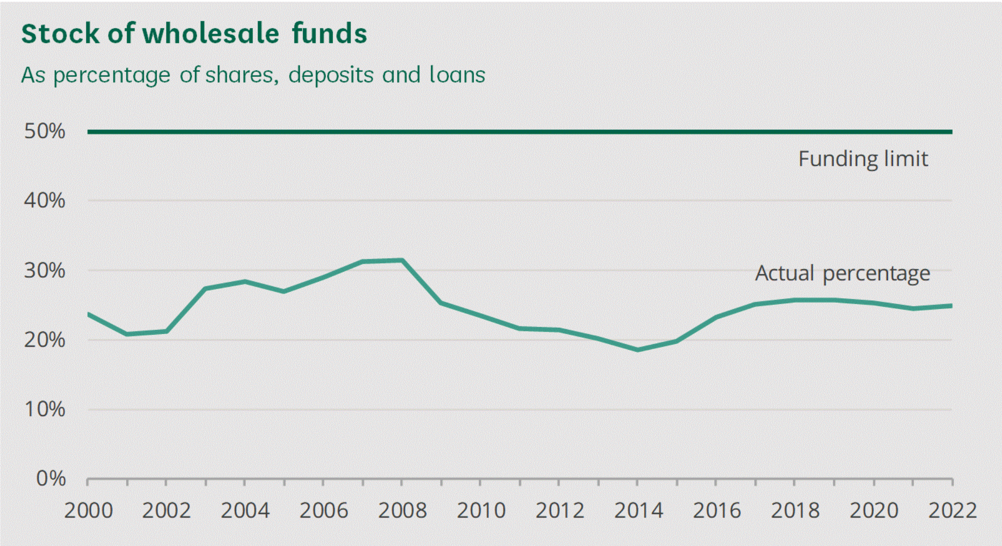
> Building societies are subject to lending and funding limits, which help to determine their compliance with the principal purpose test.[17]

These lending and funding limits are set out in the Building Societies Act 1986.

At least 75% of its business assets must be in the form of loans and mortgages secured on residential property (the lending limit).[18] At least 50% of a building society's funds (with some exceptions) must be raised in the form of member savings, while no more than 50% of funding can come from other sources, like bonds, (the funding limit).

The Building Societies Act 1986 (Amendment) Bill would change the rules governing the funding limit, to increase the flexibility of building societies to fund their operations from other sources (referred to as wholesale funding).

As shown in the chart below, in practice, building societies operate far below the 50% funding limit and have done so for many years.



Source: Building Societies Association, figures to 2021 from Sector Key Operating Ratios, 21 November 2023, 2022 figure via correspondence.

Data for 2000 excludes Bradford & Bingley, from 2009 excludes Britannia, from 2010 excludes Kent Reliance. Figures up to and including 2008 compiled from returns to FSA and are for end of the calendar year. Data since 2009 based on annual accounts data. Figures are weighted averages.

Years are financial years ending from 1 February in that year to 31 January in the following year.

17 FCA, FCA Handbook, BSOG 1.2.3 (accessed 9 January 2024)

18 Building Societies Association, "The Building Societies Act 1986 – A BSA Summary Sixth Edition", 5 December 2013

Societies operate with a buffer to ensure they don't breach the limit in adverse scenarios.

The average across all building societies was 25.0% in 2022, with the highest figure for an individual building society at 35.1%.[19]

Previous changes to the funding limit

The rules around the funding limit have been changed via legislation several times before.

The 1986 Act originally set the limit at 20%, which was extended to 40% and finally 50% with the Building Societies Act 1997.[20]

The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 allowed the Government to further increase the limit to 75% should it wish, though the Government never did so.

Speaking during the Bill's Commons Committee Stage, then-deputy leader of the Liberal Democrats Sir Vince Cable MP noted that Northern Rock, a building society until 1997, had said funding limits were crucial to its decision to demutualise and become a bank.[21]

This suggested raising the funding limit may reduce incentives for other building societies to demutualise.

However, Sir Vince also noted that few, if any, mutuals had taken advantage of the 50% limit they were allowed, though as mentioned earlier, building societies may operate far below the limit to provide a buffer, should they need to access wholesale funding in stress scenarios.

The Financial Services (Banking Reform) Act 2013 disregarded small business deposits as wholesale funding up to a maximum of 10% of the society's group funds.[22]

The rationale was that small business deposits are more like retail deposits than wholesale funding.

The Government's impact assessment said that the change may, in theory, benefit societies by giving them more flexibility with sourcing funding, but as

19 Building Societies Association, via correspondence – see notes under the chart for more on the data.

20 Cook, J., Deakin, S. and Hughes, A., "Mutuality and corporate governance: The evolution of UK building societies following deregulation", June 2001, p13

21 Financial Mutuals Arrangements Bill Deb 25 April 2007 c5-6

22 HM Treasury, Financial Services (Banking Reform) Bill Government Amendments: Building Society Changes (PDF), October 2013

no building society was near their funding limit, the change was unlikely to create direct monetary benefits.[23]

2.3 2021 Government consultation on changes to the Building Societies Act 1986

In December 2021 the Government consulted on proposed amendments to the Building Societies Act 1986.[24]

It said it believed the 1986 Act to be largely fit for purpose, but that there was interest and rationale in making changes to allow building societies to compete on a more level playing field with banks and promote competition within the financial services sector.

Its proposals are largely mirrored in the provisions in the Building Societies Act 1986 (Amendment) Bill 2023-24, though with some differences.

These largely concern proposals from the consultation being taken forward using secondary legislation rather than primary legislation:

- The Government proposed removing four types of wholesale funding from the funding limit calculation. One of these was deposits from businesses with less than £6.5 million annual turnover (deposits from businesses with turnover less than £1 million are already disregarded, with some qualifications).

  The Bill does not mention these deposits, but the Government said in a response to a Parliamentary Question that the turnover threshold will be amended using secondary legislation, as provided for under section 7 of the 1986 Act.[25]

  The rationale given for raising the threshold was that it would establish greater parity with banks.

  Since 2019 the largest UK banks have been required to separate core retail banking services, from their investment and international activities, known as ring-fencing.[26]

  Core services extend to banking services provided to businesses with a turnover of less than £6.5 million, which must be placed within the ring-fence.[27]

23 HM Treasury, Amendments to the Building Societies Act 1986, currently set out in Schedule 9 to the Financial Services (Banking Reform) Bill 2013 Validation Impact Assessment (PDF), 13 December 2013
24 HM Treasury, Consultation: Amendments to the Building Societies Act 1986, 9 December 2022
25 Correction to PQ HL 4237, 21 September 2023
26 Bank of England, "Ring-fencing", 31 January 2023
27 HM Treasury, "Ring-fencing information", 24 March 2017

- The Bill would provide a power to make regulations to specify types of funding which may be disregarded from the funding limit calculation. This regulation-making power was not explicitly mentioned in the consultation proposals.

- The Government proposed removing the requirement for two directors and the CEO to sign the balance sheet. This isn't addressed in the Bill but the Government has said this change will be made using secondary legislation under section 104 of the 1986 Act (which allows parts of the Act to be brought into line with companies law using statutory instruments).[28] [29]

- Responses to the consultation proposed removing the "normal retirement age" in the 1986 Act for directors. This requires directors above 70 who wish to be re-elected to have their age notified to each person entitled to vote and for the board to approve by resolution that the individual is eligible for re-election.

  Respondents to the consultation raised the issue of age discrimination and how this rule potentially contravenes the Equality Act 2010.[30] Equivalent provisions have been removed from the Companies Act 2006.

  The Government said it would legislate to remove the normal retirement age for directors, though this does not appear in the Bill.

  The Government has said these provisions will be removed using secondary legislation, also using provisions in section 104 of the 1986 Act.[31]

28 HL 4237 [on Financial Services: Regulation], 15 December 2022

29 Correction to PQ HL 4237, 21 September 2023

30 HM Treasury, Consultation: Amendments to the Building Societies Act 1986 Call for Evidence – Response, December 2022, p9

31 Correction to PQ HL 4237, 21 September 2023

3 What the Bill does

The Government's explanatory notes to the Bill say it will put building societies on a more level playing field with banks by increasing their fundraising capacity via exclusions from the funding limit (clause 1) and bringing administrative requirements more into line with banks (clauses 2 and 3).

The Bill extends to England, Wales, Scotland and Northern Ireland. It will come into force two months after the day it is passed.

3.1 Clause 1: Funding limit proposals

Clause 1 would amend section 7 of the Building Societies Act 1986 which sets the funding limit (see section 2.2). It would exclude three types of wholesale funding from the funding limit calculation, as specified in regulations to be made by the Treasury.

These are:

Amounts drawn from specified liquidity insurance facilities provided by the Bank of England

These comprise funding from the Bank in the form of cash or easily-monetised assets, which are exchanged for less easily-monetised assets. In its consultation, the Government considered that the limitation on a society's ability to access these facilities places them at a disadvantage in comparison to banks and could restrict societies' efforts to manage liquidity stress.[32]

Amounts represented by debt instruments issued by a society to maintain the minimum requirement for own funds and eligible liabilities

Building societies above a certain size must maintain what is called a minimum requirement for own funds and eligible liabilities (MREL). These are funds and liabilities which can absorb losses. The Bank of England explains that this ensures that investors, not the taxpayer, absorb losses when a firm fails.[33]

When a bank or building society is liquidated, creditors are paid in a priority order. For a liability to be eligible under MREL, it must be subordinated, which

32 HM Treasury, Amendments to the Building Societies Act 1986: Consultation, December 2021, p8-9

33 Bank of England, "Interim and end-state minimum requirements for own funds and eligible liabilities (MRELs)", 18 April 2023

means it is prioritised below other "preferred" debt when a firm is bankrupt and so is less likely than other debt to be paid back. Senior non-preferred debt is debt that is subordinated to the most senior level of debt but prioritised above other forms of subordinated debt.[34]

In its consultation, the Government said that as these form a small amount of a society's funding, it would not expect this to significantly change a society's funding composition.[35]

Sums received under sale and repurchase agreements entered into by a society with a view to complying with specified rules set by the Prudential Regulatory Authority (PRA)

Building societies are required to hold sufficient stock of high-quality liquid assets (HQLA). These can include cash or easily-monetised assets like gilts (UK Government debt). In its consultation the Government said that societies may monetise these assets through sale and repurchase agreements to test the liquidity of their portfolio and "avoid negative signalling during a stress scenario".[36]

However, when this happens, the HQLAs remain on the society's balance sheet, as well as the cash received for them, counting towards the wholesale funding limit "while no extra source of funding [is] created". They are essentially double-counted for the purposes of the funding limit.

In its consultation the Government said removing these sale and repurchase agreements from the funding limit would help societies manage their liquidity but that "as the amount of funding societies obtain from [sale and repurchase] activity is relatively small, we anticipate that this change would not significantly change the funding structure of societies".[37]

Clause 1 also gives HM Treasury the power to specify these funds, or the PRA rules relevant to the sums received under sale and repurchase agreements, via statutory instrument subject to the negative procedure.

3.2 Clauses 2 and 3: Corporate framework proposals

In its consultation, the Government explained:

> Building societies operate under a separate legal framework to companies, which recognises societies' member ownership model. However, the separate frameworks have not always been modernised at the same time. In some

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34 Regulatory Policy Committee, Bank Creditor Hierarchy Directive (PDF), 26 November 2018

35 HM Treasury, Amendments to the Building Societies Act 1986: Consultation, December 2021, p10

36 As above, p9

37 As above, p10

> places in the 1986 Act, building societies have legislative requirements which may place extra burdens on them in relation to companies.[38]

Clauses 2 and 3 would amend some rules specific to building societies.

Clause 2 would amend Schedule 2 of the 1986 Act. It would explicitly allow virtual member participation in meetings such as annual general meetings (AGMs).

Building society members with savings accounts are given the right to vote on resolutions at AGMs.[39]

However, the 1986 Act is not explicit about whether real-time virtual member participation at AGMs is allowed, whereas it is explicitly allowed for companies.

In 2020 the Corporate Insolvency and Governance Act temporarily allowed virtual participation in AGMs for building societies, in response to the Covid pandemic, but these provisions expired in March 2021.

Clause 3 would amend section 104 of the 1986 Act. It would enable the Treasury to remove the requirement that to execute a deed, building societies must affix a seal.

The Companies Act 2006 states that companies may either affix a seal or obtain the signature of directors, but the Building Societies Act 1986 requires a seal.[40]

Specifically, section 104 of the 1986 Act allows the Treasury to modify certain parts of the Act for the purpose of bringing it into line with company law. Clause 3 of the Bill would extend this power to Part 2 of the Act, with respect to seals and the execution of documents.

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38 HM Treasury, Amendments to the Building Societies Act 1986: Consultation, December 2021, p12

39 As above, p12

40 As above, p13

4 Progress of the Bill (Commons)

4.1 Second reading

The Bill's second reading took place on 19 January 2024.[41]

Members across the house were supportive of the Bill and the mutuals sector in general. Sponsoring the Bill, Julie Elliott MP (Lab) commented that the Bill would help building societies offer more mortgages to first-time buyers.[42] Sir Oliver Heald MP (Con) suggested the Bill might reduce the desire from building societies to become banks.[43]

Natalie Elphicke MP (Con), former director of the Principality building society raised some substantive points on the Bill.

On the proposal to allow building society members to virtually participate at AGMs Mrs Elphicke noted the value of face-to-face AGMs, saying:

> It will be important to ensure that a decision to proceed with virtual arrangements does not diminish effective participation, and that the decision is not made for other reasons, such as to cut costs or to hold an AGM somewhere more difficult for members to get to, on the basis that they can participate virtually. This particularly matters because, as the House has recognised, physical attendance has a special value.[44]

Mrs Elphicke added her desire that the Bill committee would consider increasing the protection of customer deposits under the Financial Services Compensation Scheme from £85,000 per customer per firm to £100,000 for building societies.

Finally, she added she hoped the committee would consider further steps to expand mutual funding structures beyond those in the Bill, to level the playing field with banks and increase competition.

Speaking for the Official Opposition, Tulip Siddiq MP (Lab) was supporting of the Bill, saying that the Labour party believed more legislation is needed to level the playing field with banks and secure the future of the mutual and co-operative sector.[45]

41 HC Deb 19 January 2024 c1131-1163
42 As above, c1131
43 As above, c1133
44 As above, c1146-1151
45 As above, c1158-1159

4.2 Committee stage

The Bill's committee stage took place on 7 February 2024.[46]

There was no substantive debate on any area of the Bill, no amendments were proposed and the Bill was reported without amendment.

Report stage is scheduled for 19 April 2024.

[46] HC Deb 7 February 2024, c1-8

5 Commentary

5.1 Industry response to the Government's 2021 proposals

As mentioned above, the Bill largely reflects proposals made in a consultation the Government published in December 2021, with small differences outlined in section 2.3. The Government published responses to its consultation in December 2022.

It received responses from three building societies, the Building Societies Association, and financial services company Hargreaves Lansdowne.[47]

All were in favour of the proposed changes to excluding sources of funding from the funding limit, agreeing the proposals would help building societies during stress scenarios, provide greater flexibility in accessing liquidity, and help promote competition with banks.

Additionally, some respondents raised the issue of funding from deposit aggregators, also known as intermediated savings platforms.

Writing for the House magazine website, chief executive of the Building Societies Association Robin Fieth explained:

> The way in which people save is changing, with people increasingly using savings platforms – online hubs that provide access to a range of savings accounts from different building societies and banks through one website. The structure of these platforms means that savings deposits are held in an aggregate account as non-member deposits rather than share accounts, even though the underlying cash is from individual savers. This means that under current legislation these balances are excluded from the 50% member funding limit.[48]

Respondents asked these funds either count as retail funding, rather than wholesale funding, or be excluded from the funding limit calculation.

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47 HM Treasury, Consultation: Amendments to the Building Societies Act 1986 Call for Evidence – Response, 9 December 2022

48 Robin Fieth, "Keeping building society legislation relevant for the 21st Century", The House, 22 March 2022

The Government said it would "commit to revisiting the treatment of funding obtained through the intermediated savings platforms in the medium term".[49]

All responses to the consultation were also supportive of the proposed changes to the corporate framework, namely allowing virtual participation in meetings and reducing the burden on signing balance sheets and executing deeds.

5.2 Response to the Bill

The Building Societies Association welcomed the Bill, saying it would enable building societies to lend more and level the playing field with banks.[50]

It said:

> The bill has been subject to significant consultation in recent years and has broad support from across the building societies and mutuals sector, as well as backing from both sides of the House.

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49 HM Treasury, Consultation: Amendments to the Building Societies Act 1986 Call for Evidence – Response, 9 December 2022, p6

50 Building Societies Association, "BSA welcomes proposed changes to the Building Societies Act", 6 December 2023

Annex 1: Members of the Public Bill Committee

Chair: Stewart Hosie (SNP)

Afolami, Bim (Economic Secretary to the Treasury)
Brine, Steve (Winchester) (Con)
Chamberlain, Wendy (North East Fife) (LD)
Dinenage, Dame Caroline (Gosport) (Con)
Elliott, Julie (Sunderland Central) (Lab)
Elphicke, Mrs Natalie (Dover) (Con)
Firth, Anna (Southend West) (Con)
Fovargue, Yvonne (Makerfield) (Lab)
Freeman, George (Mid Norfolk) (Con)
Green, Damian (Ashford) (Con)
Harris, Rebecca (Comptroller of His Majesty's Household)
Howell, Paul (Sedgefield) (Con)
Mearns, Ian (Gateshead) (Lab)
Morris, Grahame (Easington) (Lab)
Oswald, Kirsten (East Renfrewshire) (SNP)
Phillips, Jess (Birmingham, Yardley) (Lab)
Stevenson, John (Carlisle) (Con)

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