A manifesto for financial mutuals

What we are asking from the political parties and the next government

- recognition of the value of mutuals, demonstrated by a requirement placed on the regulators to set regulation which is appropriate and proportionate for different organisational forms

- extend the requirements on the regulators to carry out their statutory competition duty to include specific consideration of the impact of regulation on fostering diversity of financial services providers

- the removal of the restrictive barriers to raising mutual capital, making it easier to run and to set up new financial mutuals such as building societies, friendly societies and community banks

- a policy on lowering the barriers to entry for new financial mutuals to complement the regulation already in place to facilitate new plcs and privately owned challenger banks

- more joined-up thinking in terms of policies to promote mutuals and to coordinate government policies and initiatives in housing

Introduction

This Manifesto for Financial Mutuals brings together proposals from the Building Societies Association (BSA) and the Association of Financial Mutuals (AFM), which are designed to help the next government to deliver:

- a fair deal for consumers
- a level playing field for financial mutuals
- a rational approach by regulators to capital
- a more coordinated approach to promoting mutuals, creating a stronger savings culture and tackling the housing crisis

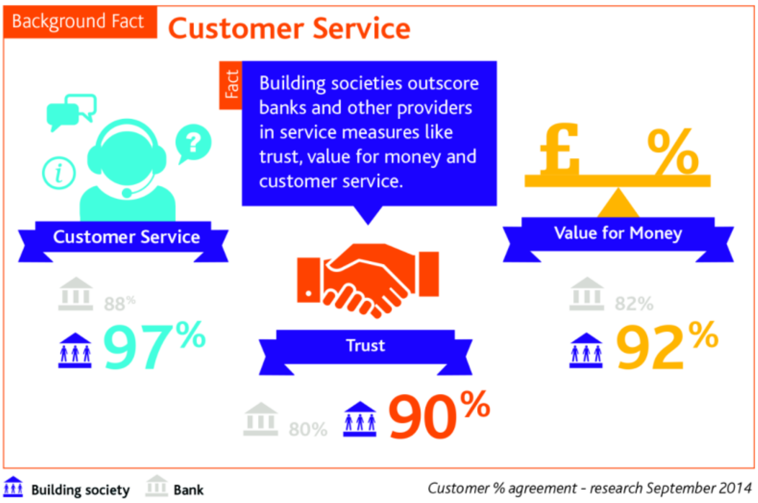
The financial services sector in the UK is critical to our economy, but a few years ago it nearly bankrupted our nation. The business practices of a few plc banks were largely to blame. The necessary reform programme is ongoing to restore confidence in the whole financial services sector. The Government's main approach has been through increasing regulation. But many politicians also recognise that having a more diverse range of firms in the financial services sector delivers a better deal for consumers and a more sustainable and resilient financial system.

Plc and mutual firms have equally valid business models but their purpose and approach to business is different. A plc has a primary duty to maximize shareholder value whereas a mutual's primary purpose, irrespective of its shape or size, is to create value for its members: customers and policyholders.

This structural difference matters

It is reflected day to day in the operational decisions taken and the experience and outcomes for individual customers. However it is not generally reflected by policy-makers and regulators, who appear to be fixated on a one size fits all approach based on the plc model - this imbalance tends to favour plcs, is damaging to mutual firms themselves and hampers their ability to deliver sustainable value for consumers and communities.

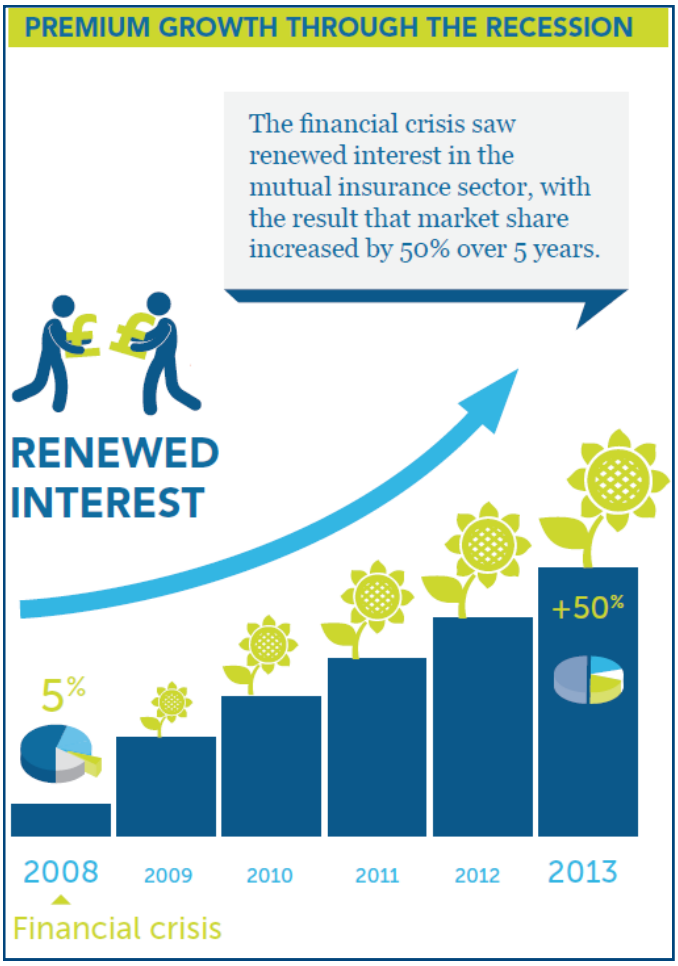
This manifesto sets out some important steps and policy proposals which we are asking political parties to adopt to enable the next government to restore the balance in financial services between plcs and mutuals, and explains why this is good for us all



1. A fair deal for consumers – the value of mutuals

A strong mutual sector provides

- better prices and service standards for members and customers
- a diverse supply of financial products for housing, savings and insurance
- local ownership and management of financial companies, more responsive to the needs and circumstances of local customers and businesses
- support for small and mid-sized builders through mortgage finance
- a long-term approach to value creation



How do mutuals help to achieve this?

- mutuals don't have shareholders in the same way as a plc. Their focus is on the needs of members and the delivery of long term value for them
- this focus is also shown in the delivery of a consistently better customer experience
- they operate at the lower end of the financial risk spectrum, demonstrated by a more consistent financial performance, giving consumers greater stability
- mutuals weathered the financial crisis better than plc banks and required virtually no direct state support
- building societies have been quicker to increase lending to consumers in the wake of the financial crisis. Mutual insurers saw their market share grow rapidly at the same time as plc insurers and lenders withdrew products
- mutuals have a strong track record of delivering good value products to people on limited incomes, and of providing innovative solutions to help people better manage their money
- UK mutuals are owned by people up and down the country; many are wholly locally owned and play an active role in their communities
- a significant number of mutuals operate within defined geographical areas and have a very good understanding of the needs and circumstances of local consumers. This gives them the confidence to lend when large plc banks have to rely on centralised rather than local criteria for assessing eligibility and affordability

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If political parties adopt the policies we outline in this Manifesto, then we believe that consumers will get a much better deal from a more diverse, responsive and sustainable financial services sector

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Mutuals supporting housing finance

In 2013 Leeds Building Society's membership grew to a record 714,000, helping thousands of people to buy their homes and build their savings. Innovation has been a strong part of its success and 30% of its new lending in 2013 was to first-time buyers.

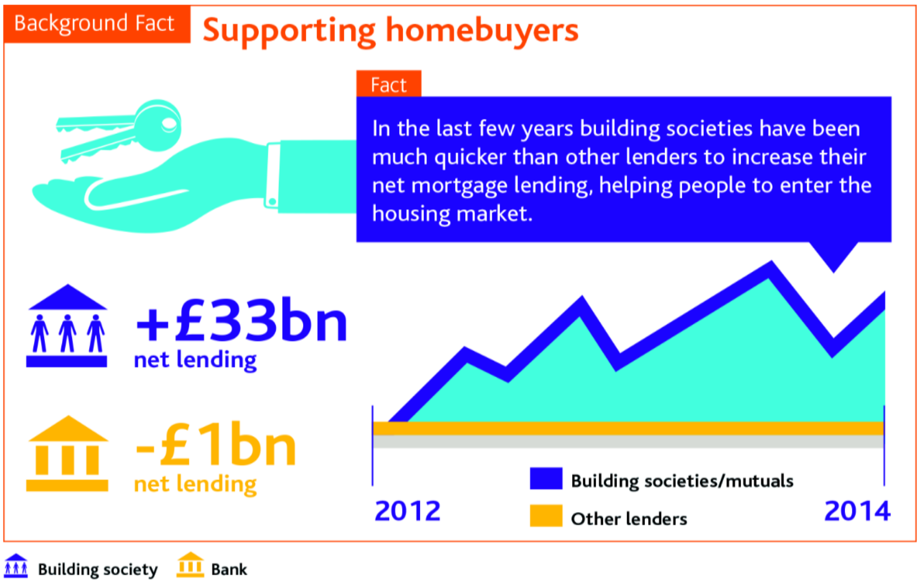
Since September 2012 the society has worked with Leeds City Council to help first-time buyers in the Metropolitan boundary of Leeds on to the housing ladder via a joint scheme. Called the Helping Hand scheme, it is aimed at those who have the means to be able to make the monthly repayments of a mortgage but cannot provide the large deposits required by some lenders.

Eligible first-time buyers are able to secure a property valued at up to £160,000 with just a 5% deposit and the Council underwriting the other 20% of the deposit. Leeds City Council set aside a total of £2 million for the scheme for an initial five year period.

The media reported that the first successful applicant was 30 year old John Egginton. Using the Helping Hand scheme he had been able to buy his first home in Kippax, a village and civil parish in the City of Leeds Metropolitan Borough. Two years previously John had rented with a friend but when his circumstances changed he moved back in with his parents to save money. He had intended to move out immediately and rent, but he found available lets hard to come by, expensive and low quality. At the same time buying seemed a pipe dream until he saw an advert for the joint scheme.

The Leader of the Leeds City Council, Councillor Keith Wakefield, praised the scheme as a great example of how new ideas can have a real impact on individuals. The scheme is also a major benefit to the local economy via all the related businesses which are part of buying or moving into a house.

A number of other societies have launched similar mortgage schemes in conjunction with local councils, including the Marsden, Leek United and Penrith building societies.



2. A level playing field for financial mutuals

The issue and why it matters

- some legislation has been slow to change for mutuals, leaving them at a competitive disadvantage to plcs
- the developing prudential regulatory framework is plc based, pays little or no regard to impact on firms with a mutual structure, resulting in an inappropriate and/or disproportionate regulatory burden
- an unbalanced market dominated by plc banks and insurers will lead to poorer outcomes for consumers and for society
- a thriving mutual sector adds competition, choice and a different business approach to the benefit of consumers and society
- in a future financial crisis, a more diverse banking and insurance sector should improve the sector's overall resilience; different ownership structures are an important aspect of this diversity
- policy-makers should require regulators to actively ensure that a range of different providers can thrive by considering the mutual model equally alongside the plc model

How can this be achieved?

The recently imposed requirement on the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) to consider the specific impact on mutuals of any new rules comes too late in the regulatory process – it needs to be embedded from the start of policy-making and regulation setting, rather than added on at the end as an afterthought.

A new government must legislate to create a statutory duty for regulators to foster diversity and to report to Parliament annually on the effectiveness of competition in financial services, including measuring the level of diversity, and the actions they have taken to promote mutuals

The mutual structure and mutual organisations should be treated side by side with other types of financial services businesses. Too often the legislation and regulation for the financial services sector focuses almost exclusively on big plcs and fails to consider the real collateral impact when applied to mutuals. One size does not fit all when it comes to regulating financial services.

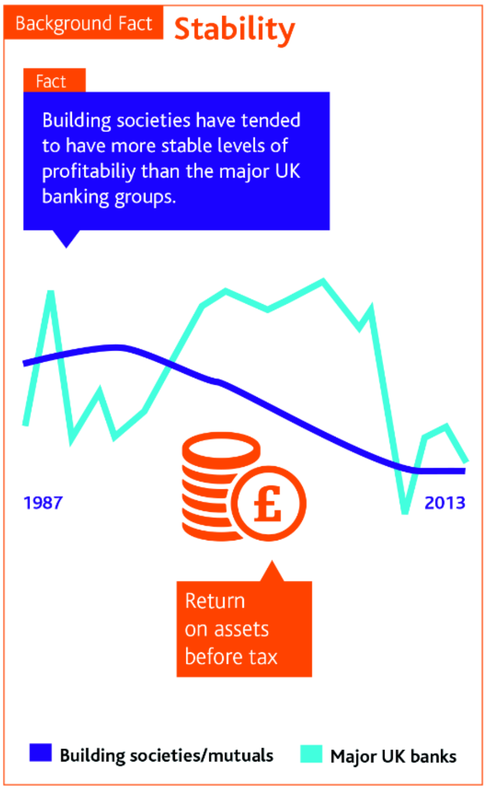
A new government must therefore create a regulatory regime that is appropriate and proportionate in relation to the different types of businesses being regulated

Legislation enabling mutuals to be able to communicate corporate information electronically to their members, for example, took eight years longer to be implemented than the equivalent for plcs. Mutuals can often find themselves at a competitive disadvantage to plcs due to this kind of time lag in legislative and regulatory reforms. This has meant that over the 20 year period since 1994, the UK has gone from having the largest mutual insurance sector in Europe (with more than half the domestic insurance market) to having one of the smallest sectors.

A new government must ensure that laws relating to mutuals keep pace with modernisations in laws governing plcs

The last update to the Friendly Societies Act was in 1992 and the legislation has now become outdated. It is restrictive, incompatible with company law and regulatory standards and ill-suited to modern forms of business. **A new government needs to modernise this legislation to enable friendly societies to operate more effectively.**

There has been no new mutual retail insurer or friendly society created since 1995 and no new building society since 1980. There are significant barriers to entry for a mutual, including the scale needed to meet regulatory expectations and the requirement to have a significant capital base. This reduces competition in general and reduces the potential for locally based solutions to people's financial needs.



A new government must create the policy and regulatory environment in which new mutuals can be developed to provide consumers with a more diverse choice of financial services

Tax Exempt Savings Plans are offered by friendly societies where deposits are invested on behalf of their members to provide a tax-free return. The last time the investment limit, which currently stands at only £25 per month, was raised was in 1995. **A new government should bring forward proposals to increase the limit to at least £50 per month to at least bring the limit in line with inflation.**

The Financial Services Compensation Scheme (FSCS) is vital in protecting consumer deposits. The current funding model means that building societies pay proportionately far more in relation to their total balance sheets than banks. Societies are currently paying up to 16% of their pre-tax profits to FSCS.

The unfair structure of the FSCS funding system needs to be urgently reviewed

Mutuals in insurance

LV= is one of the UKs largest financial mutuals offering a range of insurance, investment and retirement income products. Over the last decade, LV= has undergone significant change to become the business it is today. In 2006, Liverpool Victoria (as it was known then) was in a range of diverse product lines, had low brand awareness with no TV presence, was losing 10,000 customers a month and operating at a loss of £20 million. Since then, the company has embarked on a transformation, underpinned by mutual principles, by delivering excellent customer service and generating long-term member value.

As part of the turnaround, and to move with the times, the company rebranded in March 2007 to LV=. It kept the L and V, mindful of its heritage as Liverpool Victoria, but presented itself in a more modern and vibrant light. It’s shorter and more memorable, and the equals sign (=) shows that it is a society of ‘equals’ because it is owned by its members and doesn’t answer to external shareholders.

LV= also gave itself a new vision; to be Britain’s best loved insurer whilst its goal remained to grow member value. The business now has high brand awareness of over 70% and focuses on offering competitively priced products coupled with an excellent level of customer care. This customer service strategy has helped LV= achieve excellent renewal rates of circa 80% on general insurance products.

Today, LV= is the UK’s largest friendly society, with more than 5.5 million members and customers. Since 2006 it has made a number of successful acquisitions including Tomorrow, Britannia Rescue and Highway Insurance. The business has two main product areas in general insurance and life & pensions. It is the third largest private motor insurer in the UK with around 13% market share and is the UK’s most recommended insurer according to research by YouGov. Since 2006 the company has achieved year-on-year profitable growth and at year-end 2013 reported a pre-tax profit of £156 million. As a result of this financial success LV= has introduced a member bonus, which has paid out over £60 million in the last three years.

3. Rational approach to capital

A rational approach to capital would mean:

- mutuals being able to raise capital in new ways
- regulators avoiding disproportionately penalising businesses that represent a low risk to their objectives
- Governments and regulators not gold plating and front running EU legislative proposals
- setting capital leverage ratios by business model and risk

How can this be achieved?

Regulators need to better understand and appreciate the way in which mutuals operate.

They don't generally have access to the money markets to raise capital.

However, mutuals are treated as if they pose the same risks as those firms that use the money markets to finance their activities or supplement capital.

Much of the capital requirements framework in the UK has been designed purely on the plc mindset, severely affecting the amount and types of capital mutuals have needed to build up and the way it can be used. Mutual insurers have spent ten years engaging with regulators over capital rules that risk taking away much or all of their capital and restricting the way capital is used across their businesses.

Regulators in the UK also have a habit of gold plating and front running European and international regulatory initiatives. In terms of capital requirements, this can often result in disproportionate effects on mutuals given their limitations in terms of raising capital quickly.

The Financial Policy Committee's announcement on 31 October 2014 about the capital leverage ratio showed that the Bank of England had listened to some of the multiple concerns that had been expressed about the impact of a higher leverage ratio, introduced ahead of EU and international agreements. Overall, the framework that the FPC is recommending to HM Treasury is less draconian than feared, although certain elements such as the changes to how total qualifying capital is to be calculated remain unwelcome.

If the EU legislative process confirms the principle established in Article 511 of the Capital Requirements Regulation, for leverage ratios differentiated by business model, then the UK should accept and implement this

The introduction of Core Capital Deferred Shares (CCDS) for building societies was supported by the mutuals sector. We also welcomed the announcement in the 2014 Budget that CCDS would be eligible to be included in stocks and shares ISAs, yet the minimum denomination restriction of £25,000 imposed by the FCA meant that it is not possible for ordinary investors to benefit from this. The restriction also continues to prevent many smaller building societies from raising capital and all building societies from raising capital from their own members using CCDS.

Like members of industrial and provident societies who are able to invest in fundraising instruments such as mini-bonds, building societies should be able to make these products available to their members

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The BSA has given a qualified welcome to the FCA's consultation paper issued on 29 October 2014 which proposes a sensible way forward in terms of the retail distribution of CCDS and we have called for the £25,000 restriction to be lifted immediately.

A Private Members Bill (Mutuals' Redeemable and Deferred Shares Bill) has made good progress in the House of Lords, to provide mutual insurers with a similar form of deferred share to CCDS. The Bill has enjoyed cross-party support, and the sector has worked hard with the Treasury to demonstrate its value.

We are seeking Government time for the Bill to speed its path into law.

Mutual capital

Ecology Building Society has developed a new form of instrument to raise Common Equity Tier 1 capital, based on the Core Capital Deferred Shares (CCDS) model and consistent with its mutual status (one vote per member, regardless of size of shareholding). The Society seeks to expand its capital base to enable it to scale up its lending for ecologically positive projects across the UK.

Ecology began in 1981 with 10 members contributing £500 each, creating £5,000 in working capital, with no reserves. In 1983 the Society issued Deferred Shares which were taken up entirely by its members, making it the only building society to issue such shares under the 1962 Building Societies Act. These were finally repaid in full in 2004. Since forming, the Society has built up £125 million in assets, supported by £7 million in capital.

It would now be impossible for a building society to start small and to grow in the way the Ecology did, due to more onerous capital requirements and other regulatory burdens, meaning that any start-up society would require at least £1 million initial capital and other resources such as fully developed systems.

Ecology Deferred Shares (EDS) are more practical as a model for smaller capital raises than CCDS, which have a high cost of issuance (£1 million minimum). Ecology's market for capital is likely to be small ethical funds, charitable institutions and individual social investors; therefore any instrument must be easily digestible for this type of counterparty. EDS are intended to be available in multiples of £1,000, making them more suitable to smaller investors, and the Society is able to repurchase up to 5% of shares at any one time, at its sole discretion, to account for the lack of an established secondary market.

Ecology sought to engage the FCA from the earliest stages of developing the instrument. While expressing concern at the potential for EDS to be sold to 'unsophisticated investors', FCA representatives initially showed a positive approach in discussions. However, in spring 2013 the FCA warned that they would impose a one year ban if EDS were marketed to retail investors (including the Society's own members). In June 2013 the FCA announced that it planned to consult on a marketing restriction for such investments and would consider applying a temporary product intervention rule should any institution attempt to promote these shares to retail customers. A de facto £25,000 minimum denomination was established to prevent this.

The delay in releasing the consultation paper (issued on 29 October 2014) created uncertainty and 'planning blight' for the Society's capital-raising plans, and this will continue until the details of the marketing restriction are finalised.

4. Joined-up Government

A more joined-up approach from government is needed, including:

- specific responsibilities for the Cabinet Office to coordinate government policies to support mutuals
- the appointment of a Housing Minister at Cabinet level

How can this be achieved?

While there are growing calls from all parties and streams of opinion for a greater role for mutuals in areas as diverse as the NHS and financial services, there is currently little joined-up thinking across Government to drive the development of the mutual model or to coordinate Government policies across different departments.

France, The Netherlands, Belgium and Austria have all demonstrated that government can, through legislation, make it easier for mutuals to succeed.

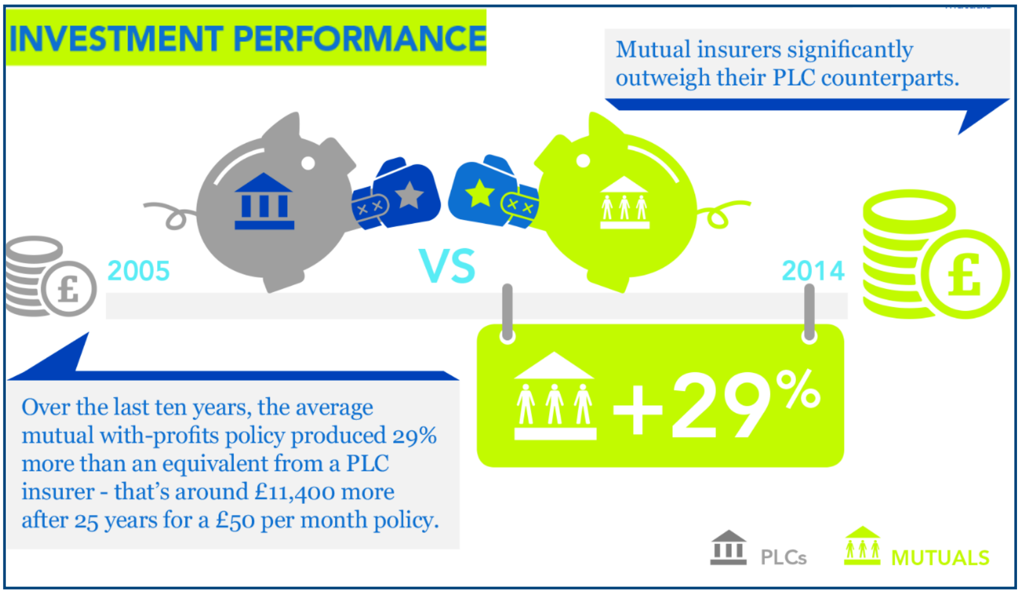
The Cabinet Office should have a dedicated function to champion mutuals in government, promote sharing of best practice and to drive forward government policies to support and foster mutual ownership across the economy

Housing is rapidly becoming a totemic political issue of the age. This is not surprising given the unfolding crisis in terms of lack of affordable accommodation in many parts of the country, leading to overcrowding and having a negative impact on the economy. Successive Governments have failed to get to grips with the housing crisis in part due to a structural failure in government which sees housing split across a range of government departments with no central voice in the Cabinet.

There needs to be a Housing Minister at Cabinet level empowered to coordinate government initiatives and actions across the broad range of issues which affect housing policy, including planning, construction and housing finance.

Similarly, the National Health Service is suffering from acute over demand and a severe funding crisis. As people live longer the problem will intensify. Mutuals are already working alongside the NHS to provide complementary services, to ease the financial burden on NHS trusts and to reduce waiting times, as well as to provide consumers with low cost solutions for essential care such as dental and optical cover. They also provide services such as rehabilitation and advice, which help people to get back to work more quickly, easing the impact on employers and the state.

Targeted government support would mean they could do more to help people take more responsibility for their own healthcare planning



benendenhealth
because life is precious

Mutuals in the UK healthcare economy

Health mutuals pre-date the NHS and were hugely influential on its creators. Now in 21st century Britain politicians and policy-makers must look again to community owned mutuals as a way to pool resources to benefit the health of society.

Benenden Health has been providing discretionary healthcare services to its 900,000 members since 1905. By doing so we remove millions of pounds every year from the NHS bill. But we believe mutuals can do more by working with Clinical Commission Groups (CCGs) and local authorities.

By using expertise in providing and commissioning services in a cost effective manner, while taking account of the wishes and needs of our membership community, we believe that mutuals have a great deal to offer in terms of the whole-person/ integrated care agenda.

However, there is more to health mutuals than purely helping to ease the financial burden on cash-strapped services; they also have a role to play in helping with the public health agenda. For example, we are able to engage with members on a regular basis to reinforce information on, and the importance of, healthy lifestyles.

In order for mutuals to be able to support the health and social care agenda there needs to be more recognition and understanding of the whole of the mutual sector (not just the employee owned model). This would enable officials to make policies that allow mutuals to thrive and ensure that the many qualities of mutualism can be utilised for the benefit of the whole of society.

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November 2014