S 3008

PREM 19/3802

Part Two

JM MT

Confidential Filing

Organization and structure of Building Societies
Mortgage Rates
House Purchase Finance Review Group

Housing

Part 1: May 1979
Part 2: July 1984

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~19.7.84~~		~~30.7.87~~					
~~1.8.84~~		~~31.7.87~~					
~~7.8.84~~		~~25.1.88~~ 27-1-88					
~~19.4.85~~							
~~8.5.85~~							
~~17.5.85~~							
~~20.5.85~~							
~~31.5.85~~							
~~4.6.85~~							
~~5.6.85~~							
~~26.6.85~~							
8.11.85							
~~27.11.85~~							
~~3.12.85~~							
~~6.12.85~~							

PREM 19/3802

chex.kf/ob1/30

(1) cc Chris
Jonathan (HM)

(2) BF 22/12 (MF)

Mary/. M. adams p/a
for New Year i/draws
Put to Chequers
Reg.
4/14.12

c - Alex.

Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

10 December 1992

Mrs Mary Francis
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Prime Minister

cc Ps/Chx
Ps/EC

Mortgage holders will benefit by over £4.5 billion a year from interest rate reductions since Britain left the ERM.

MF 11/12.

Dear Mary,

... The Chancellor thought the Prime Minister be interested to see the attached figures on how recent reductions in base rates are being passed on by banks and building societies to mortgage payers.

The attached table covers movements in mortgage payments from 1 December by five high street banks (Abbey National and the four main clearers) and the twelve largest building societies, which together account for about 8 million mortgages, over 80 per cent of the total.

The position at present is that around 4 million borrowers have had their monthly mortgage payments reduced by over £30 on average as a result of base rate cuts made since the UK left the ERM, giving an aggregate of £128 million a month in spending power to borrowers. By 1 January 1993, over 4.8 million borrowers will have received an average reduction of nearly £46 in their mortgage

payments since September. The total benefit to mortgage payers will be over £220 million a month.

The remaining 3.2 million borrowers in this survey are on building society annual review schemes. Their mortgage payments are adjusted annually, taking into account changes in interest rates over the previous year. Borrowers in this position do generally have the option of taking advantages of falling mortgage rates earlier if they apply in writing to the society.

2.7 million of these annual review cases are due to have their mortgages reduced by April 1993. The majority are paying around 11½ per cent at present and will enjoy a reduction of around 3 percentage points if base rates stay at their current level. The 1.2 million Halifax borrowers on annual review are currently paying 10.95 per cent and will therefore get a smaller reduction. The aggregate gain to mortgage payers on annual review will be around £156 million per month, bringing the total increase in mortgage payers' spending power since September to around £378 million a month, or £4.5 billion a year. Since the survey excludes smaller lenders, the true figure is almost certainly somewhat higher.

The remaining half million borrowers on annual review are with the Leeds and Woolwich Building Societies. They are currently paying around 10 per cent and their next annual review dates are in the autumn of 1993.

Of course, the overall economic effect will depend on the extent to which the increase in disposable income for borrowers is offset by a decrease in income for depositors, and the behaviour of those two groups.

In summary, most mortgage payers have already gained as a result of reductions in base rates since September and will benefit from a further cut in mortgage rates by 1 January 1993. But a significant number of borrowers on annual review schemes, who have not yet had their mortgage rates reduced, will see substantial reductions in their monthly payments in early 1993. Perhaps £¼ billion per month, or two thirds of the total increased spending power which we expect mortgage payers to receive as a result of reductions in base rates since September, has still to make its way into mortgage payers' pockets.

Yours,

Owen

OWEN BARDER
Assistant Private Secretary

chex.kf/ob1/31

TIMETABLE OF REDUCTIONS IN MORTGAGE RATES FROM 1 DECEMBER

Date	Event	Number Affected ('000)	Average Monthly Saving (£) *	Cumulative Number Affected ('000)	Cumulative Monthly Saving (£m)
1 Dec	9 socs and 5 banks reduce rates for existing borrowers to around 9¼ per cent	3,960	14.90 for most 36.10 (C & G) 31.85 (Northern Rock) 30.80 (Abbey National/N & P)	3,960	128†
15 Dec	Britannia reduces rates for existing borrowers to around 9¼ per cent	300	31.00	4,260	137
17 Dec	Woolwich and Bristol & West reduce rates for existing borrowers to around 8½ per cent	595	30.60 (Woolwich) 49.70 (B & W)	4,855	159
by 1 Jan	Other societies and banks reduce rates for existing borrowers to around 8½ per cent	4,260	14.80	4,855	222
Feb 93	Annual review date for Nationwide, Bradford & Bingley and National & Provincial borrowers (move from 11½ to 8½ per cent)	1,085	63.75	5,940	291
Mar 93	Annual review date for Cheltenham & Gloucester and Yorkshire borrowers (move from 11½ to 8½ per cent)	410	63.75	6,350	317
Apr 93	Annual review date for Halifax borrowers (move from 10.95 to 8.55 per cent)	1,200	51.00	7,550	378
late 93	Annual review dates for Leeds and Woolwich borrowers (move from around 10 per cent to ?)	495	-	8,045	

* based on mortgage of £33,000

† including effect of other mortgage rate reductions since September

mg1.dr/July92/min/019

UNCLASSIFIED

FROM: J P McINTYRE (MG1)
DATE: 17 July 1992
EXT: 4699

MR HUDSON

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir T Burns
Sir N Wicks
Mrs Lomax
Mr Turnbull
Mr Gieve
Mr Gray
Mr S Davies
Mr Franklin
Mr Woodman

Mr Butler - DNS

Prime Minister

Other key points :-
- nothing to do with Bundesbank's increase
- other Building Societies (eg Halifax, Nationwide) have said they will not increase rates

MF 17/7

CHELTENHAM AND GLOUCESTER

We spoke earlier about the C&G's statement this morning that their base mortgage rate is going up from 10.75 per cent to 10.99 per cent and that responsibility for this lies with the rate at which the new National Savings First Option Bond was launched last week.

2. I suggest the following line to take on this:

i. investment and mortgage rates are, of course, for individual banks and building societies to determine.

ii. a number of building societies had already introduced a similar product to the First Option Bond, with guaranteed rates over a fixed period.

iii. in setting the rates for the First Option Bond, the Government took account of the rates being offered in the market by building societies and insurance companies. the rates payable on First Option Bond are not the highest being offered. (First Option Bond rates are 10.34 per cent gross - 7.75 per cent net of basic rate tax - on amounts from £1,000 to £20,000; 10.74 per cent is payable on £20,000 to £250,000 - 8.05 per cent net).

iv. it should be noted that the First Option Bond guarantees a fixed rate for 1 year. The C&G statement refers to adjustments in their variable product rates.

v. DNS also offer variable rate products. The gross rate payable on income bonds (where the investor must give 3 months notice before withdrawals) is 9.25 per cent. The rate on the investment account (where 1 month's notice is required) is 8.5 per cent. These variable gross rates are therefore lower than the fixed rate offered on the First Option Bond.

vi. the Government has taken steps to create a more level playing field for savings institutions, with the introduction of TESSAs and the abolition of composite rate tax.

3. If the question of access to wholesale money is raised, you might also make the point that societies can get up to 40 per cent of their funds from the wholesale markets and that none of the big societies are close to that limit.

Defensive

Will government now reduce DNS rates?

DNS rates are under continuous review in light of market developments. Cannot speculate on if or when rates might change.

J P McINTYRE

CBG

27 January 1988

BUILDING SOCIETTES: SCHEDULE 8 REVIEW
STOCKBROKERS

The Prime Minister was grateful for the further information set out in your letter of 26 January. She has noted the restrictions proposed upon building societies' ability to own stockbrokers, in particular that stockbroking subsidiaries will be precluded from market making, and on this basis is content for the proposal to go ahead.

I am copying this letter to Miranda Harvey (Department of Trade and Industry) and Helen Ghosh (Department of the Environment).

(PAUL GRAY)

Guy Westhead, Esq.,
Office of the Economic Secretary,
HM Treasury.

53/2/LPD/3749/049

CABG.

Prime Minister

Content? X seems to me the key condition that makes this proposal acceptable.

PRC6
26/1

ECONOMIC SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Paul Gray Esq
Private Secretary to the Prime Minister
No.10 Downing Street
LONDON
SW1

26 January 1988

Yes

Dear Paul,

BUILDING SOCIETIES : SCHEDULE 8 REVIEW : STOCKBROKERS

The Prime Minister asked for further information about the proposal to allow building societies to own stockbrokers (your letter of 25 January.)

Building societies are already allowed to give advice on investments to individuals and to make arrangements with stockbrokers for a share dealing service. Societies will be able to give their customers better informed advice and a faster, more integrated service if they are allowed to take a stake in, or acquire, stockbroking firms. This will allow them to cement brokership arrangements, and to acquire the necessary broking, research and settlement expertise. Our present intention, subject to further detailed work, is to require that building societies' stockbroking subsidiaries ensure that a significant proportion of their business (something like a half) is for individuals. This will encourage building societies to establish shareshops in their high street branches, which will give a welcome boost to wider shareownership.

X1 It is proposed that societies' stockbroking subsidiaries will be precluded from market making; the riskiest aspect of broking. In addition societies will have to ensure that customers have funds in their accounts before the society deals on their behalf thus removing the main risk of agency brokers - non-settlement. The broking subsidiaries themselves will be supervised by the Securities Association, and will have to meet in full the capital and conduct rules of the TSA. The Building Societies Commission will retain their role as lead regulator of all building societies' activities and the two supervisors will make arrangements to co-ordinate their activities.

I would be grateful if you could let me know if the Prime Minister is now content for an announcement to be made as soon as the necessary Parliamentary Question can be put down.

I am copying this to Miranda Harvey (DTI) and Helen Ghosh (DOE).

Yours sincerely,
Guy R. Westhead

GUY WESTHEAD
Assistant Private Secretary

HOUSING: Building Societies
Pt 2

CONFIDENTIAL

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

25 January 1988

REVIEW OF SCHEDULE 8 OF THE BUILDING SOCIETIES ACT 1986

The Prime Minister has seen your letter to me of 22 January and is broadly content with the proposals. She is however a little concerned about the proposals that societies should be allowed to own stockbrokers. I should be grateful if you could let me have a note detailing the limitations that are proposed in this area.

I am copying this letter to Miranda Harvey (Department of Trade and Industry) and Helen Ghosh (Department of the Environment).

PAUL GRAY

Guy Westhead, Esq.,
Economic Secretary's Office,
H.M. Treasury.

CONFIDENTIAL

53/2/MAD/3749/30

CONFIDENTIAL

Prime Minister
Content?

Treasury Chambers, Parliament Street, SW1P 3AG

Paul Gray Esq
Private Secretary to the Prime Minister
10 Downing Street
LONDON SW1

22 January 1988

Dear Paul,

REVIEW OF SCHEDULE 8 OF THE BUILDING SOCIETIES ACT 1986

The Treasury and the Building Societies Commission have been reviewing Schedule 8 of the Building Societies Act 1986, which lists the new financial and housing related services that societies are permitted to provide. The Economic Secretary proposes to announce the results of the review, and a number of proposed extensions to societies' powers, on Tuesday 26 January by means of a written PQ and Treasury press notice.

At present the Act is framed so as to prevent societies from undertaking new financial services activities unless they are expressly provided for in Schedule 8. This creates problems because the detailed terms of the Schedule may not correspond exactly to the best commercial way of doing things. The review has had two purposes. The first was to examine whether Schedule 8 could be recast so that it permitted any activities within certain broadly specified areas instead of banning everything except narrowly specified activities.

The review also considered the Building Societies Association's request for a substantial extension of societies' powers. The original intention was to allow societies time to gain experience of the new activities already permitted under the Act, and then to use the Act's quite considerable secondary powers to liberalise step by step over a period of years adding or widening one or two powers at a time.

It is now clear that this step by step approach has drawbacks. We have always recognised that different societies might develop in different ways as best suited their commercial circumstances. Indeed

within the range currently permitted individual societies have been commendably cautious in extending into only a limited number of new areas. Societies have argued, in pressing for liberalisation, that they need to be able to plan a few years ahead knowing what will be legislatively possible. They tend each to want to extend into only one or two new areas. And these differ from society to society. So step-wise liberalisation would arbitrarily meet some societies' wishes whilst frustrating others until their turn came up for their favoured deregulation.

We therefore propose to replace the step by step approach by an immediate wider measure of deregulation, and rely on prudential supervision (with limitations via capital requirements and proven management caution) to prevent any individual society diversifying excessively.

It is intended that the mainstream business of societies should remain that of raising funds from the public for lending for home ownership. But, following discussions with the Chancellor and the Parliamentary Under Secretary for Corporate and Consumer Affairs, the Economic Secretary has concluded that it is right that societies should be allowed to undertake activities which either complement their mainstream business or which will enable them to compete more effectively by providing the wider range of financial services which customers expect of financial institutions. Societies will, as at present, continue to provide services primarily to the personal sector, rather than to companies. But the Economic Secretary has decided that societies should also be allowed to:

a. own both life assurance and, with restrictions, general insurance companies;

b. manage unit trusts generally (rather than just for the provision of pensions, as at present);

c. own stockbrokers (subject to limitations);

d. offer a wider range of banking and housing related services than hitherto.

There will be some limitations on these new powers. The Economic Secretary does not consider that it would be appropriate for societies to become involved as stockbrokers in market making, nor would it be desirable for societies to become fully exposed to the risks inherent in general insurance business. The draft orders which will be brought before the House in due course will set out the proposed restrictions.

Two other changes to the Act are also proposed. First, societies have represented that the limit on unsecured lending to individuals, currently £5,000, is too low. This limit covers personal loans for such items as furnishing and cars as well as credit card limits. It is proposed to increase the limit to £10,000. This is far less than the increase to at least £25,000 requested by the BSA. But the Economic Secretary believes it will be adequate for legitimate lending purposes whereas a higher figure might arouse concern about diversion of potential mortgage lending into other personal credit.

The Building Societies Commission will ensure that societies continue to have adequate credit assessment and exposure monitoring systems.

The second change concerns the asset limits built into the Act. These limits restrict the assets that societies may hold outside the traditional area of loans secured on property. It is proposed to bring forward an order which will provide for staged increases in these limits to the maximum extent possible within the Building Societies Act by the early 1990s.

This gradual relaxation will prevent societies from diversifying into new activities too rapidly, though the main restraint apart from managerial caution, will be prudential supervision of business plans by the BSC.

I am copying this to Miranda Harvey, Private Secretary to the Parliamentary Under Secretary for Corporate and Consumer Affairs at the Department of Trade and Industry and to Helen Ghosh, Private Secretary to the Minister for Housing and Planning at the Department of the Environment.

Yours sincerely,
Guy Westhead.

GUY WESTHEAD
Assistant Private Secretary

PA

psl/53K

RESTRICTED

CC/3C.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

31 July 1987

D R Norgrove Esq
10 Downing Street
LONDON SW1

Dear David

BUILDING SOCIETIES AND CREDIT CARDS

The Building Societies Act gives societies a variety of new powers in the housing and personal finance field, including the power to lend unsecured. Societies can now, therefore, offer personal loans. They do not have a specific power to issue credit cards but, because credit card lending is one form of unsecured lending, societies have assumed that they are able to issue them. There is, however, a technical defect in the Act which, if not corrected, effectively prevents societies from issuing cards as principals, although they can (and indeed already do) issue cards as agents for banks. The defect is relatively easy to remedy, requiring an affirmative resolution to be laid and debated.

Although the Government is not committed to permitting societies to issue credit cards, the Chancellor believes it would be wrong to prevent them from doing so if they wish to. The three largest societies (which between them hold over half of the society retail share market) have indicated that they do wish to issue cards. They will provide a useful competitive stimulus to the banks which dominate the credit card business. And both the Chancellor and the Building Societies Commission are satisfied that societies can prudently engage in credit card lending. The Commission will ensure that societies' internal systems are adequate and will commend to societies the use of the various credit reference agencies.

The Chancellor has considered carefully whether a move on this now might raise new doubts about the Government's stance on credit growth. He is satisfied, on the advice of the Bank, that the impact on credit growth is likely to be minimal. Much society lending will simply displace other forms of credit. And one of the three societies which wish to enter this market already issues a credit card as agent, with funds provided by a bank. There is clearly some

RESTRICTED

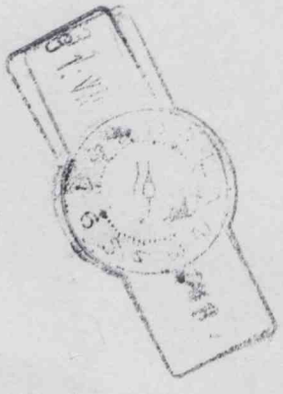
presentational risk. But the Chancellor believes, as do the Bank, that it will be possible to prevent an untoward market reaction by suitable background briefing by the Bank and the Treasury. This will point out the displacement effect on other credit and emphasise that this is not a substantive new power for societies.

The Chancellor has also considered the timing of the announcement. It is important that the announcement be low key. He therefore proposes that the Building Societies Commission should write to the societies next Monday, 3 August, informing them of Ministers' decision to table the necessary Order when the House returns in the autumn. There will be no press notice. But suitable background briefing will be prepared for use as necessary.

Yours ever,

Tony

A W KUCZYS



PRIME MINISTER

MORTGAGE RATES

The position remains rather confused.

Two days ago Abbey and the Halifax were discouraging expectations that their mortgage interest rates for existing borrowers would be reduced to match those for new borrowers. Yesterday, Abbey announced a decision to bring them together at 10.5%. Halifax has a rate for new borrowers which is at present 10.8%, and has said it will reduce its rate for existing borrowers on 1 September but has not said the level it will set. Nationwide have said it would be "barmy" to cut rates.

Nat West and Lloyds are at 10.5% and 10.8% respectively. Nearly everyone else is at 11 per cent or more.

MEA

D.R.N.
31 July 1987

PMMAFA

10 DOWNING STREET

2

Prime Minister

To note the publication of this consultative document with the Building Societies Bill today, Friday.

TSB problems caused the Treasury to handle it this way. Substantive clauses will be put down at Committee stage.

DKN

6/12

BUILDING SOCIETIES BILL

CONVERSION OF BUILDING SOCIETIES TO COMPANY STATUS
A consultative paper by HM Treasury

The Government has announced that the Building Societies Bill, which is published today, will contain provisions allowing building societies to convert themselves into public limited companies, with the approval of their members. In view of the complexity of the issues, the Government has decided to seek comments on a possible scheme before introducing substantive provisions into the Bill during its passage through Parliament. This consultative paper sets out the Government's present thinking. Comments are invited by 31 January 1986, and should be sent to Mr R.B. Saunders, HM Treasury, Parliament Street, London SW1P 3AG.

Introduction

2. There are two broad reasons for having such a procedure. First, the underlying objective of the new legislation is to allow building societies greater scope to increase the range of services they offer to the public, while continuing to be recognisably distinct and specialist institutions. But the greater range of powers open to societies will inevitably mean that different societies will evolve in different ways and at different speeds. Some may in due course find that the logic of their further commercial development is no longer consistent with the constraints appropriate for building societies generally. The option of becoming a company, no longer subject to building society legislation, would be an important one in such cases.

3. Second, at a time of rapid change in the financial and housing services offered to the public, such developments could provide a stimulus to competition. To the extent that conversion to company status allowed different forms, a society either going it alone or making the change in conjunction with some other institution, the range and variety of institutions competing in this market might be further increased.

4. A building society which became a company would no longer be covered by building society legislation. It would instead be registered under the Companies Act, and would require deposit-taking authority under the Banking Act with all that that implies. It might have been possible in principle to devise other types of corporate status, for example joint-stock companies registered under the Building Societies Act and subject to its provisions, like the "stock thrifts" in the United States. But legislating to provide for a new type of body corporate under UK law in this way would be a matter of extreme complexity without apparent compensating benefits. It would be an unsatisfactory hybrid, neither a building society in the conventional sense nor a company free to develop in its own way.

The need for safeguards

5. It would be wrong however if the procedures were set up in such a way as to encourage conversions to take place for the wrong reasons. If an outside institution were able to hold out the prospect of an immediate distribution of shares to members of the society, and offer to buy them at a significant premium, that could be highly destabilising. Members might be tempted by what was in effect a cash bonus rather than consideration of what was in the best long term interest of their society, secure in the knowledge that they could transfer their money to another building society once the process was complete. This could precipitate a rush of conversions involving too rapid and disruptive a change to the building society movement, as well as liquidity problems for newly converted companies. As has been the experience in the USA with conversions of mutually-based savings and loan associations to joint-stock status, there could be large speculative movements of funds between societies on rumours of impending conversions.

6. The process must also ensure clear definition and protection of the rights of shareholding members in building societies. That must be done in such a way as to ensure reasonable continuity and not to provoke a rush of ill-founded conversions as a result of a too readily encashable benefit being conferred on members.

The rights of shareholders

7. Shareholding members have certain rights in their building society. In some ways, their legal and constitutional position is similar to that of members of a company. Both have rights to vote on resolutions and in electing the board of directors. But there are fundamental differences between them.

a) Building society elections are generally conducted on the basis of "one member, one vote", unlike companies where voting rights are in proportion to the number of shares held.

b) Building society shares are withdrawable, capital certain and non-transferable. They earn interest related to market interest rates, not to the profitability of the society. In all these respects, they differ from shares in companies. The effect is that, in financial terms at least, they are more like subordinated deposits. Indeed building society shares and deposits are treated in the same way for many purposes, for example the application of composite rate tax, and building society share accounts compete directly with bank deposit accounts.

8. Shareholders in both companies and building societies have contingent rights to the residual reserves in the event of a winding up. For obvious reasons, however, this is a largely theoretical benefit for a going concern. But, notwithstanding the theoretical similarity, the direct financial benefit is very different in the two cases.

9. There are very few circumstances in which a building society shareholder's interests in the reserves are reflected in any direct financial way. There may sometimes be a small bonus payment to members on a merger, but that would represent at most only a fraction of the society's reserves. The company shareholder, on the other hand, will see the value of his asset fluctuate as its market price changes. While a great many other factors influence share prices, particularly in the short term, there is often a broad correlation between the underlying net worth

of a company and its market value in the longer term. To that extent, therefore, a company shareholder may be able to realise his stake in the company in a way that a building society shareholder cannot. Moreover, the building society shareholder has paid nothing for his contingent interest in the reserves, which have been built up by past members. In contrast, the company shareholder will have subscribed capital or otherwise paid for his interest in the reserves when buying his shares.

10. There is thus no general equivalence between the rights and expectations of shareholders in building societies and companies respectively. Most building society shareholders would not want their investments - which they will regard as deposits - turned into company shareholdings after a conversion. They would become deposits instead. It does not follow that their interest in the reserves of the society should be protected by their automatically becoming shareholders in the new company rather than by some other means. It would not be possible to provide an exact continuation of the precise rights enjoyed by shareholders before conversion. What is clearly essential, therefore, is to give the members full opportunities to consider and approve any proposal, to ensure that their interests are properly reflected.

Voting requirements

11. A decision by members of a society to go ahead with conversion needs to be properly informed and taken by a sufficient number of them. There must be voting thresholds high enough to reflect the profound change in the nature of the institution that is involved.

12. Any proposal for conversion would therefore require approval by a special resolution of the society, to be carried by at least 75% of investing members voting. It would also be subject to a "borrowing members' resolution", as with mergers under the proposals in the Building Societies Bill, requiring the support of 50% of borrowers voting, because the change of status might well affect policy on, for example, interest rates charged to borrowers. The best way to safeguard the interests of borrowers would be to require their approval of the prosposal. The resolution would also have to be approved by a prescribed minimum proportion of investors eligible to vote. The appropriate figure should

certainly be no less than that for a small building society to merge with a much larger one, for which 20% is provided in the Bill.

13. Regulations will set out in detail the information to be circulated to members ahead of voting on these resolutions, as described in more detail in the Appendix. This would include information about the financial position of the society, interests of directors and compensation payable to them, and any proposed changes in the terms of mortgages, as for mergers. A conversion proposal would also include the proposed memorandum and articles of association of the new company, and appropriate confirmation from the Bank of England about the granting of deposit-taking authorisation under the Banking Act.

14. Information would also need to be given about the terms of any issue of shares in the new company. To the extent that this constituted a prospectus, it would need to comply with all the relevant requirements for new issues and, where appropriate, for a Stock Exchange listing.

The conversion procedure

15. The legislation will need to set out the broad framework within which particular conversions could proceed. Central to this would be the basis for issuing shares in the new company.

16. The Green Paper "Building Societies: A New Framework" discussed the possibility of a "scrip" issue of shares to all existing shareholders in the society, to the full value of the reserves. This would in effect convert the reserves into shareholders' funds in the company sense. Investors in the building society would have their shareholding converted into a deposit, but would also at once become shareholders in the new company. But this combination of a shareholding in, and a deposit with, the new company would amount to more than just a shareholding in a building society. To provide for it might limit the flexibility that should be allowed to deal with the particular circumstances of individual cases. Moreover, as discussed above, an issue of immediately marketable shares could precipitate too disruptive a series of changes.

17. It would be perfectly proper however to recognise the contingent

interest of members of the building society in its reserves without giving them the option of cashing them in immediately, by delaying the issue of shares to them. This could be arranged in such a way as to promote other desirable outcomes, notably encouraging building society members to subscribe for shares in the new company and encouraging them to stay on as depositors rather than taking their money to another building society.

18. There would be a public offer of shares, with investing shareholders in the society given a statutory right to priority in the allocation. Further benefits would be available to them as follows.

a. After one year, those who subscribed to the issue would become entitled to a bonus scrip issue, in relation to their original holding with the society.

b. After a further year, the others might be offered a choice between a cash bonus not exceeding, say, 1%, or some form of share interest in the company. This would continue the voting rights of former members and their interest in the reserves, but might not immediately enjoy other benefits of ordinary shares, such as dividends or full marketability, for example by making voting rights not transferable when the shares are sold.

In all cases, it would be necessary to confine these benefits to members of some standing, so as to forestall speculative flows of money on rumours of imminent conversions. A possible criterion might be those who had been members for at least 2 years before the share issue and one year before the business transfer resolution.

19. Provisions on these lines would provide members of the society with incentives both to participate fully in the new company and to retain their deposits. At the same time it would give them at least the protection and benefit that they could have expected had the building society remained as such rather than converting to company status.

Ownership

20. On conversion, a building society would probably need to

increase its capital in view of the greater range of business which it would be able to undertake as a company. It is quite likely that terms for a share issue discussed above would be sufficiently attractive to members of the society that they would provide most, if not all, of the funds. That would clearly be a very satisfactory basis on which to proceed. But the possibility must be acknowledged of a substantial proportion coming from outside sources. It would be wrong if that need for additional capital were to lead to a loss of the new company's independence as the price for raising it.

21. A former building society would need to establish itself in the company sector, to build up a track record and to develop investor confidence. In the early stages, it might find itself vulnerable to takeover through no failing of its own but simply because the business and investment community had not had sufficient time to assess its prospects. In the special circumstances of an institution adapting to a new environment of company and banking legislation, it may be appropriate to provide some restrictions on initial ownership. This might take the form of a requirement that no person, or connected group of persons, may hold 15% or more of shares issued for the first five years of the new company's life.

22. There should however be room for flexibility. There might well be circumstances in which a takeover during the first five years would be best for shareholders in and depositors with the company. There would therefore be a provision that the 15% limit on individual shareholdings could be varied or revoked upon a vote in favour of such a proposal by the holders of at least 75% of shares; such a vote could not be taken in the first two years, before the issues of shares to former members had taken place.

23. There may also be circumstances in which an immediate takeover by an outside institution would best serve the members of the society. These circumstances would probably be exceptional, and would therefore need an exceptional level of membership approval. Thus, a society might be allowed to transfer its engagements to an existing company, rather than to a new company set up by the society, if approval was forthcoming from at least 50% of investors eligible to vote, and from holders of 90% of share capital. The

Building Societies Commission would have discretion to waive the voting thresholds in cases where societies have run into difficulties and a transfer to a company would be the best way of securing the capital of shareholders and depositors.

24. Under this accelerated procedure, the steps outlined earlier for a normal conversion would have to be conflated. There would be a no share issue to investing members, because the engagements were being transferred to an existing company. But there would be a bonus payment to investors representing at least the full value of the reserves, though perhaps subject to a maximum.

25. There would however be scope for these safeguards to be nullified by a society entering into a series of long-term agency agreements with another financial institution which would take effective control before it could do so in shareholding terms, thus pre-empting the decisions of members. To prevent this, the legislation might provide for all agency agreements of the society to be terminated two years after vesting in the new company, except those expiring in any case before then. The new company would be required to provide in its articles of association that new agency contracts during the first five years should have terms of no more than three years, or if not have been approved by special resolution of the company. This requirement could be removed by resolution of the company in the same way as that restricting individual shareholdings to 15%.

Tax

26. A building society which became a company would enter a different tax regime. It would be subject to the banks' scheme for payment of composite rate tax, rather than that applying to building societies, and to the payment dates for corporation tax applying to companies, which differ from those for building societies.

27. The transfer of trade from the society to the new company would not in general have tax consequences, although capital allowances on assets not used for the purposes of trade could not be carried forward. Whether or not the conversion process would trigger the provisions imposing tax on distributions would depend on whether the society was "wound up" within the meaning

of the Income and Corporation Taxes Act 1970. Without specific legislative provision, the transfer of assets to a new company, no longer owned by the society, could give rise to a capital gains tax liability.

28. The process would also need to ensure that the body remained subject to composite rate tax arrangements and part of the MIRAS scheme without a break. The extent to which these and the points discussed above require specific tax legislation will be considered further.

Conclusion

Not attached

29. The Appendix to this paper pulls together the main proposals in earlier paragraphs and fills in further details, in the form of an outline scheme for conversion. It is not intended to provide all these details in legislation. New Clauses will be introduced during the passage of the Building Societies Bill dealing with those aspects which need to be covered by primary legislation. More detailed provision will be made in subsequent Regulations, although it is intended to leave sufficient flexibility to accommodate the different circumstances of different cases. Comments are invited however on the basis of the scheme as outlined in the Appendix.

(2)

PRIME MINISTER

The Building Societies Bill is published tomorrow. The Lord Chancellor is arranging for a Statement to be made about the way in which "conflicts of interest" are to be avoided. I attach the draft reply.

MGA

(Mark Addison)

5 December 1985

QUESTION

To ask Mr Attorney General, if he will make a statement about the way in which it is proposed to exercise the power to recognise institutions as suitable to offer conveyancing services to the public, provision of which is to be made in the Building Societies Bill.

The Government issued a consultation paper last year seeking views on the way in which conflicts of interest and anti-competitive practices could be avoided if building societies and other financial institutions were to offer conveyancing services to the public. Following that consultation, the Government has concluded that there is no difficulty in principle in such institutions providing conveyancing to persons to whom they are not also offering a loan. However, the Government is not satisfied that lending institutions could safely be permitted to offer both conveyancing and a loan in the same transaction. It is therefore proposed to prohibit lending institutions from providing conveyancing, either directly or through a subsidiary company in which they hold a majority stake, to those who are also borrowing from them.

The Government is also examining the possibility of estate agents providing a combined service of sale and conveyancing to vendors, and of lending institutions providing conveyancing to borrowers from them through subsidiary companies in which the lender holds only a minority shareholding. Consultation on those matters is not yet complete.

It is also proposed to set a number of other conditions to ensure proper consumer protection. In particular, institutions will be required to ensure that their conveyancing work is supervised by a qualified person; and adequate arrangements will have to be made to protect the consumer against negligence or fraud on the part of those providing the service. Details will be announced in due course, after further consultations with the interests concerned.

lile (32) ECA

bc BG.

10 DOWNING STREET

From the Private Secretary

27 November 1985

CONVEYANCING BY LENDING INSTITUTIONS

The Prime Minister has seen your letter to me of 8 November and noted the proposed provisions to be included in the Building Societies Bill about conveyancing services provided by lending and certain other institutions.

I am copying this letter to Joan MacNaughton (Lord President's Office) and Richard Stoate (Lord Chancellor's Office).

(David Norgrove)

Mrs. Rachel Lomax,
H.M. Treasury.

Nick Owen
Hear, hear! Thank you. NBPM.

CONFIDENTIAL

MR NORGROVE

14 November 1985

CONVEYANCING BY LENDING INSTITUTIONS

I have seen Rachel Lomax's reply to your inquiry of 28 October.

The position we have reached is not, of course, a satisfactory one. Why would a building society be motivated to carry out conveyancing for other building societies' borrowers? And what help is it to the borrower, compared to existing arrangements? However, it was a long battle in Cabinet and elsewhere, even to secure this. Given the outright opposition of the Lord Chancellor to lending institutions becoming involved in conveyancing at all, it is some consolation at least that it will not be necessary for a future Lord Chancellor to introduce primary legislation in order to relax the proposed restrictions. All that would be required would be an Order laid before the House. Thus, the pro-competitive faction has managed to insert their foot in the door. Let us hope that the door can be opened fully in the next Parliament.

NICHOLAS OWEN

CONFIDENTIAL

LR2.15

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

8 November 1985

David Norgrove Esq
10 Downing Street
LONDON
SW1

Prime Minister 2
To note.
DRS
8/11

Dear David

with DN?

CONVEYANCING BY LENDING INSTITUTIONS

Your letter of 28 October recorded the Prime Minister's comment that policy on conveyancing by building society solicitors needed to be decided before the building society legislation was introduced, and that the Government's clear pledge on this should be fulfilled.

You may like to remind the Prime Minister that following discussion in Cabinet on 7 and 14 March, policy was eventually determined by H Committee on 14 May.

The enclosed Clause and Schedule have now been prepared for inclusion in the Building Societies Bill giving effect to its decisions. These provisions will remove impediments to provision of conveyancing services by lending and certain other institutions. H Committee accepted that there was a potential conflict of interest in lending institutions providing conveyancing services for their borrowers. It is currently intended that the inhibition agreed by H Committee will not be included in primary legislation, following the advice in the Lord Chancellor's paper (H(85)29). The draft Schedule to the Building Societies Bill gives the Lord Chancellor a power to recognise institutions permitted to provide conveyancing services, and to introduce recognition regulations, which can include a prohibition on providing services to borrowers.

I am copying this letter to the Private Secretary to the Lord President, since he is Chairman of H Committee, and to the Lord Chancellor, because of his responsibility for policy on conveyancing.

Yours ever
Rachel

RACHEL LOMAX
Principal Private Secretary

14/12

BUILDING SOCIETIES BILL

DRAFT CLAUSE

Provision of conveyancing services by building societies and other recognised instutitions.

Schedule .. to this Act (which relates to the provision of conveyancing services by building societies and other institutions where they are for the time being recognised by the Lord Chancellor under that Schedule as being suitable to undertake the provision of such services) shall have effect.

BUILDING SOCIETIES BILL

DRAFT SCHEDULE

PROVISION OF CONVEYANCING SERVICES BY RECOGNISED INSTITUTIONS

Power of Lord Chancellor to make recognition rules

1.-(1) The Lord Chancellor may, in accordance with the provisions of this Schedule, make rules with respect to the recognition of institutions as being suitable to undertake the provision of conveyancing services.

(2) In this Schedule-

"institution" means any building society or other body corporate or any unincorporated association;

"officer", in relation to a recognised institution which is a body corporate, includes a director, manager or secretary;

"recognised institution" means an institution for the time being recognised under this Schedule;

"recognition rules" means rules made by the Lord Chancellor under this Schedule;

"unincorporated association" means a partnership or any other association of two or more persons which is not a body corporate.

(3) References in this Schedule to conveyancing services are references to the preparation of transfers, conveyances, contracts and other documents in connection with, and other services ancillary to, the disposition or acquisition of estates or interests in land; and for the purposes of this sub-paragraph -

(a) "disposition" -

(i) does not include a testamentary disposition or any disposition in the case of such a lease as is referred to in section 54(2) of the Law of Property Act 1925 (short leases); but

(ii) subject to that, includes in the case of leases both their grant and their assignment; and

(b) "acquisition" has a corresponding meaning.

(4) Nothing in this Schedule applies to the provision of conveyancing services in relation to estates or interests in land situated outside England and Wales.

Recognition of institutions

2.-(1) Recognition rules may prescribe -

(a) the circumstances in which institutions[, or institutions of any specified description,] may be recognised by the Lord Chancellor under this Schedule as being suitable to undertake the provision of conveyancing services; and

(b) the conditions which (subject to any exceptions provided by the rules) must at all times be satisfied by institutions so recognised [in relation to the provision of such services] if those institutions are to remain so recognised.

[(2) Without prejudice to the generality of sub-paragraph (1)(b) above, rules made by virtue of that provision may prescribe such conditions as appear to the Lord Chancellor to be appropriate for the purpose of protecting persons for whom conveyancing services are provided by recognised institutions from conflicts of interests that might otherwise arise in connection with the provision of such services.]

Grants of recognition

3.-(1) Recognition rules may make provision -

(a) for the manner and form in which applications for recognition under this Schedule are to be made, and for the payment of fees in connection with such applications;

(b) as to the period (whether determinate or otherwise) for which any recognition granted under this Schedule shall (subject to the provisions of any recognition rules) remain in force; and

(c) for the revocation by the Lord Chancellor of any such recognition on any of the grounds referred to in sub-paragraph (2) below.

(2) Those grounds are -

(a) that an institution's recognition was granted as a result of any error or fraud;

(b) that while an institution was a recognised institution -

(i) the institution, or

(ii) where it is a body corporate, any director, manager, secretary or other similar officer of the institution, or

(iii) where it is an unincorporated association, any member of the institution,

has been convicted by any court in the United Kingdom of a criminal offence which, in the opinion of the Lord Chancellor, renders the institution unsuitable to be recognised under this Schedule; or

(c) the institution has, while a recognised institution, failed to comply with any conditions prescribed in pursuance of paragraph 2(1)(b) above.

(3) Recognition rules may -

(a) prescribe the manner and form in which any revocation of an institution's recognition under this Schedule is to be notified to the institution; and

(b) provide for any such revocation to be effective as from the time when the institution is notified of it in accordance with the rules.

Recording of recognised status

4.-(1) Recognition rules may make provision-

(a) for the keeping [by the Lord Chancellor] of a list containing the names and principal places of business of all institutions which are for the time being recognised under this Schedule;

[(b) for requiring institutions so recognised to notify the Lord Chancellor of any change in their places of business;] and

(c) for the information contained in any list kept in pursuance of paragraph (a) above to be available for inspection.

(2) Recognition rules may make provision with respect to the giving of evidence of an institution's status as a recognised institution (or lack of such status) at any particular time by means of a certificate of a description specified in the rules.

Delegation of functions

5.-(1) Recognition rules may make provision-

(a) for enabling the Lord Chancellor to delegate the exercise of any of his functions under the preceding provisions of this Schedule, other than the power to make recognition rules, to any officer or officers of his nominated in accordance with the rules; and

(b) for a decision made by any such officer in pursuance of paragraph (a) above to be treated, for the purposes of any provision of recognition rules or this Schedule, as a decision of the Lord Chancellor.

(2) Any such rules may provide for a person who is aggrieved by any such decision to be entitled, in such cases as may be prescribed by the rules, to have the matter in question determined by the Lord Chancellor.

Supplementary provisions as to recognition rules

6.-(1) Recognition rules shall be made by statutory instrument subject to annulment in pursuance of either House of Parliament.

(2) Any such rules may make different provision for different circumstances.

(3) Without prejudice to the generality of sub-paragraph (2), any rules prescribing a fee may provide for that fee [to be reduced, or] to be waived by the Lord Chancellor, in such circumstances as may be specified in the rules.

Restrictions on conveyancing by unqualified persons not to apply in case of recognised institutions

7.-(1) Section 22(1) of the Solicitors Act 1974 (restriction on person preparing certain instruments when not qualified to act as a solicitor) -

(a) shall, notwithstanding section 24(2) of that Act (application of penal provisions to bodies corporate), not apply to a body corporate by reason of any act done by an officer or employee of the body if, at the time it was done, the body was a recognised institution; and

(b) shall not apply to any member of an unincorporated association by reason of any act done by an officer, employee or other member of the association if, at the time it was done, the association was a recognised institution.

(2) Section 22(1) of that Act shall also not apply to any officer or employee of an institution by reason of any act done by him if -

(a) at the time it was done the institution was a recognised institution; and

(b) it was done by him at the direction and under the supervision of another person who was at the time an officer or employee of the institution or, in the case of an unincorporated association, a member of that association; and

(c) it could have been done by that other person for or in expectation of any fee, gain or reward without committing an offence under section 22 of that Act.

Legal professional privilege

8. Any communication made to or by a recognised institution in the course of its acting as such for a client in connection with providing conveyancing services for him shall in any legal proceedings be privileged from disclosure in like manner as if the institution had at all material times been acting as the client's solicitor.

Modification of enactments relating to conveyancing

9.-(1) In the following provisions, namely -

1925 c.20. (a) sections 10(2), 48 and 182 of the Law of Property Act 1925;

1925 c.21. (b) sections 113 and 144(1)(xxiv) of the Land Registration Act 1925;

1972 c.61. (c) section 12 of the Land Charges Act 1972;

1975 c.76. (d) section 13 of the Local Land Charges Act 1975;

1979 c.38. (e) section 11(8) of the Estate Agents Act 1979; and

1983 c.19. (f) sections 4(3) and 6(2) of the Matrimonial Homes Act 1983,

any reference to a solicitor shall be construed as including a reference to a recognised institution, and any reference to a person's solicitor shall be construed as including a reference to a recognised institution acting for that person in connection with providing conveyancing services for him.

(2) The Estate Agents Act 1979 shall not, by virtue of section 1 of that Act, apply to things done in the course of the provision of conveyancing services by a recognised institution.

Penalty for pretending to be a recognised institution

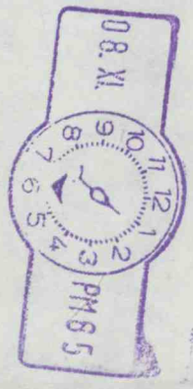
10.-(1) An institution shall not describe itself or hold itself out as an institution for the time being recognised under this Schedule unless it is so recognised.

(2) Any institution which contravenes subsection (1) above shall be guilty of an offence and liable on summary conviction to a fine not exceeding level 4 on the standard scale.

(3) Where an offence under this section which has been committed by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, manager, secretary or other

similar officer of the body corporate, or any person purporting to act in any such capacity, he as well as the body corporate shall be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

[(4) Section 42 of the Banking Act 1979 (offences committed by unincorporated associations) shall apply in relation to offences under this section as it applies in relation to offences under that Act.]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cc DW

NDT
27/6

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

26 June 1985

The Rt. Hon. Norman Tebbit MP
Secretary of State for Trade and Industry

Dear Norman

BUILDING SOCIETY LEGISLATION

Thank you for your letter of 31 May. I am glad that you are generally content with my proposals.

You raised two points. We are in complete agreement on the need to keep in close and detailed touch about the potential overlap between the building society and financial services legislation. I understand that my officials will be writing to your people shortly with some detailed questions. If you had any particular concerns in mind in mentioning the need for such consultation, I should of course be glad to consider them.

On your second point, about authorisation for investment business, the proposals were, as you know, discussed thoroughly by Ian Stewart and Alex Fletcher before the paper was finalised. We are clear that building societies should not go into securities dealing directly with the public from their own books. And it is not our intention to allow them to offer, for example, a full financial, investment and tax planning advisory service at this stage, although that is a power which could well be given to them by secondary legislation later. But I agree that some further clarification of your approach and ours would be useful. This could be considered by our officials when they discuss the interaction between our respective Bills.

I am copying this letter to recipients of yours.

Yours

NIGEL LAWSON

HOUSING: Building Societies: Pt 2.

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: J/PSO/14407/85

Your ref:

5 June 1985

Dear Ian,

I have seen your proposed speech to the Building Societies Association sent round with your Assistant Private Secretary's letter of 3 June.

In general I am quite content with what you propose. But it would be a pity to miss an opportunity for some more specific reference to the new housing powers we shall be giving societies and the opportunities these will offer for an extension of their housing role.

I suggest a new paragraph might be added to your speech. I suggest it might fit best after the existing paragraph 37 and be on the following lines:

> "Building societies have already made an enormous contribution to meeting the housing aspirations of the British people. In doing so they have established trust and respect both with their own members and in public opinion generally. Societies will have new powers to extend their contribution to British housing. They will be able to own and develop land and existing buildings for residential purposes. This is not an invitation to land speculation - indeed we shall be taking steps to prevent this. But it is an opportunity for societies to apply their enormous resources to improving housing conditions. Some of the larger societies are already innovating in this field within the limits of the existing legislation and are doing particularly interesting work in some of our inner cities. The new powers will make their life easier and allow others to follow more simply where they have pioneered. Societies will also have powers which will allow them to extend home ownership to those who presently cannot afford to buy. With the power to own land comes the capacity for societies to offer shared ownership. With the power to make equity mortgages comes a capacity to offer lower cost loans and help those on lower incomes to buy their home or - where they already own it - to improve and maintain it."

I am copying this letter to the Prime Minister and Norman Tebbit.

Yours ever

Patrick

PATRICK JENKIN

Ian Stewart Esq MP

- 5 JUN 1985

250/051

Note.
Told Treasury to proceed.
AT 5/6

ECONOMIC SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

4 June 1985

Dear Andrew,

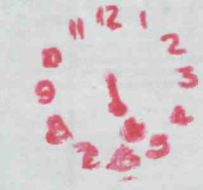
SPEECH TO BSA CONFERENCE ON BUILDING SOCIETIES LEGISLATION - PARLIAMENTARY ANNOUNCEMENT AND PRESS NOTICE

When we spoke this morning, I agreed to let you have a copy of the arranged PQ for answer on Thursday, announcing the Government's proposals in outline; a second arranged PQ, for answer the following day, drawing attention to the BSA speech which I sent to you yesterday; and a press notice. Because of the exigencies of the Finance Bill, Ministers have not yet been able to finalise the wording, but the Economic Secretary has asked me to forward it to you ad referendum, given the deadlines to be met. (The formula of two PQs, one the day after the other, is to avoid giving the impression of releasing the proposals to the BSA conference before informing the House.)

Yours sincerely

Katherine Wilford

MISS K S WILFORD
ASST. PRIVATE SECRETARY



1783/6

WRITTEN ANSWER
THURSDAY 6 JUNE 1985

DRAFT QUESTION

To ask Mr Chancellor of the Exchequer, if he will make a statement about the Government's plans for new building society legislation in the light of the Green Paper "Building Societies: A New Framework" (Cmnd 9136) published in July 1984.

DRAFT ANSWER (MR IAN STEWART)

The Government has now considered the representations it has received on the Green Paper. Decisions have now been taken on most of the issues raised in the Green Paper. Early legislation to give effect to them will be introduced, I hope in the next Session of Parliament.

The Government's proposals will in general follow the Green Paper, which has been widely welcomed. Building Societies will continue primarily as secure home for people's savings and as financers of home ownership, but the present statutory constraints on their powers will be loosened. The legislation will confirm the structure of assets and liabilities set out in the Green Paper. At least 90 per cent of "commercial assets" will be in the form of Class 1 loans - that is, loans on security of freehold or leasehold estate for the residential use of the borrower. This definition will extend to occupation by the borrower's dependants and to property which is not the borrower's main residence, if he lives in job-related accommodation.

Up to 60 per cent by floor area may be put to other residential or business uses without affecting eligibility for Class 1.

Those societies with commercial assets in excess of a stated figure (probably £100 million) will be able to hold residential land for sale, rent or development and to lend money other than on security of mortgage. They will also be able to set up, or invest in, subsidiary companies for carrying on business in other member states of the European Community.

All societies will be given new powers to offer financial and housing-related services, including money transmission, full insurance brokerage services, and the ability to act as agents for others in payments services and consumer credit. They will be empowered to provide access to the services of authorised investment businesses, whether or not members of the Stock Exchange; to offer structural survey services; and to set up estate agency subsidiaries.

The Green Paper proposals on the constitution of building societies will be confirmed, with some detailed modifications in the light of comments received. A minimum shareholding of £100 will be required for the exercise of rights as a member. Directors of building societies will be able to continue in office after the age of 70 only if their appointment is confirmed by special resolution at successive annual general meetings. There will be a procedure under which individual building societies may convert to company

status, with the approval of their members.

On the prudential supervision of societies, the legislation to be introduced by the Government will generally reflect the Green Paper proposals. Shares and deposits with all authorised societies will be treated as trustee investments under the Trustee Investments Act 1961.

1866/016

WRITTEN ANSWER

FRIDAY 7 JUNE 1985

DRAFT QUESTION

To ask Mr Chancellor of the Exchequer, if he will place in the Library of the House a copy of the speech delivered by the Economic Secretary to the Building Societies Association on 6 June.

DRAFT ANSWER

I have already done so.

DRAFT PRESS NOTICE

IAN STEWART ANNOUNCES DETAILS OF NEW BUILDING SOCIETY LEGISLATION

In a speech today ~~of~~ at the Annual Conference of the Building Societies Association at Eastbourne, Mr Ian Stewart MP, Economic Secretary to the Treasury, spelt out details of the Government's proposed new building society legislation, which he hoped would be introduced in the 1985/86 Session of Parliament. A copy of the full text is attached, together with a written Parliamentary answer setting out the main points.

2. Mr Stewart opened his speech by discussing the broad changes now under way in the financial sector, drawing attention also to the proposals in the Government's White Paper "Financial Services in the United Kingdom" and to the current review of the workings of the Banking Act.

3. In producing the detailed legislative proposals, he confirmed the Green Paper's objective of allowing societies to diversify while remaining predominantly as specialists in the housing and personal savings market. He drew attention to the dangers of imprudent deregulation, citing the experience of some savings and loan associations in the United States. He then told the building societies not to go outside their existing powers in anticipation of new legislation, warning

them that the Government would be prepared to seek special statutory powers to deal severely with any society that did so.

4. Discussing the structure of the building society movement, he said that, while it was likely that the number of societies would continue to decrease, the legislation would give greater opportunities for divergence in the type of service offered by different societies. He confirmed his belief that there would continue to be room for societies of all sizes, small as well as large.

5. He welcomed the idea of a voluntary ombudsman for building societies, along the lines of that for insurance companies and that being set up for banks. This could replace certain disputes functions of the Chief Registrar.

6. He confirmed that the prudential supervision of building societies would be developed from the existing systems of the Registry of Friendly Societies, and continue to be separate from that of banks by the Bank of England. The two systems would need to be more closely aligned as societies developed over time, with ultimately perhaps both brought together under a single supervisory authority.

7. Finally, he described in some detail the proposed new power for building societies. These will include the following.

- The structure of assets and liabilities in the Green Paper is confirmed. In particular, at least 90 per cent of "commercial assets" will have to consist essentially of loans on first mortgage of property for the borrower to live in. Some part-residential property, including for example corner shops, would be included in this definition.

- New lending powers, including the ability to lend on second mortgage or equity mortgage. The treatment of banks and building societies under the Consumer Credit Act is to be aligned.

- Societies with over a certain figure of commercial assets, probably £100 million, will be able to own residential land and lend without the security of mortgage. But such assets will be within the so-called "Class 3", which will be limited to 5 per cent of the total.

- Societies over the commercial assets threshold will be able to set up, or invest in, subsidiaries for doing business in other EC countries.

- New financial services, including money transmission, the ability to act as agents in payments services and consumer credit, and the power to offer full insurance brokerage services

- The societies will be able to offer access to investment business authorised under the forthcoming financial services legislation.

- Housing services, including mortgage management, structural survey, estate management and estate agency.

8. Concluding, Mr Stewart said that these proposals would open up a wide range of new commercial opportunities for the societies, who were facing challenges as exciting as any in their history.

NOTES FOR EDITORS

1. Building societies are incorporated under and governed by the Building Societies Act 1962.

2. Proposals for new legislation were published by the Treasury in the Green Paper "Building Societies: A New Framework" (Cmnd 9316, HMSO) in July 1984. The Green Paper called for comments by October 1984. Submissions were received from about 150 organisations and individuals.

3. The present proposals include the following main changes from the Green Paper:

a) The definition of Class 1 assets has been clarified, in particular to ensure that certain property which is only partly residential is included.

b) The threshold for a society to cross in order to hold higher risk Class 3 assets will be a certain level of commercial assets, probably £100 million, rather than £3 million free reserves.

c) The proposal that "trustee status" would be available only to societies with free reserves over £1 million has been dropped.

d) Two of the Green Paper suggestions on the procedures for mergers between societies will not be pursued, although the Government will be considering further what can be done in this area.

e) Building societies to be able to operate, through subsidiaries, in other EC countries.

f) Powers to offer estate agency, securities and insurance broking services - suggested only provisionally in the Green Paper - will be given to the societies.

g) The legislation will not provide an absolute retirement age for directors of 70, as suggested in the Green Paper; instead, directors will be able to stay on after that age subject to confirmation by special resolution at successive annual general meetings.

4 June 1985

MR TURNBULL

BUILDING SOCIETY LEGISLATION

There is no need to trouble the Prime Minister with the draft of the Economic Secretary's speech. It contains no new decisions: it simply announces a policy to which the Prime Minister has already agreed.

The only point worth bringing to her attention is that the announcement through the PQ and his speech will be taking place on Thursday.

David Willetts

DAVID WILLETTS

R8

cc DW

Do you see any difficulties? Having secured PM's consent to policy I am reluctant to trouble her a second time with a speech

AP 3/6

Treasury Chambers, Parliament Street, SW1P 3AG

3 June 1985

Andrew Turnbull Esq
10 Downing Street
London SW1

Dear Andrew,

BUILDING SOCIETY LEGISLATION

Your letter to Rachel Lomax of 20 May indicated the Prime Minister's consent to the proposals for new building society legislation in the next Session of Parliament circulated to ES by the Chancellor on 8 May.

The Economic Secretary has agreed to address the Conference of the Building Societies Association on Thursday, 6 June, and he and the Chancellor consider that this would be an appropriate occasion on which to announce the outline of most of the Government's final proposals. The building societies will need to start planning some way in advance how they intend to use the new powers to be conferred by the legislation, and an early announcement of where we propose to confirm the Green Paper proposals, and where to deviate from them, would be highly desirable. The BSA conference is attended by most people of note in the building society world and usually receives wide press coverage. An announcement here would therefore achieve considerable impact for the proposals, which are expected to be generally welcomed.

We also propose to give a summary of the principal changes from the Green Paper in reply to an arranged Written Parliamentary Question, to be tabled for 6 June. A copy of the full speech will be placed in the Library of the House.

...I attach a copy of the text which, subject to polishing, the Economic Secretary proposes to deliver. It has been approved by the Chancellor. The Economic Secretary would be grateful for the Prime Minister's approval.

The Prime Minister's assent to the proposals for new legislation was subject to any comments from ES colleagues. In his letter of 29 May, the Secretary of State for the Environment indicated that he was broadly content with the proposals, and soundings taken at official level suggest that the proposals are unlikely to cause major difficulty with other departments. I am

nevertheless copying this letter to the Private Secretaries to Mr Jenkin and Mr Tebbit, in case they have any comments which may affect the way the proposals are presented here.

Yours sincerely,
Katharine Wilford.

MISS K WILFORD
ASST. PRIVATE SECRETARY

1778/006

DRAFT 30 MAY 1985

BUILDING SOCIETIES ASSOCIATION ANNUAL CONFERENCE 1985

ADDRESS BY IAN STEWART MP, ECONOMIC SECRETARY TO THE TREASURY

Introduction

I think I am right in saying that it is three years since a Treasury Minister addressed your conference. On looking again at Sir Geoffrey Howe's speech in 1982, I am struck by how much has changed in that short time. I refer of course not only to new theories about the death of the dinosaurs, to which Geoffrey devoted the opening sections of his speech. Nor shall I be tempted to be drawn into the controversy about the aptness of the analogy between building societies and dinosaurs. Suffice it to say that the world of the dinosaurs evolved into a new and warm-blooded era - the mammals. Perhaps that is a suitable note on which to open my address to you today.

2. The most important development has of course been the emerging consensus about the need for new building society legislation and what it should contain. Three years ago, Geoffrey Howe spoke tentatively about the need for a re-examination of building society matters, and about the possibility - no more than that - of legislation in what was then the next Parliament. Since then, there have been so many Green Papers, White Papers, discussion documents and representations on matters affecting the financial sector that many of you can be forgiven for no longer knowing who

proposed what and to whom. I hope later today to bring some of the confusion to an end by indicating what will be contained in the new legislation that I hope will be introduced in Parliament this Autumn. If that hope is fulfilled, the new legislation could come into effect from 1 January 1987.

3. But first I cannot let pass without comment the fact that the last three years have embraced the period of office of your outgoing Chairman. I am advised that, although Roy Cox took over as Chairman at your Annual General meeting yesterday, Herbert Walden remains in office for the purposes of the Conference. I thought it was only in the House of Commons that procedures were so complicated. Whether he is still in office or not, however, I know that you will all agree with me that Herbert Walden has been an outstanding Chairman of your Council. Tributes have, I know, been paid to him over the last two days. I would just like to add what a pleasure it has been for me to work with him. Herbert will be a hard act to follow, but I feel sure that Roy Cox is ready for the challenge.

Financial Services

4. To turn for a moment to wider matters, the financial world is suffering from the ancient Chinese curse of living in interesting times. Institutional structures that have endured for many years are now changing fast, in the face of new technologies, wider markets and an invigorating gust

of competition. The forces at work will ultimately be to the benefit of all concerned. But as the old divisions break down, and new alliances are forged, the Government needs to rethink its approach to regulation.

5. The proposals for new legislation in the White Paper 'Financial Services In The United Kingdom' reflect this. The new regulatory structure for the securities industry will not impinge directly on building societies. But the societies will be directly affected by the other leg of the proposals, since you are already important intermediaries in the insurance market and the proposals I shall be announcing later will allow you scope for further expansion in the areas that will be covered by the Marketing of Investments Board.

Review of Banking Supervision

6. A second major strand in the Government's current work is the review of the operation of the Banking Act announced by the Chancellor in December 1984. While the review has in part been prompted by the Johnson Matthey episode, it goes much wider. It is approaching six years since the Banking Act came into effect, and the time is clearly ripe to assess its operation in the light of experience and to reconsider its provisions.

7. This too affects building societies. Although there will remain significant differences between the two sets of institutions, it is now widely accepted that greater equivalence of treatment between banks and building societies

is to be encouraged. The tax changes in the 1984 Budget were one illustration of this. The growing convergence of supervisory methods and criteria is another.

8. It is therefore timely that the banking legislation is being reviewed at the same time as that of building societies. But this does mean that some proposals inevitably cannot be finalised until the review of banking supervision is complete. Questions for further consideration include the form of any appeal against, or review of, revocation of authorisation and other decisions of prudential supervisors, and a number of detailed accounting and audit questions. And, although we are clear that there needs to be a statutory scheme for the protection of investors in building societies, its precise form remains to be settled. Decisions on these matters will be announced in due course.

Competition and its effects on building societies

9. Building societies have been experiencing a healthy increase in competition with banks and others in respect of both mortgages and personal savings. The effects of that competition, and the reaction of building societies to it, have been beneficial. Competition will be fostered by our intention, announced in the Green Paper, to withdraw the exemption of your interest rate arrangements from the restrictive trade practices legislation. That will not outlaw building societies talking to each other about interest rates. It will merely make agreements registrable and require them to be justified in the public interest. Speaking as a member of the Government who has to justify his proposals

at the Despatch Box in the House of Commons, I can assure you that is a useful discipline.

Structure of the building society movement

10. The renewal of competition and the proposals for widening the powers of building societies should make us pause for a moment to consider some fundamental structural issues. The first of these is mutual status. It is sometimes suggested that mutuality is an anachronism that should be removed under new building society legislation. That is not a view I accept. While it undoubtedly makes for certain difficulties in accountability, variety and choice in the institutional structures available to investors is a good thing. But equally it would be wrong to ossify individual institutions in a constitutional form that might no longer be relevant to the logic of their commercial development. The Green Paper therefore proposed that the new legislation should provide building societies with the opportunity to convert themselves into companies with the approval of their members. I can confirm today that such a provision will be contained in the legislation. It will be a flexible procedure in order to allow for the range of circumstances in which a conversion might be taking place. This is a complex issue, and one in which I know your Council have expressed interest. I can give the assurance that there will be further consultation on the details.

11. Rather similiar issues are raised in considering mergers between building societies and the procedures governing them. The Government does not have any view as to the optimum

number of building societies, or their size. But I do believe it would be a pity if the existing variety of building societies was lost. While the number of societies may continue to reduce, the range of options available under the new legislation should help to increase diversity among them. Building societies of different sizes will be able to develop their own distinctive role and find their own place in the market. While the largest societies may well wish to adopt a good many of the new powers that will be open to them and offer a wide range of services to the public, I believe there will continue to be a significant role for the smaller specialist society offering a straightforward service in the areas where it has traditionally been strong. In between, there will continue to be a place for the society offering an intermediate range of services and trading with a regional identity. I hope the present variety will continue, and indeed develop, for a diverse movement is a healthy one.

12. The Green Paper put forward some specific proposals in respect of merger procedures, and these need to be considered against this background. First, we have concluded that it would be wrong to allow mergers to be confirmed on a majority less than the 75% required for other special resolutions. The second suggestion was that borrowing members should be entitled to a vote on special resolutions dealing with merger proposals, irrespective of whether they are also investing members. This proposal is confirmed. In order to be effective, a special resolution on a merger will need the support of at least 50% of borrowers voting,

as well as 75% of investors voting. Similar thresholds will apply to votes for conversion to company status.

13. The third of the Green Paper suggestions in respect of mergers was the most controversial. This was the idea that one building society should be able to circulate a proposal direct to the members of another without the intervention of the second board. It has been suggested that this could lead to an auction for the votes of members of small societies through inducements in the form of bonus payments. I accept that this could have undesirable effects on the structure of the movement and that the proposal should not be pursued in its present form. I believe there remains however a need to reduce the constrictions on the merger process, and I shall be considering further whether modifications are possible to meet the objections that have rightly been made against the original suggestion.

New building society legislation

14. I have discussed the general context within which the proposals for new building society legislation will be put forward. I emphasise that the Government's main concern is to respond to current and forseeable developments in the market place. I do not know what sort of market or regulatory needs there will be in 10 or 20 years time. The new building society legislation may not prove suitable to determine the pattern into the 21st century. But our aim will be to make it as flexible as possible, so as to allow for some further evolution without primary legislation. I would not therefore rule out the chances of its surviving

for some considerable time.

15. That legislation will broadly follow the Government's Green Paper published last July. A great many useful and interesting comments were received on the Green Paper, and they have been considered most carefully. While there was a general welcome for the Government's overall proposals, there were many comments on particular aspects of them. As a result of these, we have made several modifications and clarifications.

16. The overall shape of the package remains. We want to see building societies remaining as specialist providers of housing finance and as secure homes for people's savings. While there is legitimate room now for significant relaxation of existing restrictions, we are not about to rush headlong into imprudent deregulation. We have all watched with concern the problems of the savings and loan associations in the United States. While many of their problems stem from financing fixed rate mortgages with funds raised at market rates, it is also clear that some savings and loan associations have used their new powers recklessly. Deregulation that was in part intended to help them diversify out of their problems may have ended up by compounding them. While I would not wish to press the analogy with building societies too far, the American experience is a cautionary one, which in my view fully justifies the Government's gradualist approach to the evolution of building societies.

17. Before coming on to the detailed proposals, I should

like to sound one note of warning, just in case it is necessary, although I would hope it is not. Until the new legislation is not only passed, but is also brought into effect, the powers of building societies remain those provided under the 1962 Act. A society which sought to anticipate the new powers before then would be acting irresponsibly and ultra vires. Lest any society is tempted to steal a march on its competitors in this way, I should leave you in no doubt that the Government would not be prepared to tolerate societies jumping the gun. If necessary, a sanction against this could be included in the legislation. Any society which goes beyond its statutory powers from now on, notwithstanding this warning, may well find not only that the Chief Registrar would take legal action to stop it doing so, but also that it could be subject to severe penalties or limitations on its activities.

Detailed proposals - constitution

18. With regard to the constitutional proposals in Chapter 5 of the Green Paper, we have decided to confirm many of these in the light of the consultation. Thus, the threshold shareholding for voting on resolutions and elections to boards will be £100. There will be a statutory right for members to circulate ordinary as well as special resolutions, so long as they are supported by ten members of at least two years' standing, and to circulate a statement in support of no more than 100 words. Members will be enabled to stand for election to boards if they are nominated by at least 10 other members. They will not have to satisfy any minimum shareholding requirement before election. They will also

be entitled to circulate personal particulars and other matters relevant to the election. These provisions will be capable of variation by subsequent order, if amendment appears necessary in the light of experience. We also propose a new statutory requirement that, where a society proposes a proxy to be appointed by members, they shall have the right to instruct him on which way to cast their vote.

19. I should add that we have decided after careful consideration not to propose an absolute retirement age of 70 for directors. Instead, directors over the age of 70 will be able to stay on, but only if their appointment is confirmed by special resolution at succesive annual general meetings.

20. I have been interested to see the suggestion that an ombudsman should be established for building societies, along the lines of the insurance ombudsman and that being introduced for the banks. It is not of course for legislation to set up such arrangements, and I believe this is a question to which your Council has been giving some thought already. It is an idea which the Government strongly supports. As building societies expand their activities, the scope for mistakes, misjudgements and misunderstandings clearly becomes greater. They are however better dealt with by an efficient and responsive mechanism set up by the industry, rather than formal statutory procedures. The legislation will therefore contain powers to suspend or repeal the existing disputes functions of the Registry, if and when an ombudsman is established.

Prudential Supervision

21. Change in financial institutions always bring an increase in the risks to which they will be exposed. But the Government considers it essential that the changes in the activities of building societies should not jeopardise their enviable reputation for protecting the money placed with them..

22. This will require awareness of the risks by the boards and management of societies, and care taken to guard against them. Societies will have to limit the use of their new powers in line with their management capacity and their reserves. I understand that the Chief Registrar was talking about this to some of you this morning.

23. It will also require a strengthening of the prudential system in the ways outlined in the Green Paper. I have no doubt that over time the supervisory arrangements for building societies and banks need to be brought closer together. Eventually there should probably be a single supervisory authority for both. But I am satisfied that for the years immediately following this legislation the circumstances of societies and banks will remain sufficiently different for it to be better to retain separate authorities and distinct supervisory regimes. They will be directed to achieving the same degree of protection for investors, but the methods by which this is achieved will reflect the differencecs between banks and building societies, and in particular the statutory limits on the range of activities

of societies.

24. The supervisory regime for societies will therefore be developed from the present one of the Registry. But in developing the system, the Chief Registrar will have very much in mind the desirability of the eventual convergence of the two systems.

25. I would like to take this opportunity to emphasise a point which I and the Chief Registrar have both made several times, and which I know he made again this morning. The roles of the board of a society and of the Registry are not the same. It is the role of the board to manage the society in the best interests of its members, reconciling the different interests of different groups, notably borrowers and investors. They have the primary responsibility also for acting prudently, to protect the investors. As the Green Paper foreshadowed, their duties to do this will be spelt out in the Act.

26. The role of the Registrar is primarily to ensure that the boards perform this second prudential task. He will not be addressing the question "is the proposed policy in the best interests of the members" - that is for the board. But he will instead be addressing the question "has the board done what it ought to protect the interests of investors, or is it running risks which it cannot afford or should not take". If a society is in a strong revenue and reserves position, if it has strong management and if keeps well within its capacity, the chance of the Registry

not being so satisfied, and accordingly disputing a board proposal, is slight. Even in those cases where it does, it will seek to work by persuasion, rather than by dictat.

27. Some fears about the Registry usurping the role of the boards may have stemmed from the suggestion in the Green Paper that societies wishing to hold land and property should obtain the Chief Registrar's prior approval. I have decided that it is wrong to single out one particular form of diversification in this way, and that a procedure for specific prior approval would be unnecessarily bureaucratic. Instead, societies will be expected to inform the Chief Registrar of their future diversification plans generally as part of the normal exchanges between individual societies and the Registry. It will then be open for the Registrar to ask for such further information, if any, as he thinks neccessary to satisfy himself that investors will not be put at risk thereby. If the society cannot satisfy him on this, he will seek to persuade it to modify its plans to the extent necessary to do so. Very exceptionally, he may use his new power to impose a condition on authorisation: but the criterion he will have to apply will be whether that is expedient to protect the interests of investors.

Detailed proposals - assets and liabilities

28. The overall framework for the composition of building society balance sheets will be broadly as in the Green Paper. Liquid assets will accordingly have to account for no more than one third of the total, and 80% of funds - at least initially - will have to be raised from retail sources.

Of the commercial assets - broadly speaking, total assets less liquidity and fixed assets - at least 90% will have to be in Class 1 loans and no more than 5% in Class 3 assets. All these percentages will be capable of subsequent variation.

29. The Green Paper suggested that Class 3 assets should be available in the main only to societies with free reserves exceeding £3 million. This proposal has attracted some criticism on the grounds that the absoloute level of free reserves may not be the best indiciator of a society's capacity to take on these higher risk assets. There could also be room for dispute about whether the threshold had been crossed, depending on the accounting policy employed, and scope for manipulation, for example through sale and leaseback arrangements. We have therefore decided to adopt a different criterion. The main purpose of the provision is to ensure that the higher risk business is open only to societies with both the capital and management resources to handle them. A threshold based on total commercial assets, which represent the total business of the society, would therefore achieve the objective more precisely and more fairly. I am therefore considering a threshold of £100 million commercial assets when the legislation comes into force, a test which would be passed by most of the societies who had £3 million free reserves at the time of the Green Paper. I should add that the range of new assets and functions available to societies below the threshold will still be wide enough to give them considerable scope to diversify their business.

30. Representations have also been received about the proposal that trustee status should be available only to societies with free reserves in excess of £1 million. It has been argued that this would have an unfair effect on small societies which have up to now been able to hold trustee funds. The Government accepts these arguments, and the Bill will therefore provide that trustees will be able to invest in any authorised building society.

31. I turn now to the composition of the three classes of asset. A good deal of comment on the Green Paper, particularly that from building societies, has centred on the definition of Class 1 assets, those which must account for at least 90% of commercial assets. It has been put to us that this would bear unfavourably on those societies which have specialised in lending, for example, on corner shops or small lodging houses, or on retirement and holiday homes.

32. Taking all of these points into account, the Government proposes a definition of Class 1 as follows. It should consist essentially of loans fully secured on first mortgage of premises which are for the use of a borrower as his or her only or main residence. But loans secured on property for the use of a dependent relative would be included in this definition, as would loans on residential property owned but not occupied by a borrower who for the time being is in job-related accommodation; this last provision will follow broadly the MIRAS definition. At least 40% of floor area should be for the exclusive use of the borrower and his family, and there will be no stipulation as to the use

of the remaining 60%. This would let in many small business premises, such as corner shops, as well as houses split into two flats, a point to which your Association drew attention in its response to the Green Paper.

33. I am firmly of the view that the definition of Class 1, representing as it does the prime assets of building societies, must be clear and simple, and not trespass onto lending that is clearly outside the traditional role of the societies. If, over time, the proposed definition appeared to be too restrictive, I should be readier to consider some modification of the 90% minimum for Class 1 than a substantial redefinition of its contents.

34. Class 2 will extend to all other loans on first or second mortgage, including equity mortgages. And, as proposed in the Green Paper, Class 3 assets will consist of loans not secured on mortage, investment in land, and equity investment in joint operations and other subsidiary or associate companies. Class 3 loans will be limited initially to £5,000 per person.

35. We intend to amend the treatment of banks and building societies under the Consumer Credit Act in order to bring the two into line. At present, all building society lending on mortgage of land is exempt, whereas such lending by banks and licensed deposit takers is not. This is clearly inequitable, especially with the increase in mortgage lending by banks in recent years and the new power for building

societies to lend on the security of second mortgage. The legislation will therefore provide that the Consumer Credit Act shall apply to all second mortgage lending by building societies, as it already will for unsecured lending. The treatment of first mortgage lending by building societies, banks and licensed deposit takers respectively will be brought into line, but a final decision on how best to achieve this has not yet been taken.

36. As to the other Class 3 powers, shared ownership schemes will be open to societies below the threshold, notwithstanding the general prohibition on their holding land. Such assets would be split between Classes 1 and 3, with the loan on the portion owned by the tenant scoring against Class 1, and the remaining equity in Class 3.

37. The power to invest in subsidiaries and associates would extend to companies engaged in any activity open to the society itself. In the case of subsidiaries, however, the assets and liabilities would be fully consolidated with those of the parent society for the purpose of the commercial asset limits, so as to avoid devices for getting around those limits.

Detailed proposals - services

38. The Bill will provide building societies with new powers to provide a range of financial and housing-related services. This will offer significant new commmercial opportunities, but building societies will have to use them with responsibility and not abuse their powerful market position.

I understand that the Director General of Fair Trading has addressed you in more detail on these matters earlier today, and I know his Office will be watching developments with interest. The Bill will require building societies to price individual services separately, so that any cross-subsidisation is brought clearly above board, and will prohibit the granting of Class 1 loans on condition that some other service of the society is used.

39. Building societies will be given power to offer full money transmission and foreign currency services. These will be framed in such a way that the prohibition on unsecured lending by small societies does not prevent them from offering guarantee cards, automated teller machines, point of sale services, and so on. The societies will also be able to act as agents for other bodies in respect of payment services and consumer credit. This will allow the further development of the links that some societies have already built up with banks, finance houses and credit card companies. You will also be enabled to provide access to the services of Stock Exchange members and other bodies authorised under the forthcoming financial services legislation, which should provide a further step in the development of wider share ownership.

40. The societies will be allowed to act as insurance intermediaries in respect of any type of insurance business. As I said at the beginning of my speech, life business will be subject to the requirements of the financial services legislation. You will either have to operate clearly as

the agents of particular insurance companies, or you will need authorisation in your own right. If you choose the latter, you would have to submit to the requirements of the financial services legislation, which are likely to include conduct of business rules, the avoidance of undue dependence on a particular company, and the need for the business to be run by persons who are "fit and proper" for the task. Such an independent insurance broking operation would probably have to be carried out through a separate subsidiary.

41. Those societies meeting the criterion for holding Class 3 assets will be able to offer an estate managment service, and all societies will be able to offer a mortgage management service. Both these powers might be used when land or mortgage assets have been sold to another financial institution which is prepared to engage your expertise.

42. Building societies will be able to offer estate agency services and structural surveys. As the Green Paper indicated, however, there is significant scope for conflict of interest if a building society manager is responsible both for selling a property and approving a loan to its purchaser. We therefore propose that the management and operation of the two functions should be separated. As to the proposal that building societies should have a power to provide conveyancing, this has proved to be a complex issue, and, since it is still under review, I cannot expand today on what has already been said. I can say, however, that the Government will be seeking the introduction of

a code of conduct for building societies offering any services relating to house purchase.

Europe

43. Finally, building societies will be given a power to invest in, or set up, housing finance companies in other member states of the European Community. This will extend to investment in companies established in the United Kingdom to provide cross-border mortgage credit. Such investments will be Class 3 assets open to societies above the commercial assets threshold.

44. In deciding to give the societies this power, the Government was impressed by the emphasis laid on this in the response of your Association to the Green Paper, and the careful thought that is clearly being given to the question. It is also fully consistent with the Government's wish to see a more effective internal market in the European Community, particularly in the provision of financial services. The balance sheets of such bodies will not be consolidated with those of the parent society, so that loans in other member states will not be confined to 5% of commercial assets.

Conclusion

45. I hope that what I have said today will enable you to undertake your planning more effectively. I believe that the package I have presented will open up a wide range of new commercial opportunities for building societies, but consistent with the central role in savings and house

purchase that they have carried out so successfully for nearly 200 years. While none of us can say what the future will hold for the societies and the financial markets, I believe that these measures will allow the further evolution that is already needed as well as the flexibility to respond to future developments. The challenges now facing your movement are as exciting as they have been at any time in its history. The Government will introduce the legislation to enable you to respond to them. The rest, as they say, is up to you.

F3 JUN 1985

NDPM AT 3/6 cc DW

DEPARTMENT OF TRADE AND INDUSTRY
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Secretary of State for Trade and Industry

31 May 1985

Rt Hon Nigel Lawson QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

D Nigel,

Thank you for sending me a copy of your minute to the Prime Minister of 8 May and the accompanying memorandum on building society legislation which sets out your main proposals in this area.

2 The issues involved in building society reform are clearly going to arouse considerable discussion as well as lively debate when the Bill is presented to the House. Members on both sides will be looking to see whether the Government has struck the right balance between the need to maintain specialist organisations for the provision of housing finance which also offer a safe home for the 'small' saver, and the need to allow building societies to make a much greater contribution to society by providing a wider range of services. I am broadly satisfied that the policy paper strikes that balance.

3 There are, however, just two points I would like to make. You rightly highlight the overlap between the Financial Services and Building Society legislation and the timing of their passage through the House. In order to achieve consistency between the two, I would emphasise the need for consultation between Treasury and DTI officials to be as full as possible.

4 Secondly, para 16 suggests that building societies will only be allowed to offer transactions in securities and related services through the medium of other authorised investment businesses, and will be unable to apply for authorisation to provide these services themselves. This is in contrast to the treatment accorded to the clearing banks and contrasts with the insurance broking side of their affairs, where authorised building societies will be able to advise consumers on suitable endowment policies and transact the business directly. I would be grateful for some clarification on this point.

5 I am copying this letter to the Prime Minister, other members

JH2AQJ

of ES, the Lord Chancellor and to Secretaries of State for the Environment, Scotland and Wales, the Lord Privy Seal, the Lord Advocate, the Solicitor-General, Chief Whip and to Sir Robert Armstrong.

Yours ever
Norman

NORMAN TEBBIT

JH2AQJ

Housing Pt 2

Building Societies

ECL

CONFIDENTIAL

bc David Willetts

10 DOWNING STREET

From the Private Secretary

20 May 1985

BUILDING SOCIETY LEGISLATION

The Prime Minister has seen the Chancellor's minute of 8 May. Subject to any comments colleagues may have, she is content for the Chancellor to proceed along the lines he proposes. The way in which the Bill deals with conveyancing is, of course, still to be resolved.

I am copying this letter to Private Secretaries to members of ES, John Ballard (Department of the Environment), John Graham (Scottish Office), Colin Williams (Welsh Office), David Morris (Lord Privy Seal's Office), Iain Jack (Lord Advocate's Department), Richard Stoate (Lord Chancellor's Office), Henry Steel (Law Officers' Department), Murdo Maclean (Chief Whip's Office) and Richard Hatfield (Cabinet Office).

(Andrew Turnbull)

Mrs. Rachel Lomax,
H.M. Treasury.

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ECL

Prime Minister (1)

Agree Chancellor's proposals, with position on conveyancing still to be settled? Yes MT

AT 17/5

MR TURNBULL

17 May 1985

BUILDING SOCIETY LEGISLATION

We recommend you agree with the Chancellor's proposals for the Building Societies Bill in 1985/86. They are close to the Green Paper published earlier this year, but with some ifs and buts removed. The legislation would:

- Rationalise and extend the range of assets which buildings societies can hold, subject to proper supervision.

- Permit them to provide a wider range of financial services. They could, for example, allow stockbrokers to use their premises to set up high street share shops.

These are useful measures to liberalise the régime for building societies. But they will look pretty cock-eyed and half-hearted if we don't open up the régime for conveyancing. So we need to claw back the position on conveyancing before the Bill is published.

David Willetts

DAVID WILLETTS

transcribe
Building Socs pg. 2

P2.57

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cc JR

B/f with response from Depts or PM.
AT 13.5

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

BUILDING SOCIETY LEGISLATION

Last July we published the Green Paper "Building Societies: A New Framework" (Cmnd 9316). The attached memorandum, which I am circulating to ES colleagues, seeks policy approval to proceed with legislation.

2. The Green Paper proposed that the existing legislation governing building societies should be brought up to date, and that they should be given wider powers to compete with other major financial institutions in a developing market. But it also proposed that their role as principally providers of mortgage finance and their reputation as a safe haven for individual investors should be maintained. My proposals for legislation reflect this.

3. The Treasury has received comments from approximately 150 organisations and individuals on the Green Paper, the majority supporting the Government's objectives. My officials will be consulting the Building Societies' Association as appropriate about the drafting of the legislation. In addition Ian Stewart has been in touch with Ian Gow and Alex Fletcher about details, and the proposals now have their support.

4. This Bill is likely to attract lively back-bench argument and discussion, reflecting both the public interest in building societies generally and the concerns of particular groups affected by individual proposals.

5. The attached paper summarises my proposals. These follow the Green Paper closely and deal with the structure of societies' assets and liabilities; the provision of wider financial and housing-related services; prudential supervision; and the constitution of building societies.

6. The paper covers only the main proposals for new legislation. There are three respects in which it is still incomplete:

(a) the proposals in respect of house buying services are necessarily somewhat tentative while firm decisions have yet to be taken on conveyancing, in the light of proposed legislative changes relating to employed solicitors. I am quite clear on the principle that building societies should be able to offer an estate agency service. But the precise provisions cannot be settled finally until we know the form in which the societies are going to be able to offer a conveyancing service;

(b) there are several points of overlap with the planned Financial Services Bill, which should be going through Parliament at much the same time. Further work will need to be done as proposals in this area evolve, and detailed adjustments may be necessary to ensure consistency;

(c) as indicated in the final paragraph of the attached paper, there are some outstanding technical issues which we are still working up. Many of them are being considered in the context of the review of banking supervision that the Treasury and Bank are conducting in the wake of the Johnson Matthey affair. A place has been provisionally reserved in the 1986/87 Session of Parliament for a Banking Bill. Final decisions on many of these issues cannot be taken until later in the year.

7. Since these outstanding points, with the exception of conveyancing, are largely self-contained, I would propose that they should be settled without reference back to ES. My officials will of course continue to consult other interested departments on individual issues.

8. Finally, on a structural point, I have decided to go for a Bill that would replace rather than amend existing legislation. An amending Bill would be very difficult to follow, entailing heavy cross-referencing both for Parliament during its passage and for building societies and others who will need to refer to it when it

has become law. Moreover, the Bill is not a tidying-up measure: it embodies a major reform and liberalisation of building society legislation, the first for 111 years. We also need to confine its scope to building societies as closely as possible, although it has been proposed that amendment to the Solicitors Act 1974 relating to conveyancing should also be included: to go beyond that could open up the Bill to a wide range of undesirable amendments.

9. I am copying this minute to other members of ES, the Secretaries of State for the Environment, Scotland and Wales, the Lord Privy Seal, the Lord Advocate, the Lord Chancellor, the Solicitor-General, the Chief Whip, and to Sir Robert Armstrong.

N.L.

8 May 1985

CONFIDENTIAL

BUILDING SOCIETY LEGISLATION

This paper sets out the Treasury's detailed proposals for new building society legislation in the 1985/86 Session of Parliament. The proposals are made in the light of comments received on the Green Paper "Building Societies: a New Framework" and further consideration of the issues.

ASSETS AND LIABILITIES

2. The basic structure proposed in the Green Paper should be confirmed. In brief, this is as follows.

(a) At least 90 per cent of "commercial assets" (that is, total assets less fixed assets and liquidity) should be first mortgages to owner occupiers, Class 1 assets.

(b) Up to 10 per cent may be in the form of secured mortgage lending (Class 2) or other new types of asset (Class 3), Class 3 to amount to no more than 5 per cent of the total.

(c) Liquid assets should be not more than one-third of the total.

(d) Retail deposits from members of the public should amount to at least 80 per cent of funds.

3. The detailed definitions of "liquid assets" and "retail deposits" would be set out in secondary legislation. The percentage limits, and contents of the asset classes could

be varied by order.

Class 1 assets

4. These would be loans secured on first mortgage of freehold or leasehold estate for the residential use of the borrower. They would include loans on property partly (but not mainly) used for business proposes, such as corner shops. By analogy with the arrangements for mortgage interest relief, "owner-occupation" would include occupation by a borrower's dependent relative, or former spouse, and property for later occupation by a borrower currently living in tied, job-related accommodation. Second homes, which offer considerable scope for letting, should be excluded. And, to exclude blocks of flats etc, the borrower (or his dependant) should occupy exclusively at least 40% by floor area, thus allowing him to let half the property, with some allowance for common areas. Loans to bodies corporate, such as housing associations would not be included. If this appeared in due course to be squeezing the supply of funds to such bodies, this could be taken into account in considering the case for changing the 90% limit on Class 1.

Class 2 assets

5. The Green Paper proposal that these should include second mortgages, equity mortgages and loans above valuation indemnified by a local authority under the 1980 Housing Act should be confirmed. Other first mortgages not in Class 1 would also be in Class 2. Second mortgages would be subject to no statutory limit as a percentage of valuation.

Class 3 assets

6. As foreshadowed in the Green Paper, most Class 3 assets would be open only to societies which passed a minimum size test. The threshold should not however be the £3 million free reserves suggested in the Green Paper, but £100 million commercial assets, a test that is at once clearer and generally a better indication of size.

i. **Lending**

7. Class 3 loans - that is, those without Class 1 or 2 security - would be subject to an initial limit of £5,000 to any one person, although this figure could be increased if there is pressure during the passage of the Bill through Parliament.

8. Building societies and other lenders should be treated in the same way for the purposes of the Consumer Credit Act 1974. (At present all mortgage lending by the societies is exempt, but banks have no such general exemption). The Building Societies Bill would extend the Act to building society second mortgages; first mortgages by banks and licensed deposit takers could be exempted in the Banking Bill provisionally planned for the 1986/87 Session.

ii **Land and Property**

8. The larger societies would be able to purchase, build, hire or lease property whose purpose was primarily residential, and subsequently to sell or let it. They would also be able to hold land for the purpose of development or improvement for primarily residential purposes. Shared ownership schemes (when the occupier buys part of the equity with the aid of a building society mortgage and rents the remainder from the society) would be open to all societies. The mortgage on the portion owned by the tenant would be in Class 1 and any residual equity owned by the society in Class 3.

iii **Investment in subsidiaries and associates**

10. The societies would have a general power to transact elements of their business through subsidiaries, and might be obliged to offer some services (eg estate agency) in that way. They would be empowered to issue guarantees to subsidiaries and associated bodies.

11. The assets and liabilities of subsidiaries carrying on

business which societies can do themselves - for example, housing associations or consumer credit subsidiaries - would be fully consolidated with those of the society.

Overseas operations

12. The societies should be allowed to set up or invest in housing finance subsidiaries in other countries, and to invest in UK-based subsidiaries providing cross-border services. This subsidiary route is preferred to direct operations through branches principally because of the constitutional and legal complexity of operating direct, but it should also enable better management of exchange risk through the matching of assets and liabilities in different currencies. The assets and liabilities of such subsidiaries would not be aggregated with those of the building society for purposes of the asset classes, although their nature and scale would have to be taken into account in supervision.

13. The power would initially extend only to other EC countries, although it could be extended by order later, because it is only in the Community that a good co-operative supervisory framework exists. The legislation will also need to confine the investment power to institutions engaged primarily in housing finance.

Financial futures etc

14. A power to enter into financial futures contracts, gilts options and other financial instruments is proposed, but it would need to be suitably framed to ensured that it applied to hedging operations, and not to speculation in futures.

Liabilities

15. As well as the 80% minimum of liabilities to be raised from individuals, there would be a requirement for at least 50% to be in the form of shares (ie capital) rather than deposits and other loans.

SERVICES

16. We should provide building societies with broad powers to offer **money transmission** and **other financial services** to their members. These would enable the societies:

-to enter into reciprocal payments arrangements and joint operations with other financial institutions, and offer foreign exchange facilities, etc;

-to guarantee payments, and thus to issue guarantee cards, etc;

-to collect payments, transmit documents, provide receipts etc. as agents for other bodies. The societies could, for example act as agents for the Crown (TV licences, National Savings, benefit payments, etc), local authorities (rent and rates), utilities (bills), or retailers, but there would be no prescribed list;

-to provide credit facilities as agents for banks, licensed deposit takers and credit card companies;

-to allow authorised investment businesses to offer transactions in securities and related services through building society branch networks, although implementation of this part of the legislation might need to wait until the new financial services legislation was fully operational.

17. The societies would be able to offer **mortgage management** services to others, which may help the development of a secondary

mortgage market. The larger ones would also be able to provide an **estate management** service as an adjunct to their power to hold housing assets. All societies would be allowed to offer full **insurance broking** services, and would be subject to the requirements of the financial services legislation.

18. The provision of **conveyancing** services by building societies is being considered separately. They should be allowed to offer **estate agency** and **structural survey** services, although separation of the management of the estate agency from that of the lending business would be needed to avoid conflicts of interest. The precise details will need to be considered in the light of final decisions on conveyancing.

19. There would be a power to add other financial and housing-related services to this list. Making the provision of loans conditional on the use of any of these services should be illegal. The societies should also be required to quote the price of each individual service separately, so as to bring any cross-subsidisation above board. The BSA would be asked to prepare a code of conduct for societies offering housebuying services. A reserve power would be taken to make regulations if a satisfactory code of conduct was not drawn up or was persistently ignored; the sanction for failing to observe the regulations would be withdrawal of the society's power to offer the particular service.

PRUDENTIAL SUPERVISION

20. The main instrument of prudential supervision by the Registry of Friendly Societies would be the granting and revocation of authorisation to take money from the public. A new power to impose statutory conditions on continued authorisation would be provided. There would also be new powers to require information from societies and restrictions on its disclosure. The existing powers to control advertising would be continued.

21. Building society boards would be made subject to a series of specific duties, broadly as described in the Green Paper, to protect the interests of shareholders and depositers. Their fulfilment would be crucial to decisions about the use of prudential powers.

22. The general objective would be to enable the Registry to provide an equivalent level of investor protection as the Bank does for recognised banks and licensed deposit takers, but with a rather less onerous prudential regime, reflecting the narrower range of building society assets. Whenever appropriate, the prudential powers would be harmonised with the Banking Act in order to ease the path of an eventual merger of bank and building society supervision in the longer term.

23. Building societies would not have to seek the prior approval of the Chief Registrar for particular innovations, although they should be generally required to keep him informed of their plans for future development. As proposed in the Green Paper, the Chief Registrar should no longer have a power to designate particular societies for the purposes of trustee investment. But the Green Paper proposal that only those with free reserves greater than £1 million should have trustee status should be dropped in view of the strong protests from and on behalf of small societies.

24. The Registry would monitor compliance with the main balance sheet limits, with discretionary powers to require societies to draw up plans for conversion to company status if they breached the limits and were unable or unwilling to rectify the position. There would also be a specific prudential duty on boards to comply with the commercial asset limits, because of their prudential overtones. In the case of the limits on wholesale funds and liquid assets, which are more liable to accidental breach and easier to rectify, the supervisory authority should have discretion to act in the event of transgressions.

CONSTITUTION

25. The Bill should provide a procedure under which societies could convert to company status.

26. The Green Paper proposals in respect of ordinary and special **resolutions**, and **elections of directors** should be broadly confirmed, although with several detailed modifications in the light of

comments received on them. A new proposal would be that proxy voting forms would have to give the member the opportunity to specify how the proxy vote should be cast, although he could still give it to the Chairman with discretion to cast it as he saw fit. It is also not now proposed to impose an absolute retirement age of 70 for directors; the most likely alternative would be along the lines of the Companies Act requirement that directors over 70 need to be re-elected annually by resolution of the annual general meeting.

27. It is proposed that borrowers should be given the right to vote on **merger** proposals, something that is available only to shareholders at present. But a separate Green Paper suggestion that the majority required to signify approval of a merger by the members should be reduced from 75% to 60% should not be pursued. A third suggestion - that the board of one society should be able to circulate members of another with a merger proposal - is likely in its present form simply to result in too much concentration in a few large socieites. Further thought is being given to other possible ways of promoting desirable rationalisation of the industry.

28. An **ombudsman** has been suggested for building societies, as already exists for insurance companies and is being introduced for banks. This should be encouraged, but on a non-statutory basis. Provision would be included in the Bill for the suspension of the Registry's existing disputes functions, for use if the ombudsman proposal got off the ground.

Other Issues

29. There remain some further, relatively self-contained topics which it has not yet been possible to work up. They will be dealt with as soon as possible. They include:-

-the detailed procedures for conversion to company status;

-the introduction of a statutory investor protection scheme giving equivalent protection to that given under the

Banking Act to depositors with the monetary sector. This would replace the voluntary scheme now run by the BSA;

-limitations on directors' interests;

-how the procedures for review of the Chief Registrar's control powers should be strengthened, whether by an independent appeal procedure, as under the Banking Act, or otherwise.

HM TREASURY

30 April 1985

Housing: Building Socs.

PRIME MINISTER

Mortgage Rates

Sir Peter Middleton and Frank Cassell at the Treasury saw the Building Societies Association this morning to discuss the prospects for mortgage rates. Despite the fact that there had been a fall in bank interest rates during the course of the morning and despite being told by Sir Peter Middleton that there was a reasonable prospect of still further downward movements in the future, the building society representatives said there could be no question of withdrawing the proposed increase in their rates. Mortgage demand was high and the inflow of deposits was still much too low to sustain this. Following the change to the composite rate of tax, the banks were bidding aggressively for deposits from the retail sector. The building societies thought that base rates would have to fall to 11.5 per cent before a reduction of 1 per cent in their mortgage rates could be justified. Even then they might want to adjust only slowly as they needed to rebuild their liquidity which had suffered over the past three or four months. The outlook is, therefore, rather gloomy on this front.

The Treasury also report that the RPI Advisory Group which has been considering whether mortgage interest should be a component of the RPI is unlikely to recommend a change in the present position.

ANDREW TURNBULL

19 April, 1985

Prime Minister (2)

Arundel Castle

7 August 1984 R8

The Rt Hon Mrs Margaret H Thatcher MP
10 Downing Street
LONDON SW1

Dear Prime Minister,

I am disgracefully late in thanking you for having come to lunch at the Building Societies Association headquarters on 1 August, but I have been travelling around.

It was a great occasion for them and the first visit by any Prime Minister. You were truly generous in talking so freely and, in particular, they were thrilled at your final comment that you would never withdraw the tax relief on mortgage interest.

The Green Paper has provided an excellent basis of discussion before the coming Bill is drafted; and I hope eventually a solution will be worked out on the lines of the strata system in Australia for dealing with the ownership of flats. Your brilliant decision to allow Council houses to be purchased has greatly extended home ownership; and I personally, having seen in my many years in Germany the great advantages of private rented housing for young married couples who wish to move, through being promoted in their firms, hope something can be done on the lines of shared ownership in this country.

If it is not impertinent, may I congratulate you on all you are achieving, particularly in up-dating our industrial relations. If only we had the Ernest Bevin charter that was given to Germany in 1945 of only 15 Unions, no closed shops and all decisions by secret ballot!!

Yours very sincerely

Mike.

pps to CF

Lunch 1.8.84.

R3

PPS

THE BUILDING SOCIETIES ASSOCIATION
3 Savile Row, London W1X 1AF
Telephone: 01-437 0655

1st August 1984

MT

(4)

Dear Prime Minister,

We very much appreciated your presence at our luncheon today and found it, for our part, a very stimulating and interesting occasion. Thank you for being so frank with us and for showing such an interest in our activities.

The future for building societies promises much – I hope we can play our full part in making home ownership available to many more people, in keeping in housing generally and in making financial services more competitive.

I intended to thank you for your letter regarding our Conference next year – I do fully understand the reason you cannot accept the invitation.

I know I speak for all my colleagues in expressing gratitude to you for sparing time in your busy schedule to meet us.

Best wishes

Yours sincerely

Herbert Walden

Secretary-General: Richard S. Weir MA.

CC Master CONFIDENTIAL

FCE 84

SUBJECT

10 DOWNING STREET

From the Private Secretary

1 August, 1984

Dear Adrian,

Prime Minister's Lunch with the Building Societies Association

The Prime Minister had lunch today with the Building Societies Association. (I was grateful for the briefing provided by the Treasury and the Chief Registrar.) It was an enjoyable occasion for the Prime Minister which provoked a lively discussion.

Mr. Walden drew the Prime Minister's attention to the BSA's views on leasehold reform. They had put to the Lord Chancellor a recommendation that new blocks of flats could be built adopting the strata title system developed in Australia. This would enable owners of flats to acquire a permanent freehold. The Prime Minister acknowledged that leasehold was often unsatisfactory and she took note of the point.

The discussion then turned to the role of building societies in developing new forms of tenure, particularly in the inner cities. Mr. Ellis (Abbey National) argued that fiscal parity was increasingly being applied to banks and building societies, though the latter were investing, out of a sense of social concern, in projects which generated less than a full commercial return. He wondered whether building societies should be offered some fiscal concession in recognition of this. (He also pointed out that the application of VAT to alterations had upset the economy of the Stockbridge Village Project.) The Prime Minister argued that it would be wrong to offer concessions to building societies generally. Where additional finance was needed, it was best offered in the form of specific grants, e.g. from the urban programme, or through the provision of infrastructure, as had been done with the Merseyside and London Docklands Development Corporations. Mr. Spalding said the Halifax welcomed the opportunity to own land. They preferred to wait until this was permitted by legislation

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rather than go through the elaborate intermediaries which the Abbey National and the Nationwide had been forced to adopt.

Mr. Cumming (Woolwich) said the Green Paper had been too timid on the prospects for building societies operating in Europe. It would inevitably be difficult to secure the consent of other Governments but building societies would find it difficult to press for this while there were still obstacles set by the UK Government. The Prime Minister said she welcomed the principle of greater freedom of trade in services in the community and she agreed to consider this point further.

There followed a animated discussion on differential mortgage rates. The Prime Minister took the view that these had no economic justification as larger mortgages did not cost more to administer and that they were unfair to those living where housing was more expensive. She was naturally supported by Mr. Cumming (Woolwich has no premium rates) and Mr. English (the Nationwide does not charge a premium under £40,000 though it has a higher basic rate at the moment). Mr. Cox tried to defend differential mortgage rates on the grounds that building societies raised a large proportion of their finance at premium rates. The Prime Minister argued that the different cost of deposits should be averaged out.

Mr. English (Nationwide) argued against ending the advised rate. He believed that it was helpful, particularly for small societies, for the BSA to meet and advise a rate. The Prime Minister argued strongly that the rate each society set should reflect its circumstances, as would the prices charged by different retail outlets. It was appropriate for the BSA to provide a forum for discussion but not to advise a single rate for both large and small societies. Mr. Cox argued that the mortgage demand was still not satisfied. Competition was therefore greater on the investment side and a freer regime was likely to push interest rates up rather than down. Mr. Spalding said this asymmetry would last so long as there was unsatisfied demand. Owner occupation was currently around 63 per cent and would eventually go over 70 per cent. The free market would operate satisfactorily when the market was in equilibrium but this was some time off.

The Duke of Norfolk argued that the private rented sector should play a greater role and suggested an extention of tax relief, particularly for shared ownership. The Prime Minister shared his regret about the decline of the private rented sector but resisted extension of tax relief. She confirmed that mortgage interest relief would remain so long as she remained Prime Minister. She also added that she thought the ceiling was too low.

I am copying this letter to Richard Stoate (Lord Chancellor's Office), Paul Britton (Mr. Gow's office) and Michael Bridgeman (General Registrar, Friendly Societies).

Yours sincerely

Andrew Turnbull

ANDREW TURNBULL

Adrian Ellis, Esq.
Economic Secretary's Office

MR TURNBULL 31 July 1984

LUNCH WITH THE BSA

We suggest the Prime Minister could focus on two main subjects at tomorrow's lunch:

- putting across the positive themes in the Building Societies Green Paper, and emphasising the opportunities now open to building societies

- emphasising that the demise of the interest rate cartel should not lead to delay in reducing mortgage rates.

The Building Societies Green Paper

There are four key themes to the Green Paper:

i. Building societies must remain a safe, reliable place for the small investor to put his savings. They don't have the management resources or skills to engage in fancy financial and lending operations risking significant amounts of their assets. The last thing we want is a building society crisis in a few years' time like the secondary banking crisis of the 1970s.

ii. The building societies have done a lot to spread home-ownership, and their activities should continue to be

focussed on this key objective. The Green Paper suggest a rule that 90 per cent of building societies' assets must be mortgages on residential property. Do they have any further ideas for encouraging wider home-ownership?

iii. But there is scope for buildings soceities to provide a rather wider range of services, particularly related to housing and land. So they could use up to 10 per cent of their assets for, for example, buying land and housing directly. They should also be free to engage in conveyancing and property surveying. And finally, their retail network is well-suited to a variety of financial services like carrying out share transactions for clients, or paying people's bills by transfers. If they move into these areas, there would be more healthy competition in the high street.

iv. The Green Paper is a prelude to new building society legislation in the 1985-86 Session, as the 1962 Building Societies Act is now very much out of date. The financial scene is changing so fast, so the new legislation must be more flexible than the old legislation was so that, where possible, regulations can be changed by Statutory Instruments rather than new primary legislation.

The Green Paper has broadly been welcomed by the building societies, and they should be happy with these themes.

The quality of building society management

The Prime Minister won't wish to raise this explicitly, but the lunch is an opportunity for her to assess the vigour and competence of building society management. They have had an easy life providing a relatively simple financial service at low risk and with a cartel fixing the cost of a mortgage. Any entrepreneurial energies they possessed have gone into growing bigger than their rivals - hence the mass of high street branches.

By encouraging them to extend their operations and end the cartel, we encounter a chicken and egg problem. Opponents of change argue that because the societies have been nannied, they won't have the drive to take advantage of the opportunities we've offered. The reformers say that unless these wider opportunities are offered, there is no incentive for a society to become more commercial. We favour this bolder approach. The Prime Minister will want to assess whether the building societies are likely to rise to the challenge offered by the Green Paper.

The demise of the interest rate cartel

Currently, the BSA's interest-fixing arrangements are exempt

from the Restrictive Trade Practices Court. Legally, this will change with the promised building society legislation. In practice, the cartel is already beginning to break down.

The building societies may argue that the end of the cartel will make mortgage rates stickier. Why should a bold society bring its mortgage rate down if the cautious ones do not follow suit? All the existing mortgagees can't immediately transfer to the society offering lower rates, and so it gets the same amount of business as before, but makes a smaller turn than its rivals. Is there an asymmetry, with rates going up fast to keep mobile depositors?

There are two answers to this:

- In the long run, the end of the cartel will create real competition. If the better building societies succeed in cutting their costs, they will be able to offer relatively higher deposit rates as well as reducing their mortgage rates. So they will be able to attract and finance a lot of new business, and thus grow relative to their competitors.

- Meanwhile, a building society will gain prestige from leading rates down.

The lunch is an opportunity for the Prime Minister to exhort the building societies not to be slow to move rates down when financial circumstances permit.

David Willetts

DAVID WILLETTS

CONFIDENTIAL

cc D Wiltshire

30 JUL 1984

FROM: **M A HALL**

30 July 1984

1. **ECONOMIC SECRETARY**

2. **MR TURNBULL No 10**

c c PPS
Sir Peter Middleton
Mr Cassell
Mr Saunders
Mr Portillo
Mr Bridgeman RFS

THE PRIME MINISTER'S LUNCH WITH THE BSA : WEDNESDAY 1 AUGUST

I attach the following briefing notes:-

(i) Note by the Chief Registrar on the Prime Minister's hosts, and the particular interests of their societies.

(ii) Note by the Lord Chancellor's Department on the BSA's report "Leaseholds - A Time for Change".

(iii) Note by the Treasury on:-

(a) Interest rates and the Chancellor's Bow Group speech.

(b) Competition for Savings.

(c) Investor Protection.

I hope they will be prepared to discuss opportunities in general terms.

2. The Prime Minister will find the Building Society representatives reluctant to talk about their future plans in front of competitors. Rather than asking the individual societies where they see their future opportunities, the Prime Minister might strike more of a spark by asking them whether they regard themselves as equipped and their staff as adequate, to cope with the new possibilities. She may also care to

glance at the record of the Economic Secretary's dinner, which gives the flavour of their initial reactions to the Green Paper.

M A HALL

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CHAIRMAN'S COMMITTEE OF THE BUILDING SOCIETIES ASSOCIATION

1 AUGUST 1984

The hosts are the President of the BSA (the Duke of Norfolk), the eight members of the Chairman's Committee and the Secretary-General. The Committee is the steering committee for the 30-strong Council, normally meeting twice a month ahead of the Council meeting. Like the Council, it is composed almost exclusively of chief executives. (Building societies usually have non-executive chairmen and largely non-executive boards.)

2. The Committee includes representatives of the 5 largest societies. Together the eight represent nearly 60% of the assets of the movement. The members, and their societies, are:-

Duke of Norfolk (Miles)

President since 1982 - succeeded Earl of Selkirk. No previous links with building societies.

Earl Marshal. Major-General (ret'd). Director of Robert Fleming (Holdings) Ltd since 1969.

Walden (Herbert) **Heart of England BS** (£0.3bn)

Age 57. In middle of two years as Chairman of Council. Has proved very effective through a testing time for Association - break down of "cartel", New Cross, taxation of gilts, second version of report on Constitution and Powers following reaction of building society boards against first:

General Manager since 1974 of Heart of England BS. A West Midlands society, formed by a series of amalgamations, head office in Warwick. Mr Walden has worked with Warwick BS and its successors since end of war. Was Chairman, South Warwickshire Hospital Management Committee 1964-72. Other interets: football, cricket.

Society is well run, but relatively conservative. Mainly interested in new powers for widening housing functions of societies.

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Cox (Roy) — **Alliance BS** (£2.8bn)

Age 58. Deputy Chairman. Presumptive Chairman from June 1985 to May 1987. Has reputation for being slightly unpredictable. Still to be tested in BSA office.

Chartered accountant. Joined Alliance in 1965. Chief General Manager since 1970. Has built up a strong financial management team under him, certainly on a par with the largest societies.

Main innovations have been on raising money. Pioneered issue of "yearling bonds". More recently has set up with Bank of Scotland "BankSave", possibly the most effective of the building society/bank joint schemes so far.

Is interested in development of housing finance. But also anxious to develop consumer credit, whether unsecured or secured by second mortgage, where he is convinced societies could out-compete finance houses.

Cumming (Alan) — **Woolwich Equitable BS** (£4.5bn)

Age 52. Chartered accountant. Joined Woolwich 1958. Chief Executive since 1969.

Was Chairman of BSA 1981-83. Almost certainly best chief executive of the larger societies and has built up strong management team under him. Was good, but not outstanding, Chairman of BSA.

Has expressed irritation at limitations of present legislation, but has been less specific about which particular powers he would envisage Woolwich using. The Woolwich has set up a housing trust company (like Nationwide) to take initiatives which they cannot do at present under existing powers.

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Ellis (John) **Abbey National BS** (£14.3bn)

Age 51. Chartered secretary. Joined Abbey 1956. Secretary since 1979. A "substitute" member of the BSA Council. Appointed last autumn when Clive Thornton resigned as Chief Executive. Apparently chosen because it would have been invidious to choose one of the internal candidates for the succession to Thornton. Thornton's successor, Peter Birch (ex Gillette), is now in post but has not yet taken over as representative. This has caused some problems since for the last nine months of marked changes, the second largest society has not had an authoritative representative at BSA.

Abbey's prime objective is to overtake the Halifax. Under Thornton it took a number of new initiatives, particularly in relation to housing. It formed the Abbey Housing Association to provide low cost homes and houses to rent. (Arrangements of this type under existing legislation are inherently unsatisfactory and have to be limited in scope. A major objective of new legislation will be to enable this to be done properly.) The Abbey were associated with Barclays in the major renovation scheme for an ex-council housing estate outside Liverpool (Cantril Farm). They have also launched a cheque scheme, for which the Co-op Bank act as clearing agent.

Under chairmanship of Sir Campbell Adamson the society is likely to continue emphasis on housing.

English (Cyril) **Nationwide BS** (£7.3bn)

Age 61. Joined society (then the Co-operative Permanent BS) in 1939. Chief General Manager since 1981. Retires next year.

Appears to be a very competent manager. Professes himself against "fashions", but is probably more innovative than an initial conversation would suggest.

Nationwide have set up a housing trust company, to do broadly what the Abbey Housing Association does. They have, over the years taken a significant number of initiatives in inner city areas, but with less blowing of trumpets than the Abbey. Would like to use new powers in the housing field, and also in some areas of money transmission which is not possible under present legislation. But is likely to be fairly cautious, at least in front of other societies, in saying what they would like to do.

The Nationwide have been a target for the Building Societies Members' Association (Mr Punt and others). In some ways this is ironic because Nationwide has given members more rights than some other societies. Neither side has come out particularly well. The management (but not Mr English personally) have been somewhat inept. The members have concentrated most of their criticism on relative trivia.

Hemingway (Peter) **Leeds Permanent BS** (£4.8bn)

Age 58. Chartered accountant. Joined Leeds 1962. Chief General Manager 1982.

The Leeds gives the impression of being the least dynamic of the big building societies. Yet it continues to grow at much the same rate and to be reasonably strong financially. It is just putting its toe into the water with the installation of Automatic Teller Machines (ATMs) - about six so far.

Spalding (John) **Halifax BS** (£16.8bn)

Will be 60 on Saturday next. Solicitor. In local government service before joining Halifax in 1964. Chief General Manager since 1982. Does not appear to carry as much weight in discussions in BSA as might be expected for occupant of his position. Still tends to look at things from a narrow legal viewpoint, and not to recognise implications of Halifax being a major financial institution with considerable economic influence.

Is BSA representative on the Conveyancing Committee (Chairman Professor Farrand).

Chaired the original BSA working party, which led to its first report on Constitution and Powers, published in spring 1983. (That report is usually referred to as the "Spalding Report", although the BSA Council changed some of the recommendations of the Spalding Committee before it was published.)

The Halifax's prime objective is to stay ahead of the Abbey. It too has a cheque scheme. It has made more headway than any other building society with installation of ATMs and will have more than 200 by the end of this year. It too has been supporting various housing initiatives in inner city areas. A new chairman, Richard Hornby (ex MP and junior minister, who then retired from politics to J Walter Thomson) took over last year and it remains to be seen whether it will change its "somewhat slow, sound and thoroughly reliable" image.

Strickland (Frank) **Sunderland and Shields BS** (£0.2bn)

Age 56. Whole career in building societies. Joined one of the constituents of his present society in 1963. Chief Executive since 1975. While on the BSA Council has been mainly concerned with its finance and tax work.

The Sunderland and Shields has been formed by bringing together some 15 societies over the last 20 years, all in a relatively tight geographical grouping between Durham, Sunderland and the River Tyne. It is a good example of a strong local society competing effectively with national societies. (NB Mr Strickland may be somewhat reticent to say too specifically how he does it, in front of the national societies!)

Like the Heart of England, Sunderland and Shields is probably mostly interested in the widening of the housing powers.

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Weir (Richard)

Age 51. Barrister. Secretary-General of the BSA since 1981. Previously Director of the Retail Consortium and before that Secretary, Co-operative Wholesale Society Limited.

Registry of Friendly Societies
30 July 1984

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BSA REPORT: "LEASEHOLDS - TIME FOR A CHANGE?"

1. The transfer and enforcement of positive and restrictive covenants in both freehold and leasehold property give rise to fundamental problems in property law. The problems were recently examined in depth by the Law Commission in their report on Positive and Restrictive Covenants (Law Com. No. 127). That report proposes a new scheme of land obligations but is intentionally incomplete, because of the need to solve some outstanding problems including transfer of Crown land and questions relating to compulsory purchase. The Lord Chancellor has accepted the report as a working document for further consultation and has written both to Members of Parliament and to the Building Societies Association to say that this is his intention.

2. A separate Government initiative has been taken by the Minister for Housing and Construction over the law governing the management of blocks of flats. He has set up an enquiry on the subject under the Chairmanship of Mr E G Nugee, QC, although that Committee is working on the matter in the context of the law of landlord and tenant rather than that of tenure.

3. The BSA's report "Leaseholds - Time for a Change?" thus forms part of a wider consideration of these issues. The BSA advocate the so-called strata title * system which has existed in New South Wales for some years. The Lord Chancellor has acknowledged the Building Societies Association Report and asked his officials to consider it in conjunction with the Law Commission Report No. 127. The Minister for Housing and Construction has sent a copy of the B.S.A. report to the Nugee Committee with a request that they should take its findings into account.

Line to take

4. The BSA report "Leaseholds - time for a change" presents an attractive and persuasive argument for dealing with the leasehold flat problem by adopting the strata title system developed in New South Wales. However, the proposals will have to be examined in greater depth before any conclusion can be reached and account taken of its relationship with the Lord Chancellor's work on the Law Commission Report on Positive and Restrictive Covenants (Law Com. No. 127) and with the Committee on the management of privately owned blocks of flats chaired by Mr E G Nugee QC, to whom Mr Gow has sent the BSA report.

* I will secure a layman's description of this in the morning.

INTEREST RATES AND THE CHANCELLOR'S BOW GROUP SPEECH

Following the increase in bank base rates, the BSA increased its "advised rates" on 13 July, by 2¼ per cent on mortgages to 12½ per cent, and 1½ per cent on ordinary share accounts to 7¾ per cent. But most of the big societies have announced that their basic mortgage rates will be higher than the advised rate. The most common figure is 12¾ per cent, although Abbey National have gone for 12 7/8 per cent, and Nationwide and Leeds Permanent 13 per cent. (They have in general stuck to the advised share rate, so that the extra income can be used to widen margins and/or finance new premium accounts.)

2. The BSA have suggested that this was encouraged by the Chancellor's speech to the Bow Group on 3 July, in which he trailed the main Green Paper proposals, including withdrawal of the interest rate cartel's exemption from restrictive trade practices legislation. The BSA were given about 24 hours' notice of the content of the speech. They were aware earlier that the cartel would be discussed in the Green Paper, with a strong steer towards its abolition, although they were not expecting the recommendation to be as firm as it came out.

Points to make

a. For a year or so, mortgage rates had been less uniform between societies. The cartel was breaking down in practice. Why should the Chancellor's speech make such a difference? The Green Paper's comments on the cartel have been generally received as retrospectively validating what the societies have already done.

b. The main reason for the increase was that in bank base rates. The Chancellor's speech could not have anticipated this.

COMPETITION FOR SAVINGS

The attached table shows the relativities between interest rates paid by National Savings, building societies and banks on comparable investments before and after the recent increases in rates. National Savings have become more competitive compared with building societies for tax payers, but the societies can still offer better rates. For non tax payers, National Savings do better than banks, and both give a higher return than building societies. There is no building society instrument comparable with the new National Savings certificate, which offers 9 per cent per annum tax free over five years.

2. The building societies have not reacted strongly against the new National Savings package. They will be watching the total amount funded through National Savings, and will be quick to react if National Savings look like exceeding the target of £3bn for the current financial year.

TABLE: INTEREST RATES AND DIFFERENTIALS BETWEEN NATIONAL SAVINGS, BUILDING SOCIETIES AND BANKS (%, NET OF TAX)

	National Savings			Building Societies			Banks		
	Non Tax-payer	Basic Rate	60%	Non Tax-payer	Basic Rate	60%	Non Tax-payer	Basic Rate	60%
	INVESTMENT ACCOUNT			28-DAY NOTICE ACCOUNTS			HIGH-INTEREST ACCOUNTS		
Interest Rate OLD	9.25	6.475	3.7	7.5	7.5	4.29	8.75	6.125	3.5
NEW	12.0	8.4	4.8	9.0	9.0	5.14	11.0	7.7	4.4
Interest Differentials* OLD	-	-	-	1.75	-1.025	-0.59	0.5	0.35	0.20
NEW	-	-	-	3.00	-0.60	-0.34	1.0	0.70	0.40
Change	-	-	-	1.25	0.425	0.25	0.5	0.35	0.20
	DEPOSIT BONDS			90-DAY NOTICE ACCOUNTS					
Interest Rate OLD	10.0	7.0	4.0	7.75	7.75	4.43			
NEW	12.75	8.925	5.1	9.25	9.25	5.29			
Interest Differentials* OLD	-	-	-	2.25	-0.75	-0.43			
NEW	-	-	-	3.50	-0.325	-0.19			
Change	-	-	-	1.25	0.425	0.24			

Notes *Differential = National Savings Rate less Competing Rate

OLD rates are those prevailing for Banks before 6/7/84, and for Building Societies ~~after~~ before 13/7/84

NEW rates ~~are~~ for National Savings will be effective from 31st July (Investment Account) and 2nd September (Deposit Bonds)

INVESTOR PROTECTION SCHEME

At present a voluntary scheme run by the BSA protects investors in societies. It guarantees 90 per cent protection to investors in participating societies (which represent the great majority) and 75 per cent for the minority of very small societies who do not contribute to the scheme.

2. The Green Paper proposes replacement by a statutory scheme, still underwritten by societies as a whole, which has several advantages, notably earlier repayment in cases like the New Cross. Minimum protection along the lines of that under the Banking Act - 75 per cent of deposits up to £10,000 - is proposed. But it would allow further protection if the societies wanted voluntarily to top up to the level of the existing BSA scheme.

3. This was highlighted in the "Times" report of the Green Paper, attached, the gist of which was that building society investments would as a result be less secure. Unfortunate remarks by the Abbey National and Nationwide were included.

Line to take

4. The Prime Minister could take the offensive. We are concerned about the unfortunate remarks by some societies quoted in the press. As the Green Paper makes clear, investor confidence is essential for the societies as a whole. Remarks like those quoted could undermine that confidence. If it would be preferable instead to go for a higher degree of mandatory protection than under the Banking Act, the Government would certainly be prepared to consider it.

5. It may be suggested that in practice societies in trouble are taken over, so avoiding any risk of loss by investors. (The Woolwich did so in both the Gray's and New Cross cases.) If that is the case, however, the remarks in the "Times" become doubly unfortunate because they will have caused needless concern.

TUESDAY 24th JULY 1984

THE TIMES

Building societies win freedom to act as banks

By Lorna Bourke

Building societies have effectively received government approval to offer a full range of financial services, including cheque books, overdrafts, personal loans, cheque guarantee cards, cash machine and money transmission facilities, in direct competition with the high street banks.

But the price of this freedom could be a significant reduction in the degree of protection offered investors in smaller societies, and a reluctance by societies to cut the mortgage rate when interest rates are falling.

"The days are over when the big societies are going to bend over backwards to protect investors in the small societies", Mr John Bayliss, a general manager of Abbey National Building Society, said.

Firm government proposals contained in a Green Paper published yesterday give societies most of the concessions they requested – the ability to offer the full range of personal banking facilities and the freedom to hold land which would enable societies to build homes for renting or sale.

These proposals will be included in legislation, due to be enacted in the 1985-86 Parliamentary session and are expected to be in effect by January 1987.

But the controversial aspect of them is the firm recommendation that the building societies existing compensation scheme be brought into line with the deposit protection provisions under the 1979 Banking Act. This would reduce the amount of compensation to which building society investors are entitled.

Under the voluntary scheme investors in building societies are compensated in the event of a building society failing, for 90 per cent of their investment, without limit. The 1979 Banking Act offers compensation for a maximum of 75 per cent on deposits up to £10.000.

The Green Paper envisages the continuation of the 90 per cent cover as a voluntary "top up" arrangement in addition to the statutory minimum. But there will be little incentive for the larger societies to join such a scheme.

"I don't know whether all societies will want to contribute to a voluntary scheme. It will certainly be very difficult to get 100 per cent agreement – it is a difficult situation", Mr Herbert Walden, chairman of the Building Societies Association, said.

That view was echoed by Mr Malcolm Hughes, general manager (market planning of Nationwide Building Society.

"I think a lot of buildings societies are becoming progressively more unhappy about the way small societies are becoming very aggressive in the fight for deposits, while hiding behind the voluntary compensation scheme", he said. "I think it will be very hard to get agreement on a voluntary top-up scheme."

Mr Bayliss (left) and Mr Walden: new freedom

The other proposal which could upset building society borrowers is the Government's recommendation that the societies' exemption from the Restrictive Trade Practices Act be withdrawn.

That exemption allowed the societies to operate the interest rate agreement - now largely abandoned. But if they were precluded from even "advising" on rates, as they might be once the exemption is formally withdrawn, then there could be real difficulties in getting mortgage rates down when interest rates generally are falling.

Other proposals, contained in the Green Paper, that societies should be free to offer estate agency, insurance broking, conveyancing and valuation services on an in-house basis have not yet been given full government approval and are still under review.

Opposition reaction to the Green Paper was adverse. Dr Oonagh McDonald, Labour's spokesman on economic affairs, said: "It will mean lending short term at greater risk without the essential expertise in credit analysis and control.

● From September next year, building societies will be obliged to quote an annualized percentage rate to borrowers, in line with the requirements of the Consumer Credit Act, the Department of Trade and Industry announced yesterday. This will make it easier for borrowers to compare rates with the banks, which already quote an APR.

UNCLASSIFIED

NOTE FOR THE RECORD

DINNER WITH THE BSA: WEDNESDAY 25 JULY

The Economic Secretary attended a small dinner hosted by Herbert Walden, Chairman of the BSA and members of the Chairman's Committee. A guest list is attached. Before broaching the main topic of the evening's conversation, the Green Paper, Mr Walden raised two points which concerned the BSA.

Corporation Tax

First, members of the BSA were worried by the implications of the loss of the special rate for Building Society Corporation Tax announced in the Budget. Would building societies be hooked up in any eventual rise above 40 per cent? The Economic Secretary made two comments in reply. First, while he obviously could not speak for any future administration, this one had no intention of letting the rate of corporation tax rise. Secondly, he explained that one of the implications of greater fiscal neutrality was the dismantling of special rates. The move had been part of the broader trust of the Budget.

Taxation of Pensions

Mr Walden said that he was aware that there were rumours circulating to the effect that the Government was considering whether or not the commuted part of pensions ought to be subject to tax. Not only would the staff of the building society movement be adversely effected by any such move, the pattern of investment would also be affected as the commuted part of pensions were more often than not invested

in building societies. He hoped that, if such a move were being considered, then there would be no question of it being introduced "out of the blue" in the same way as the changed basis of taxation for building society gilts had been on 23 February. The Economic Secretary explained that this topic was far from his Ministerial remit but that he would certainly pass on the points raised.

Green Paper

Mr Walden gave the Green Paper 18½ out of 20, marking it against the BSAs recommendations. It was marked down on the following points:

i) Class one assets. Confinement to owner occupied housing was a little too restricted. What about purchases on behalf of other members of the family?

ii) Estate agency: the recommendations here were too pale a shade of green. The Government was clearly not convinced of the merits of a move by building societies into this area;

iii) Minimum holdings for resolutions. £100 was much too low. Why not the BSA's recommendation of £250?

iv) Investor protection. 75 per cent was too low a figure. Mr Walden would have preferred to see 90 per cent and doubtless the BSA would be recommending some form of top-up scheme to take societies above the 75 per cent level;

v) Removal of the cartel. His own considered view was that the removal of the cartel would on balance result in higher rates, and the downward movement of rates would be more sticky than had been the case in the past. There would need to be careful consideration of how, in the absence of cartel, an advisory system would operate for the smaller societies.

In picking up discussion of the cartel, Roy Cox commented that although in theory there was a period of some years grace before the exemption from the Restrictive Practices Act was removed, in reality there was, as one can see from the latest mortgage rise, no transitional period at all. He and Mr Walden were both of the opinion that the Chancellor's trailer of the abolition of the cartel in his recent speech had been decisive in shaking a number of societies loose from the recommended rate. Both he and Mr Spalding expressed concern that if "unarraigned" competition in attracting funds had an adverse impact on macro-economic factors in general and PSL2 in particular, then the Government ought not to attempt to control the volume of lending through other means. This would, inevitably, be a temptation but would be at odds with the whole thrust of competition policy. Mr Spalding added that he was concerned that if the various deregulatory measures anticipated in the Green Paper did have adverse implications to monetary policy, then the Treasury would not communicate its displeasure with "oblique and easily misunderstood signals". Early and explicit consultation with the building society movement should be sought.

Prudential Framework

Mr Spalding observed that the tighter prudential framework had the danger of awarding Draconian powers to the office of the Chief Registrar. He had some misgivings about such

powers being awarded to an officer of Government. Mr Walden welcomed the proposal for an intermediate powers and commented that it would have been useful if the Registrar had had such powers during the New Cross case. It offered protection to the Chief Registrar and to any society with which he was concerned. The Economic Secretary commented that in considering the appropriate system by review, he had come to the conclusion that a general framework was needed rather than a highly discretionary one. The movement at present was not suited to the sort of discretionary system under which licenced deposit-takers were reviewed under the Banking Acts. Mr Weir agreed.

Impact of Proposals on Smaller Societies

Mr Walden commented that he was not worried by the suggestion in the Green Paper that societies with less than £3 million free reserves should be allowed the same powers as the larger societies. They would not, in any case, have had the infrastructure to exercise them. In an aside Mr Bolleat commented that middle-sized societies would be the most adversely affected by the proposals. The smaller societies would carry on much as they had done and would be supported by their strong local roots. The very large ones would move rapidly into new areas. The middle ones would be left with neither the infrastructure to exercise new powers nor the local roots to survive on traditional business.

AE

A M ELLIS

26/7.

Circulation

PS/Chancellor
PS/Financial Secretary
PS/Sir P Middleton
Mr Cassell
Mr Lankester
Mr Hall
Mr Pratt
Mr Saunders
Mr Portillo
Mr Bridgeman - RFS

DINNER WITH THE BSA: WEDNESDAY 25 JULY

Economic Secretary

Herbert Walden - Chairman of the BSA Council & Chief General Manager of the Heart of England Building Society

Roy Cox - Deputy Chairman of the Council & Chief General Manager of Alliance

John Spalding - Chief General Manager of the Halifax

Richard Weir - Secretary General of the BSA

Mark Bolleat - Deputy Secretary General

Barry Henderson - PPS to the Economic Secretary

Adrian Ellis

COND

PRIVY COUNCIL OFFICE

WHITEHALL. LONDON SW1A 2AT

19 July 1984

NBPM

AT

1917

Dear David

Building Societies: A New Framework

The Lord President has seen the Chancellor's minute of 12 July to which was attached the text of the Green Paper. He is content for the Green Paper to be published on 23 July.

I am sending copies of this letter to the Private Secretaries to other members of E(S) Committee, to John Ballard (Department of the Environment), John Graham (Scottish Office), Colin Jones (Welsh Office) and Richard Hatfield (Cabinet Office).

Yours sincerely

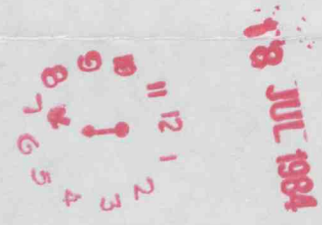
R Lawrence

R D LAWRENCE
Asst Private Secretary

David Peretz Esq
HM Treasury

Hobby May 79

Building Societies



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bc N.Owen

c LPO
FCO
HMT
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DTI
CDL

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10 DOWNING STREET

From the Private Secretary

16 July 1984

Building Societies: A New Framework

The Prime Minister has seen the Chancellor's minute of 12 July to which was attached the text of the Green Paper. She has noted the new Ministerial foreword and is content for the Green Paper to be published on 23 July.

I am copying this letter to the Private Secretaries to other members of E(S) Committee, to John Ballard (Department of the Environment), John Graham (Scottish Office), Colin Jones (Welsh Office) and Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

David Peretz, Esq.,
H.M. Treasury.

RESTRICTED

7.14

CONFIDENTIAL

Prime Minister (2)

To note the final version and to see the Chancellor's foreword which you requested.

13/7

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

BUILDING SOCIETIES: A NEW FRAMEWORK

I attch a draft of the Green Paper on the future of building societies promised in our Manifesto. The text is very similar to that which you have already seen and which incorporated comments from Patrick Jenkin and Norman Tebbit. It will form the basis of the Building Societies Bill for which QL has granted a place in the 1985/86 legislative programme. With the agreement of colleagues in ES, I intend to publish the Green Paper on Monday 23 July. I regret that printing deadlines mean that any comments which might affect the text must therefore reach me by close on Monday 16 July.

2. The main themes of the Green Paper are brought out in the Ministerial foreword. It is essential for building societies to continue to be seen primarily as safe havens for the small saver and as providers of finance for home ownership. But there is scope for societies to diversify without prejudicing that successful formula, fulfilling the twin objectives of allowing them a more direct and active role in housing and of improving competition in High Street financial services.

3. The Green Paper contains other recommendatios too. Chapter 5 deals with constitutional questions, proposing various improvements in election procedures etc, and suggesting a new procedure enabling societies who so wish to convert to company status. In Chapter 6 we propose the ending of the building society interest rate cartel's exemption from the restrictive trade practices legislation when a new Building Societies Bill is enacted. A separate appendix discusses the prudential supervision by the Chief Registrar of Friendly Societies and makes various proposals for changes in his regulatory powers, partly in the light of experience in the New Cross affair.

4. I should be grateful for colleagues' agreement to publication of the Green Paper on 23 July.

5. I am copying this minute to the other members of ES Committee, to the Secretaries of State for the Environment, Scotland and Wales and to Sir Robert Armstrong.

N.L.

12 July 1984

Housing : Building fees 5/79

BUILDING SOCIETIES : A NEW FRAMEWORK

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By the Rt Hon Nigel Lawson MP, Chancellor of the Exchequer	
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FOREWORD

Building societies play an important part in the lives of millions of British people. They have been highly successful in offering a safe haven for people's savings, and in lending people money to buy their homes. The building societies have performed a key role in increasing the proportion of home ownership in this country to over 60 per cent. Since 1980 alone, their assets have risen by more than 30 per cent in real terms to a massive £86 billion.

But the law that governs building societies was not designed for institutions as large as they have now become. It imposes limits on the business that they can do which in many cases make little sense today. As the pattern of housing has changed, people have looked to the societies to provide a wider range of improved services. But they have been constrained by their outdated legal framework from doing so.

The Government's election manifesto last year accordingly promised early public consultation on how the building societies could play a fuller part in providing people with new housing, and how to bring the law up to date. This Green Paper invites views on specific proposals which could form the basis of new legislation during the lifetime of this Parliament.

Our purpose is to ensure that the building societies continue primarily in their traditional roles - holding people's savings and lending for house purchase - while loosening the legal restraints under which they have operated for a century or more so that they can develop in other fields.

This Green Paper proposes not only a more active part for the societies in the provision of housing, but also the opportunity to offer a wider range of other services. So, by allowing the societies new powers, we can both further encourage home ownership and look forward to fuller and freer competition for financial services, to the great benefit of all who use them.

BUILDING SOCIETIES: A NEW FRAMEWORK

CHAPTER 1 - INTRODUCTION

1.1 This Green Paper reviews the present legislation governing building societies. The main legislation is the Building Societies Act 1962, which largely consists of provisions which are well over a hundred years old. It is widely accepted that the time is now ripe for a comprehensive review.

1.2 A Building Societies Association (BSA) discussion document, published in January 1983, considered possible amendments to the statutory powers and constitution of the societies. A further document "New Legislation for Building Societies", taking account of comments on the earlier paper, was published in February this year. This has been of valuable assistance in setting the scene for this public consultation and the Government's comments on the BSA's proposals are contained in this paper. It is also necessary, however, to consider matters which were not explored in depth in the BSA's documents, like the prudential supervision of building societies and the arrangements for setting building society interest rates. These questions are also therefore considered.

1.3 Comments are invited on the proposals in this Green Paper by 15 October 1984. They should be sent to HM Treasury, HF1 Division, room 37/G, Parliament Street, London SW1P 3AG.

History

1.4 Building societies began in the late 18th Century, as people moved from the country to the towns during the industrial revolution. Initially, they were "terminating" societies: a group of perhaps ten or twenty people contributed regularly until they had saved enough to buy land and start building. Members would draw lots to decide who was housed first; payments continued until all members were housed and the society then terminated. In the early 19th Century, there emerged societies which paid interest to attract investors who did not want a house, and permanent societies which did not cease to exist when all members were housed, but continued to borrow money from savers and lend to prospective house owners.

1.5 The societies were first recognised statutorily in 1836, but the major piece of legislation was the Building Societies Act 1874, which followed the report of the Royal Commission on Friendly Societies in 1871. Over the next 85 years this legislation was amended from time to time but its basic structure has been left intact. The law was consolidated in the 1962 Act.

1.6 At the turn of the century, there were over 2,000 societies, almost all locally-based. As terminating societies have wound up and permanent societies merged, their number has steadily fallen, to about 200 today. Some are still very locally based, but others have strong presences throughout particular regions or - in the case of the largest - extensive branch networks covering the whole of the United Kingdom. The volume of building society business has grown enormously, reflecting in part the growth of home ownership. The assets of the movement as a whole have increased from £87 million in 1920 to £86 billion at the end of 1983, an increase of about 100-fold in real terms. Appendix 1 gives more details about the development and present structure of the building society movement.

The Government's approach

1.7 The societies have been very successful both in offering a safe home for investors' money and in financing the growth of home ownership. Nothing should be done to prejudice their success. Their primary role as specialists in the housing finance and personal savings markets, and their mutual constitution, should remain. There is however considerable scope for them to offer new services, and to further competition in the financial services industry, without prejudicing those objectives. The environment within which the societies operate is changing fast. The Government intends to let them play their proper part in those changes.

1.8 The societies' main role will continue to be in the housing field, in particular housing finance. They have made a vital contribution to the extension of home ownership, which the Government is determined to bring within reach of as many people as possible. The building societies' role in this should continue undiminished. But there are other ways in which the expertise, resources and public standing of the societies can be applied to the benefit of all. Some societies have already made an important contribution even within the constraints of the existing legislation.

1.9 This Green Paper describes some of the ways in which societies could further contribute to the extension of home ownership and to meeting general housing needs. It outlines possibilities for new forms of lending, and for contributing to new, low cost housing and to initiatives for shared ownership. The Government also believes that building societies could help the private rented sector by owning and developing land and property. They might also participate through the management of housing investments of other bodies.

1.10 It is important that building societies should be competitive in attracting savings. Major structural changes are now taking place in the financial services sector. Although these have not directly involved building societies, they will have a significant

impact on the commercial environment in which they operate. Building societies will probably need to respond too to a trend towards "one stop" centres for financial and investment services. This paper therefore considers how far the societies might expand their services while safeguarding their main role as providers of housing finance. The Government welcomes competition in this market, for competition ensures the best service to investors. But the Government is also determined to ensure fair competition. For example, measures have been taken, notably in the 1984 Budget, which have promoted a much greater degree of fiscal equality between banks and building societies.

1.11 There is however a potential conflict between the benefits of the societies diversifying into new business and the importance of maintaining their safety as homes for investors' money. For example, diversification into property rather than loans secured by mortgage would be inherently more risky. The free play of competition between financial institutions must always be tempered by the need to ensure the protection of investors. Any move by societies into the provision of new services should not detract from their main role. The scope for diversification should therefore be limited and subject to proper prudential control. Nor should it create significant conflicts of interest. This is discussed in Chapter 2.

Building societies and monetary policy

1.12 As the societies have grown, so they have become more relevant to the formulation of the Government's monetary policy. Two monetary aggregates which include the majority of the liabilities of the societies are now published, namely M2 and PSL2. As noted in the Financial Statement and Budget Report 1984-85, the Government regards building societies' liabilities as "an important element in monetary conditions" and takes account of M2 and PSL2 in interpreting the behaviour of MO and £M3, the measures of narrow and broad money used for target purposes. Too rapid a growth of building society liabilities and lending could be a course for concern. The Government seeks to influence monetary growth by fiscal policy, funding and intervention in the money markets, which has an effect on short term interest rates. These policies have an impact on the growth of building society liabilities as well as those of the banking system.

1.13 From time to time successive Governments have also sought the co-operation of building societies in the execution of monetary policy. In 1982, the present Government became concerned that lending for house purchase might be unduly inflated by borrowers realising housing equity to finance other expenditure. Guidance was therefore issued to the banks, insurance companies and building societies which is designed to ensure as far as possible that borrowers who increase their mortgage on moving house do not reduce their own equity stake in housing.

CHAPTER 2 - THE PRUDENTIAL FRAMEWORK

The present financial structure of building societies

2.1 The existing financial structure of the societies reflects the present pattern of their business and sets limits on the scope for and pace of change.

2.2 Building society balance sheets are quite simple. The main assets are loans to members secured on mortgage (typically about 80 per cent of the total); liquid assets (usually in the range 17-20 per cent); and fixed assets, such as land, buildings and equipment, which average about 1¼ per cent of the total. The other side of the balance sheet consists largely of shares and deposits from members of the public, although recently the larger societies have been raising a proportion of liabilities (up to about 10 per cent in one or two cases) by issuing certificates of deposit or negotiable bonds, or from other wholesale money market sources. The excess of assets over liabilities is the general reserve, representing accumulated surpluses over the years.

2.3 There are some important points to make about this structure:-

(a) Normally a building society's assets are very safe. Fraud and inadequate valuations apart, the main risk might be a serious collapse in house prices in circumstances where significant numbers of borrowers had defaulted on their repayments; or if a society imprudently placed a substantial proportion of its liquid funds in assets which then recorded a capital loss.

(b) The societies have been able to keep the interest rates paid to their investors in line with market rates, despite large fluctuations, by lending on terms under which they can vary at short notice the rates they charge their borrowers. This is unlike, for example, the Savings and Loan Associations in the USA (the nearest equivalent there to UK building societies), many of whom have encountered serious problems in recent years through their inability to increase their lending rates to match increased costs of raising money.

(c) The relatively low risk of capital loss, and the absence of any need normally to provide for unforeseen losses on the revenue account, means that a building society can maintain lower reserves as a percentage of assets than other financial institutions.

(d) This in turn means that additions to reserves (in other words, profitability) can be relatively small. It is necessary for them to make some profit if only to maintain the ratio of reserves to total assets at a time of growth. Nor have

they had to earn a further surplus for distribution to proprietary shareholders. At current rates of growth, an addition to reserves of only about ½ per cent of assets per year would be typical.

(e) Building societies borrow short and lend long. It is therefore necessary for a significant proportion of assets to be held in readily realisable form, for example, cash, bills, and short dated government stock or short term deposits with local authorities. These are their liquid funds, which are necessary to enable fluctuations in cash flow to be covered without the society becoming illiquid, or even to run the risk of appearing so, and hence losing investor confidence.

2.4 For any given society, the appropriate reserve and liquidity ratios and the surplus it should aim to achieve depend on a range of factors: the quality of its mortgage book, its rate of growth, the volatility of investors' funds, and so on. But in general, the very limited range of activities in which they can engage on the assets side enables the societies to combine a high degree of security for investors with relatively low reserve ratios. Their specialisation also leads to relatively low management costs. Together these mean that they require a relatively narrow margin between the interest rates they pay and those they charge.

2.5 New building society assets or activities would tend to imply greater risks than at present. Any institution needs a capital base which is adequate to cover any conceivable losses, particularly if it is receiving deposits from members of the public who have contracted to get their investments back a pound in the pound. A building society's capital base is its reserves, but for most purposes, it is more useful to consider its "free reserves" - its general reserve less fixed assets - rather than total reserves. Reserves may be built up only out of realised profits; a society's capital base cannot be expanded as rapidly as a company's, which may do so by a rights issue, for example. It follows that a building society's free reserves should be reasonably matched from the outset to the scale and nature of the risks in the business it is taking on. Similarly, liquidity needs to be related to conceivable fluctuations in cash flow.

2.6 These concepts are not new, but they are not reflected comprehensively in existing legislation or in the current general guidance from the Registry of Friendly Societies. The Chief Registrar will be producing discussion papers on the criteria for assessing the adequacy of reserves and liquidity, similar in character to those which the Bank of England has produced for banks and licensed deposit takers.

General limits on building societies

2.7 The existing statement of building society objects - effectively the statutory definition of a society - is in section 1(1) of the 1962 Act:

> "The purpose for which a society may be established under this Act is that of raising, by the subscriptions of the members, a stock or fund for making advances to members out of the funds of the society upon security by way of mortgage of freehold or leasehold estate."

A society has at present powers to do only what is necessary for this purpose or reasonably incidental to it, such as owning offices, employing staff, advertising and arranging insurance on properties mortgaged to it.

2.8 This definition has served well over the 110 years since it was first enacted. But societies are now seeking to widen their activities in ways not forseen then. Considerable time has to be spent on establishing whether particular proposals for diversification are legal, sometimes with recourse to the courts. The definition of their purpose needs refinement and expansion to reflect the way building society business has developed and to allow the sort of diversification now proposed.

2.9 The Government therefore proposes that section 1(1) should be amended to provide that the primary purpose of a building society is to raise funds from individual members for lending on security of mortgage on owner-occupied residential property. A society could then do not only what was necessary for or incidental to that primary purpose, but also engage in a range of related activities, subject to quantified limits on those involving either the acquisition of assets or the incurring of liabilities. These permitted activities would be set out in a list, the contents of which would be variable by order, subject to Parliamentary approval, as would the quantified limits.

2.10 These broad limits would take the following forms:-

(a) At least 90 per cent of total assets, other than liquid assets and fixed assets, should be advances to individual members secured by first mortgage on residential property which the borrower occupies.

(b) A society should be required to hold sufficient liquid assets for its business, but not more than one-third of total assets. The maximum would ensure that the bulk of its funds was applied to housing, the primary purpose of societies, rather than investment in gilt-edged stocks and other money market instruments.

(c) At least 80 per cent of funds should be raised from individual members, allowing up to 20 per cent from the money markets and other sources. The

purpose of this limit would be to retain the traditional role of building societies as a home for personal savings. It would also limit their exposure to the more volatile money markets. Some exception to this rule would be needed in particular cases, notably loans from other building societies under Section 44 of the 1962 Act to a society facing a liquidity crisis. The Chief Registrar would also be able to lift the limit in exceptional circumstances and subject to conditions.

Supervisory controls of the Chief Registrar

2.11 Building societies are subject to prudential supervision by the Chief Registrar of Friendly Societies who carries out various statutory functions to protect investors. If the societies are to have wider powers, it follows that his functions will need to be extended. The statutory powers of the Chief Registrar, both present and proposed, are discussed in detail in Appendix 2.

2.12 Building societies have been restricted by law to a narrower range of significantly lower risk assets than those held by other deposit takers. Their prudential supervision has therefore differed from that applied by the Bank of England under the Banking Act - with both less intensive monitoring by means of returns and less frequent direct contact between supervisor and supervised. It has, however, been developed over the last decade or so. This has reflected the increase in public concern about the prudential standards applied generally to financial institutions, the particular weaknesses shown up by a series of building society failures, notably the Grays, and in response to the increased competition over the last few years among societies and with other financial institutions. Although the system of supervision will become more akin to that applied to the banking system, it will still differ in degree and form, and as a result place less burden on the management of societies, because general constraints will remain on building society assets.

2.13 Building societies will have to keep predominantly to their mainstream business. A society would be acting ultra vires if it did what it was not permitted to do. If a society appeared to be likely to breach any of the prescribed limits on permitted assets or liabilities, the Chief Registrar could direct it to put to its members plans for conversion to a company. If it failed to do so, if the members rejected the plan, or if the Bank of England did not give any assurance about granting a deposit-taking licence, he could apply to the Court for an order winding up the society, or imposing a reconstruction upon it, or limiting the amounts of certain types of assets which it could hold.

2.14. A building society would also have a duty to do certain things in order to protect investors' money, some of which are already specific requirements:-

(a) to maintain reserves, and more specifically free reserves, adequate for its particular business;

(b) to maintain liquidity adequate for its particular business;

(c) to observe the limits on building society assets;

(d) to have adequate management for its business and carry it on with integrity and prudence;

(e) to maintain adequate systems of internal control and inspection;

and (f) to have adequate arrangements for independent valuation of mortgaged property.

2.15 Failure by a building society to observe these requirements, or otherwise to protect the interests of its investors, would be grounds for the Chief Registrar to use his statutory powers. These would include as now a ban on advertisements, either generally or of a particular character, or the revocation of authorisation. The Government also considers there to be a case for a new intermediate power for the Chief Registrar to impose conditions on a society for continued authorisation. It will be considering further whether the existing safeguards on the exercise of these powers will continue to be appropriate after new legislation.

2.16 The Government announced in January 1983 that extra professional and other staff would be recruited to the Registry of Friendly Societies in order to strengthen the prudential supervision of building societies. The new powers discussed in this paper may require some further strengthening and increase in staffing. The additional cost would be modest and the legislation will provide for the recovery by the Registry of its full costs from the various groups of societies for which it is responsible; at the present time, the Registry's powers to charge fees extend to functions representing only about 15 per cent of its full costs.

2.17 It is also proposed that the building societies' investor protection scheme should be made compulsory for all societies and put on a fully statutory basis.

CHAPTER 3 - ASSETS AND LIABILITIES

3.1 This Chapter considers new building society powers which would involve new forms of assets or liabilities. Assets are discussed in three groups, described as Classes 1, 2 and 3 respectively, which categorise them by the nature of the business involved. Class 1 would be the principal business of the societies: mortgage loans to individual owner-occupiers. Class 2 would consist of other forms of secured lending, while Class 3 would be new types of asset, in particular unsecured loans and equity. Taken together, these are termed in this paper the "commercial assets" of societies, as distinct from their liquid assets and their fixed assets, such as office premises. A building society's spread between the asset classes would be subject to limits: at least 90 per cent of commercial assets would have to be in the form of Class 1 assets, and no more than 5 per cent Class 3, although these limits, and other features, could be amended later by order subject to Parliamentary approval. Following the introduction of these new limits, the current special advances limit, restricting loans exceeding £60,000, or of any amount to corporate borrowers, to 10 per cent of total lending, would be repealed.

Class 1 Assets

3.2 These would be advances secured on first mortgage of residential property to individuals who are owner occupiers of that property. They would include both traditional repayment mortgages and index-linked mortgages where the advance outstanding and the charge securing it is related to some general price index. At least 90 per cent of commercial assets would have to be Class 1. This is in theory somewhat narrower than existing powers since it excludes lending to bodies corporate or lending on non-residential property, which are included in Class 2. But in practice about 99½ per cent of building society advances are currently secured on domestic property, and lending to bodies corporate, already constrained legally by the special advances limit, also accounts for a very small proportion of lending. So a limit of 10 per cent of commercial assets in Classes 2 and 3 would in practice give societies considerable scope for the acquisition of new types of assets.

3.3 The BSA have suggested that building societies should be able to take into account, when considering advances of a high percentage of valuation, any additional security offered by the borrower. (At present, only certain specified types are permitted.) The Government accepts this. So long as the advance is within the valuation, there is no point in restricting the additional security which the society can take. A society's practice in respect of the percentage advance and the types of additional security may however need to be taken into account in assessing the adequacy of its reserves.

3.4 It has also been suggested that the requirements for societies to seek fresh valuations before making further advances on existing mortgages are too onerous, involving full valuations where the new loan is clearly well within the value of the security. There will clearly be many circumstances in which a further valuation is not necessary. The Government will consider whether the present law is deficient in this respect and if so what change may be required.

Class 2 Assets

3.5 Class 2 assets would consist of other forms of wholly secured lending. They could in theory account for up to 10 per cent of commercial assets. Although a less traditional form of lending than Class 1, they would not necessarily be higher risk. Some - like lending to bodies corporate or loans secured on non-residential property - are already within building society powers. If a building society felt able to make a secured mortgage loan to a small business proprietor under its existing powers, for example, this would be likely in future to be within Class 2. Class 2 would also include certain new types of asset.

3.6 The first would be loans on the security of second mortgage on a property where there already exists a first mortgage in favour of another lender, as suggested by the BSA and others. This would give greater choice to those wishing to borrow money for home improvements, etc, and would help those whose first mortgage lender - for example, a local authority - was unable or unwilling to make a further advance. Unlike further advances on existing mortgages, where the building society already has full control of the security, second mortgages are much less realisable security than first mortgages. The sum advanced on a second mortgage should allow a prudent margin within valuation and there may well be a case for providing that such a loan by a building society should not take a mortgagor's total debt above a specified percentage of a recent independent valuation of his property.

3.7 The Government also agrees that building societies should be given clear powers to make loans secured on equity mortgages. These are loans on which the borrower pays a lower rate of interest, but where the debt to the lender is not a declining cash sum, but the value of a fixed share in the equity, which is realised on the sale of the property. A lender who has made such a loan relies on the appreciation of the value of the property to compensate for the lower interest payments; as such, it involves a mismatch on income and expenditure as well as a capital risk. The extent of equity mortgage lending will therefore need to be taken into account in the assessment by the board, and if necessary the Chief Registrar, of the adequacy of reserves.

3.8 Finally, societies might lend beyond the valuation of the property, so long as the advance is secured by a local authority indemnity. This would be aimed at the situation which sometimes arises, particulary in inner cities, where the valuation of an unimproved

property would be below its cost, but where a local authority is prepared to issue a guarantee under Section 111 of the Housing Act 1980. Such loans would be included in Class 2.

Class 3 Assets

3.9 There are three main sorts of business in this Class: unsecured lending, the ownership of land or property, and equity investment. Much of it would involve more risk and would therefore need to be covered by proportionately higher free reserves than is necessary for societies' traditional business. Many small societies would not have the necessary management expertise or reserves for this business. Nor would they wish to take it on. The power to hold most Class 3 assets should therefore be restricted to societies with free reserves of more than £3 million. This would mean that the widest powers would be available to some [ ] societies, whose total assets form [ ] percent of the movement as a whole.

3.10 There would be a statutory upper limit of 5 per cent of commercial assets for Class 3, within the 10 per cent for non-Class 1 assets. Societies would be unlikely to approach this limit - which, if applied uniformly across the movement, would be nearly £4 billion at today's prices - for many years to come. But it could be amended by order later if experience suggested that it constrained societies unreasonably. The £3 million free reserves threshold could also be amended by order.

i. **Unsecured lending**

3.11 Unsecured personal loans would in many ways be a logical extension of building society business. For example, many housebuyers will also need to spend money on furniture, fittings and repairs, and may wish to approach their building society for finance. This is something that building societies may already in effect be providing in certain cases, but within the amount of the loan secured on first mortgage. And unsecured loan finance on shorter term may be a more sensible way of paying for some small home improvements and repairs than a full mortgage.

3.12 Consumer credit is a different sort of business from mortgage lending, with higher risks whose assessment is qualitatively different. It requires particular expertise, which the societies would need to develop. Any society that began to lend unsecured would therefore have to build up the business at a gradual rate, within its management and reserves capacity, and in consultation with the Chief Registrar.

3.13 There is a legitimate role for building societies in unsecured lending, both in enhancing their housing function and in enabling them to provide a broader range of

financial services. Building societies should be able to lend unsecured, but with a limit on the amount of loans to any one individual. The Government suggests £5000 initially, although this figure could be amended later. But, for the reasons discussed above, unsecured lending should be open only to the larger societies with free reserves over £3 million.

ii. Ownership of land and property

3.14 Building societies are seeking a more active role in housing and the Government welcomes this. More flexible use of some building society resources would be a powerful private sector contribution to the development of the country's housing stock. Nevertheless, history has demonstrated a need for caution. The present bar to building societies holding land followed the collapse of the Liberator Building Society, then the largest in the country, as a result of imprudent property deals towards the end of the last century. In 1959 the State Building Society collapsed after lending to property companies which failed. Most recently, the early 1970s saw the failure of several property companies. Owning land and property is a high risk activity. Some involvement by building societies would be welcome but it needs to be kept within prudent bounds.

3.15 Societies have not so far been able to enter this field directly. A few have done so indirectly by sponsoring and lending support to related housing associations or companies. They have no legal relationship with them, other than as providers of funds secured on first mortgage. This means that if the "associate" got into serious financial difficulty, the society might not legally be able to provide the necessary support. This is inherently unsatisfactory. It has been accepted as a short term expedient, provided that the scale has been limited and the operation closely monitored and controlled by the societies.

3.16 The Government proposes a new power for societies to own property. This would enable them to act directly as landlords of residential property and to own the rented element of shared ownership schemes. The societies should also be allowed to develop property for sale. They already play a part in ventures with builders, local authorities and other institutions, but their role is limited to lending on mortgage. While they should not become involved in speculative non-residential development, there is a clearly a role for them in some types of residential development, particularly in co-operation with local authorities. Some local authorities, particularly in inner city areas, have welcomed projects with a strong building society involvement when releasing land for development.

3.17 Some societies may want to undertake such operations through subsidiaries. This could be done either through a controlling equity stake in a housing trust company or through formal powers of control over a housing association incorporated as an Industrial and Provident Society. The Government's proposal would permit both forms of establishment. The society would also need to be given the power to underwrite its

subsidiary or associate. The financial exposure is however the same whether the activities are carried out directly or through a wholly-owned subsidiary, and so for supervisory purposes the balance sheet of a housing subsidiary would be consolidated with that of the parent society.

3.18 Ownership of land or property would entail new and different sorts of risk. The two sides of building society balance sheets are at present made up of interest-bearing assets and liabilities which are capital certain and well matched in terms of income. Substantial property assets would introduce an income mismatch between assets and liabilities and new risks of capital loss should property values fall. Land and property assets would therefore require considerably higher reserve cover than many other sorts of asset, so that it would not be appropriate for societies to engage in such business on a substantial scale relative to their size and assets. It is unlikely that any society would be able to have more than about 2 per cent of its assets in property for several years to come. Chapter 4 discusses however how other possibilities, such as estate management, could be opened to the societies without incurring risks directly on the balance sheet.

3.19 As with unsecured lending, such powers would not be open to societies with free reserves less than £3 million. The one exception might be a specific power to enter into shared ownership schemes where the risks are comparable to those of equity mortgages. Eligible societies wishing to hold land and property would need to obtain the Chief Registrar's approval before doing so, and to satisfy him that reserves and management were adequate for the task.

iii. Equity investment in subsidiaries and associates

3.20 The BSA have suggested more generally that societies should be able to transact certain types of business through subsidiaries. There is no reason in principle why a mutual organisation such as a building society should not own the equity of a company. There are are already examples such as the Cooperative Bank, which is owned by the Cooperative Wholesale and Retail Societies. There are likely to be advantages of financial management and accountability for societies in this. But the subsidiary route must not be regarded as a way of sidestepping prudential considerations or limitations upon the powers of societies themselves. A financial institution of the standing of a building society would take on certain moral obligations towards a subsidiary, over and above those required by the law of limited liability, to which it had lent its good name. It could not walk away if it got into trouble. Any losses made by the subsidiary - even if the possibility is remote - would potentially be those of the parent building society. Similar principles could apply where the building society was a minority shareholder in an associated company, although its exposure in particular cases would depend on how much equity it owned, the nature of the other shareholders, and how far the society had been responsible for setting up the company and

for its management. These points are particularly important for a building society which cannot raise additional capital quickly. The scope for even the largest building societies to take on such commitments is therefore not large relative to their size.

3.21 For this reason, building societies should not set up subsidiaries with potentially heavy contingent liabilities. The Government proposes, for example, that building societies could engage in unsecured lending on their own balance sheets. But it does not consider that they should be able to gear up further through a consumer credit subsidiary. Similar considerations apply to insurance underwriting. A building society insurance subsidiary - the only way in which a society could undertake insurance consistently with the requirements of supervision of the industry - would be subject to the same control as any other insurance company, which includes the maintenance of a statutory solvency margin and satisfactory capitalisation. A parent building society would again be expected to stand behind any subsidiary if it got into difficulty. If an insurance business were to grow substantially, aided by the extensive branch outlets of a parent society, this could become a major commitment, representing too great a risk for the society's investors. It would not therefore be appropriate to allow the societies into insurance underwriting.

3.22 As already discussed, however, building societies over a certain size should be able to invest in housing subsidiaries. They should also be able to invest in subsidiaries or consortia to provide jointly with other societies or other financial institutions services which they could legally provide individually to their members. It is possible to go some way with such joint ventures under existing legislation: some groups of societies are already developing proposals for automated teller machine networks. But the position needs to be clarified and some of the present limitations removed. As with other subsidiaries, there would be a need for ample reserve cover against the risk of any loss, and including any additional exposure as a result of growth. But subject to that point, all societies, irrespective of size, would be able to participate in financial services companies.

The European Community

3.23 Building societies already comply with certain general obligations under European banking legislation, notably the First Credit Institutions Directive of 1977. But there is as yet no specific legislation in the building society field. And the restriction to lending on security of freehold or leasehold estate effectively confines the societies to the Uniteed Kingdom.

3.24 The BSA have sought the power to operate in other European countries, whether through a branch, an agency, or a separately constituted subsidiary. The Commission of the European Communities have also indicated their intention of raising the questions of freedom of establishment and services for institutions specialising in lending on security of

mortgage for house purchase. It has always been recognised by all concerned that this area is one of particular difficulty. The markets in the different countries, and the relevant national laws, have grown up in distinctive and self-contained ways, reflecting their own evolution over very long periods. For this reason, progress towards a common market in this particular field is likely to be very slow.

3.25 A society operating abroad would have both to lend and raise money in foreign currencies, since it could not afford substantial exposure to foreign currency risks. There would thus be no significant diversion of resources that could otherwise have been devoted to financing housing in this country. The Government favours the establishment of a genuine common market, including financial services generally, but is doubtful about the scope for early progress in this particular field. It would welcome comments on whether building societies should able to operate in other European countries in the future.

Building society liabilities

3.26 Building societies have traditionally raised virtually all their funds from individual savers. In recent years, however, they have raised more money from wholesale sources, including syndicated loans, negotiable bonds traded on the Stock Exchange and, following changes in the tax law allowing them to pay interest gross on such instruments, certificates of deposit and time deposits. Such liabilities at present amount to about £2 billion, rather less than 10 per cent of which consist of certificates of deposit held by other building societies (which may increase the liquidity of an individual society but not of societies as a whole).

3.27 The Government welcomes those developments. Access to wholesale sources of funds is likely to enhance the ability of societies to cope flexibly with fluctuations in supply and demand. But there can be risks for financial institutions in relying too heavily on money market funds, so that the proposal that at least 80 per cent of liabilities should be raised from the personal savings sector will be a valuable safeguard. The Chief Registrar has already issued prudential guidance to building societies on the use of certificates of deposit. Further guidance will be issued as necessary.

3.28 Building societies might also develop new fund raising instruments with characteristics, notably the pattern of income and capital appreciation over time, resembling some of the new forms of asset. For example, index-linked liabilities, wholesale or retail, might be needed to match indexed mortgage lending on any scale. Taken with prudent limits on the amount of new business taken on, such matching could scale down risks from an otherwise unacceptable level, although it does not offer unlimited scope for

diversification into new forms of riskier assets. Matching is a complex subject, the role of which in assessing sufficiency of reserves will be considered more fully in the forthcoming discussion papers on capital adequacy by the Chief Registrar.

CHAPTER 4 - NEW FUNCTIONS

4.1 This Chapter considers the extension of building society powers in ways which would not affect their balance sheets directly. They do not in general involve financial risk, but need to be considered in the light of the primary role of building societies in the financial services and housing markets, and of possible conflicts of interest.

Money transmission services

4.2 Building societies should be able to offer a fuller range of personal banking and money transmission services to their members, if they so wish. Several societies have already taken some steps in this direction, but certain problems have arisen. For example, a building society cannot issue a cheque guarantee card because it would be promising to meet a payment to a third party whether or not sufficient funds were present in the individual account. The same point could arise with new electronic money transmission systems, for example certain types of "point of sale" or automated teller machine networks. Problems have also arisen because societies cannot enter into reciprocal arrangements with each other or with other financial institutions for providing, say, an encashment and paying service for each other's customers, whether at counters or through automated teller machines.

4.3 Financial institutions should be able to compete on equal terms in this field, and any unjustified impediment in the building societies legislation should be removed. A society which had the new unsecured lending power could decide to use it to overcome the problem of underwriting payments to third parties. But the legislation might also provide an explicit power for all societies to guarantee certain categories of payments, with a power to require a member to make good within a specified period any debt arising from a call on that guarantee. As a minimum, this would need to cover guarantees of up to £1500, thirty times the present limit on current account cheque guarantee cards, which would enable building societies to issue cheque books comparable to those of banks. The legislation would also enable building societies to enter into reciprocal payments arrangements with other societies and other financial institutions.

4.4 It would be necessary to extend to building societies, insofar as they are undertaking banking business, the protection given to bankers by legislation like the Bills of Exchange Act and Cheques Act. Other legislation may also need amendment. Appropriate cheque clearing etc arrangements would also have to be made, although this would not be a matter for legislation.

Integrated house buying services

4.5 The BSA have proposed that building societies should be able to offer a package of services to house buyers, including estate agency, conveyancing and structural surveys. While they cannot now offer these services directly, arrangements have developed between the societies and the professions which allow consumers to obtain services without duplication of work. For example, a building society will frequently allow the borrower's solicitor to act on its behalf. And building society panel surveyors frequently carry out surveys for prospective borrowers as well as valuations for the society. The Government welcomes moves which increase competition and the range of choice open to consumers. The question is how to avoid possible conflicts of interest.

4.6 On 17 February 1984, the Government announced proposals for legislation to enable solicitors employed by building societies, among others, to undertake conveyancing. A consultative document on the avoidance of possible conflicts was issued in April. Amendment of the Building Societies Act 1962 would be required to bring conveyancing within the statutory powers of building societies. While it would obviously be preferable to deal with this in general building society legislation, this is not essential and the Government will legislate in advance on conveyancing if necessary. At the same time, the Government set up a committee now chaired by Professor Farrand to consider the issues raised in England and Wales if non-solicitors were allowed to offer conveyancing services, and other matters. It also set up a wide-ranging review to identify means of simplifying and speeding up house transfers in England and Wales.

4.7 So far as structural surveys by building societies are concerned, the risks of conflict of interest are slight. The building society and the borrower have a common interest in ensuring that the property is sound and not over-valued. There are risks of charges of neglect if a survey were shown subsequently to have been at fault, and this would have to be covered by professional indemnity insurance. It would however be a relatively small development of present practice to allow a building society to offer this service directly.

4.8 A more difficult question - and one on which the Government would particularly welcome comments - is that of building societies engaging in estate agency. Subject to the conclusions of the Farrand Committee and the interdepartmental review, greater competition should benefit the market in house buying services. The entry of building societies into estate agency would greatly increase competition. It would enable the societies to offer an integrated service for house buying. This would be welcome to many house buyers.

4.9 The potential conflicts of interest are obvious. Building societies would almost certainly wish to run estate agencies from their branch offices, rather than through

separately housed subsidiaries. Branch managers could then be responsible both for arranging sales on behalf of the vendors and for financing the purchasers. As agents for the vendor, their duty would be to get as good a price as possible. Indeed, the society would have a direct financial interest in achieving a high selling price. But its duty to a purchaser to whom it was also making a loan, and its duty to value its security adequately, would point in precisely the opposite direction. The position would be complicated still further if the society also valued the property.

4.10 Such conflicts would be unacceptable, and safeguards must be provided for customers if building societies are to be permitted to undertake estate agency; it would also be in the long term interest of societies to avoid conflicts of interest. Some might require no more than strengthening or modification of existing provisions. But considerably more thought needs to be given to the resolution of the fundamental conflict between the roles of mortgagee and estate agent. Full disclosure of interests to the different parties involved might be one possible route; alternatively some statutory separation of capacity might be imposed. The Government would welcome further views on whether and how the conflicts could be resolved and on what safeguards would be necessary.

4.11 Any society offering new services of this sort should not of course be able to make their use a precondition of granting a loan. The Director General of Fair Trading has powers under the competition legislation to investigate such anti-competitive practices and, if appropriate, refer them to the Monopolies and Mergers Commission. If the Commission find a practice to be against the public interest, the Secretary of State for Trade and Industry has powers to act. It is however for consideration whether further specific provision should be made in building society legislation.

Agency services

4.12 The BSA have proposed that societies should have a power to act at least as paying and collecting agents for other organisations. One attraction of this proposal for the societies is that it would enable them to make fuller use of their branch offices, which are in some cases under-utilised. For example, they might collect local authority rent and rates, and bills to public utilities. To the extent that the service was open to non-members, it might also help them to attract more custom. The public, for their part, would have a convenient new service available to them.

4.13 Building societies might also offer agency services in the housing field. This might include the provision of advice services on home ownership and home improvements, possibly in conjunction with local authorities. Or they might provide a mortgage management service on behalf of other lenders. This could be particularly useful to local authorities which might wish to sub-contract the management of their mortgage business to the private

sector. Societies would act as the agents of the local authorities, but might also be able to give the borrowers a convenient way of replacing their local authority mortgages with those of the society.

4.14 A further possibility, which would allow the societies to play a wider role in housing, might be to allow them to manage property investments on behalf of others. Such investments would not be on the society's balance sheet, and profits and losses would accrue solely to those for whom the investments were being managed, with the financial involvement of the society limited to its fees for providing a management service. Such arrangements would be possible only if it were clear that the investor for whom the society acted as agent was in no sense a subsidiary of the society or otherwise had the society standing behind it. This could allow societies a useful pump-priming role beyond what they can do on their balance sheets. They might, for example, develop some homes for shared ownership, selling their total equity stake to another financial institution once all were let, but continuing to manage the properties on its behalf.

4.15 The main difficulty with these possibilities is one of principle. Building societies have traditionally existed to provide services to their members. Some of the suggestions here would involve services to non-members also, and hence a fundamental change in the nature of their operations. The Government is inclined to the view that the societies should be able to provide certain services on an agency basis for a defined list of bodies, but would welcome further views before reaching a final decision.

Insurance broking

4.16 The BSA have also suggested that the societies should be permitted to undertake the full range of insurance broking or agency services, including life assurance, motor insurance, etc. In practice building societies already act as intermediaries in respect of insurance related to their main business, such as mortgage protection policies, house insurance and endowment mortages, receiving commission from insurance companies for introducing the business. Any further extension of building society activities in this way would need to be subject to proper standards of prudence and investor protection, and to the standards of behaviour expected of the insurance services industry. The Government would welcome further comments on this.

Financial services

4.17 Many of the proposals in this paper are intended to foster more effective competition in a rapidly changing market for retail financial services. But they generally involve societies developing or extending their existing pattern of services. It can be argued that the legislation should go further so that those societies which so wished could offer the

maximum range of financial services to individuals, subject to the general legislation on investor protection. That range might include arranging for the purchase or sale of stocks and shares and providing more general financial and investment advice.

4.18 The Government would welcome comments on more radical ideas of this sort. For organisations with extensive branch networks like building societies to offer stock market services could help to offset the trend towards institutional rather than individual investment in securities. Building societies might develop arrangements with securities firms or allow a stockbroker to use their premises for offering broking services to the public. This sort of development might take place over a longer timescale than some of the other possibilities discussed in this paper. It would, for example, be necessary for a building society to consider very carefully the implications for its staffing and the risks to which it might be exposed before arranging to provide such services.

Supervision

4.19 The use of the new powers discussed in this chapter would require a somewhat different kind of supervision from the prudential controls applied to the mainstream business of societies and the new types of assets described in Chapter 3. They would be subject to the regulatory regime for the particular service where one existed, for example, conveyancing, estate agency or insurance broking. The wider financial services if included, would in many cases be subject to whatever legislation may follow Professor Gower's Review of Investor Protection. But in all cases, new services should not prejudice a society's main business. For this reason, only a few of the additional services, such as those relating to money transmission, would be open to all societies. For other services, a society - particularly one smaller than the £3 million free reserves threshold applied to the holding of new assets - would have to be able to satisfy the Chief Registrar that any services it undertook were not prejudicing the position of investors, whether by diversion of management resources, by incurring contingent liabilities or otherwise.

CHAPTER 5 - CONSTITUTION AND ACCOUNTABILITY

5.1 Building societies are member-based or "mutual" institutions. Most of their money is raised from members to lend to others. Investing members' shares generally give voting rights on a one member one vote basis. There can be no dominant shareholder as in a company. Profits are normally retained to build up the society's reserves and are rarely distributed, though on some mergers a bonus is paid to members out of reserves.

5.2 The concept of a member-based society is however difficult to apply to organisations as big as the larger societies. The largest societies have 10 to 20 times as many members as the number of shareholders in ICI, the company with the largest share register.

5.3 It is important to distinguish the respective roles of boards, senior executives and members of societies. While it is the board which gives overall direction to a society, and the senior executives who carry out the day-to-day management, it is the members who elect the directors and to whom the directors must account for their stewardship. Boards must recognise that accountability, which for the largest societies extends to the public at large. Boards must give a good account of themselves and respond to questions from the members, from the press and others, accepting their right to ask such questions. Similarly boards must be seen to be conducting contested elections fairly. For their part, members must recognise that the management of a major organisation has to be vested in the executives under the board, and that it is unrealistic to expect membership control over day-to-day management decisions.

5.4 Much of this is a matter of attitudes and is better dealt with by the leaders in the movement setting a good example than by legislation. In any case, legislation in this field tends only to deal with minimum requirements, leaving much to the rules of individual societies. While that should continue in general to be the case, some changes are necessary with the following objectives:-

(a) to improve the information available to interested members but to reduce the present burden on societies of circulating to members often unwanted reports and accounts;

(b) to give groups of members with legitimate concern about how the society is being run a greater opportunity to raise points at an annual general meeting, while at the same time making it harder to abuse the system;

and (c) to tell members more about candidates for election to the board, and to make more even-handed elections in which candidates other than those put forward by the board are standing.

Information

5.5 To allow investors to assess a society's financial position, and to help them take an interest in its affairs, building societies must now circulate the audited annual accounts and directors' report to all members, except investors with less than £25. They must also make available to members on demand the annual return which the society has to make to the Registry of Friendly Societies. The first requirement has defeated its object. The heavy cost of printing and mailing has made the societies reluctant to achieve voluntarily the standards of the better company reports to shareholders. And both the full accounts and the Annual Return are technical documents which may not be readily understood by many members.

5.6 The Government therefore proposes, as recommended by the BSA and others, that the document for members should be a simple financial statement similar to that sent to members when a merger is proposed. It would present the information in a readily understandable way, and alert members to their entitlement to receive the full accounts and directors' report on request. The financial statement would not be audited but the auditors would be asked to confirm on the annual return that it was a fair summary of the annual accounts. The directors' report would be extended to include some material at present published only in the annual return.

5.7 There would be a separate annual return to the Registry. Like the present monthly and quarterly returns which the societies provide voluntarily, it would not be on public record, since it would include commercially sensitive information which the Registry needs for prudential supervision.

Resolutions

5.8 The only statutory right that building society members have to bring an issue before the membership is that of proposing special resolutions, mainly those which propose a change in the rules. A member wishing to raise an issue at an AGM has often found that the only way in which he could do so was to turn the issue into a proposed rule amendment, however inappropriate, which the society must then circulate to all members. Members have also sought to add long preambles setting out their arguments, although the High Court has recently ruled that these need not be circulated.

5.9 The rules of many societies provide for members to table ordinary resolutions for consideration at annual general meetings. The Government suggests that this should be a statutory right. It is however reasonable that the member should have held a qualifying shareholding at the two most recent balance sheet dates of the society, and have his motion seconded by at least ten members of similar standing. To avoid abuse - for

example the circulation of advertising material - the board of a society would have power to refuse circulation if the resolution was not directly related to the affairs of the society, or if it was defamatory. Disputes over refusal to circulate a resolution would be referred to the Chief Registrar for arbitration.

Qualifying Shareholdings

5.10 At present:-

(a) any member may table a special resolution;

(b) any member with a shareholding of £1 or more may vote on a special resolution;

(c) any member with a shareholding of £25 or more is sent the annual accounts and directors' report together with notice of the annual general meeting.

5.11 It is unnecessary and confusing to have these different thresholds. It would be more logical to have a single level of shareholding at which members are entitled to receive a financial statement and notices of annual general meetings; to vote on resolutions; and to propose or second resolutions or candidates for election to the board. The choice of figure is a matter of balance. If it is too low, societies would be obliged to circulate material to many members whose interest in the society may be completely dormant. If it is too high, there is a risk of disenfranchising members with a genuine interest in the society. The Building Societies Association suggested that it should be £250. In the Government's view this is too high, and a figure of £100 would be more appropriate.

Election of Directors

5.12 There have been complaints about the way in which building society boards effectively choose their own successors, and the difficulties for members wishing to stand against candidates nominated by the board. There has also been criticism of the fairly widespread practice of new members being co-opted to the board during the year and then standing for election as outgoing directors at the next annual general meeting.

5.13 Societies need effective boards, including non-executive directors with the skills and experience to guide and support the executives who manage the society. The increased competition which societies face, and the accelerating pace of innovation, have put a heavier load on boards. The wider powers now proposed for societies will increase it further. The chairman and senior members of a board have a duty to ensure that its capability grows to match these increased responsibilities, and that there is a sufficient spread of ages of board members to maintain continuity. It is also proposed in

Chapter 2 that boards should have a specific statutory duty to ensure adequate management. In these circumstances, it must be able to form its own views on its future composition and tell the membership its reasons for preferring its own candidates for election.

5.14 But there must be a fair chance for candidates to stand against those of the board. The society should be obliged to circulate with the notice of the annual general meeting a short biographical note and election address; together they might be limited to, say, 250 words. This would ensure fairer elections than present arrangements, under which a candidate not put forward by the board can generally approach other members only if he obtains access to the register of members by securing a direction from the Chief Registrar, and then pays for the costs of circulation himself. But such members should be able to demonstrate a commitment to the society. It would be reasonable for the rules of the society to require a minimum shareholding on, say, the last two balance sheet dates, provided that the minimum was not too high - the legislation would impose an upper limit of £500. The candidate should also be able to demonstrate support from at least 10 members who had the qualifying shareholding on the last two balance sheet dates. At present, some building societies' rules contain requirements for deposits from candidates for election. It is for consideration whether this practice should be allowed to continue.

5.15 In some societies all vacancies to the board are filled by co-option. This means that no director stands for election before he or she joins the board and clearly undermines the principle that the directors are appointed by members. But mid-year co-option is sometimes justified. This should be left to the good sense of societies. But the present general practice that any director co-opted during the year must stand for election at the next general meeting should be made mandatory. Such elections would be additional to those of directors who have retired by normal rotation.

Composition of Boards

5.16 One factor that is inhibiting the reinforcement of boards is the absence from the rules of many societies of an age limit on directors. The Government consider that the BSA is right in recommending that there should be a retirement age of 70 for building society directors.

5.17 Under the Companies Act, company directors may stay on beyond the age of 70, provided that a resolution to that effect is passed at each annual general meeting. Such a procedure would not however be effective for building societies, largely because of the absence of large institutional shareholders who may be prepared to intervene behind the scenes if a director was seen to be outliving his usefulness. The Government therefore

proposes that a director should have to retire not later than the annual general meeting following his or her seventieth birthday. To allow time for adjustment, this provision would not come into effect until 1 January 1987, so long as new legislation had received Royal Assent by then.

5.18 New legislation will also have to deal with conflicts that might arise between a director's role in the society and his or her outside interests. It is clearly desirable to carry over, suitably modified, the provisions of the Companies Act 1980 in respect of loans to directors and their families, in much the same form as they apply to banks.

5.19 But there is a wider problem with building societies. Many were founded by individual professional practices, whether solicitors, accountants or estate agency, to bring together clients with money to invest and those wishing to buy a house, the practice often providing the administration. The majority of these societies have outgrown their origins and are now independent. But some are still dependent on firms or partnerships in this way. This can give rise to problems. The interests of the firm or partnership and those of the members can clearly conflict, particularly when considering whether the society should continue independently or merge. Societies today nearly always require full time executive management, not just management support from such a firm. In extreme cases, such a close relationship can lead to the directors concerned abusing their position and running the society for the benefit of themselves and their firm, rather than for that of the members.

5.20 Conflicts of interest are not confined to societies sponsored by one firm in this way. There can also be problems where a society places a considerable volume of its business with a firm in which a director is a partner, or with a company in which a director has a significant interest.

5.21 It is essential that societies should be seen to be run in the interest of their members. Legislation should accordingly provide that:-

(a) the volume of business a society could put with any partnership, firm or company of which a director is a member or in which he or his family has a significant interest, would be limited both in abolute terms and as a proportion of the society's total business;

(b) any existing arrangements of this type should be run down to the new limits within 5 years of the legislation coming into effect;

and (c) in the meantime the directors' report should disclose the existence of such arrangements and the scale of business transacted under them.

Mergers

5.22 Proposals for mergers with other societies, unlike many other issues, often arouse considerable interest amongst members. Votes on such proposals often attract a relatively high poll. Some 20 per cent of the members entitled to vote have done so in large societies, and much higher percentages in some small ones.

5.23 Under the present procedures a statement must be sent to members setting out the financial positions of the two societies and the terms of the proposed merger. For the merger to be effective, a special resolution must be passed by a three quarters majority of those voting in person or by proxy at a general meeting of the society, and the written consent of the holders of two thirds of the shares must be obtained. Confirmation may be sought from the Chief Registrar instead of the latter, which it almost always is. If the two societies are very different in size, the Chief Registrar can authorise the large society to approve the merger by a board resolution rather than by putting it to its members.

5.24 This procedure has worked reasonably well, subject only to three points. The first is that borrowing members do not have a vote in most societies, but they often have the greatest interest in a merger, because of the mortgage rate structure of the receiving society and the greater difficulty for them in switching elsewhere. They should have a statutory right to vote on a merger, irrespective of whether the rules of a society provide that they should have a vote generally.

5.25 Secondly, there can be difficulties if, as has happened several times in recent years, a merger is approved by a majority, but not a three quarters majority. This may mean that the society has to continue with insufficient management resources for modern conditions. It might even be unable to give adequate protection to funds placed with it by investors. It may be right to require a board to establish why more than a quarter of those voting have been unconvinced, and to modify its proposals accordingly. But there may be a case instead for reducing the requisite majority to 60 per cent, say. Alternatively, there might be an opportunity for a further debate and vote, at which a 60 per cent majority would be sufficient to approve the merger. The Government would welcome comments on this question.

5.26 The third problem is that mergers can take place only by agreement between the two boards. The timing and choice of partners therefore tends to be influenced mainly by personalities, by the incidence of retirements, and by the terms of compensation or transfer for the board and senior executives. This may result in some mergers taking place later than would be in the best interests of members. And, because it is often far easier for the board of a small society to accept a merger with a national society than

with another local society, it may have accelerated the decline in the number of strong local societies.

5.27 One suggestion has been that the board of one society might be able to require another to circulate a merger proposal to its members, even if the latter's board did not recommend it. But a large society could offer an inducement to vote for the proposal, in the form of a substantial distribution of the reserves to members, without prejudicing its own financial position. It might therefore do no more than the present system to encourage mergers between local societies into stronger local or regional units. The Government is not satisfied that the advantages of this proposal outweigh its disadvantages. But further comments would be welcome.

Status of societies

5.28 A compulsory change by societies to company status has been advocated by some in the past on the grounds that their mutual constitution insulates societies from the effects of competition, leaving too much scope for inefficiency and extravagance in their management. The societies are not exposed to takeover in the same way as companies. They do not face the financial discipline imposed on a company by the stock market, where performance affects the price at which it can raise capital (although money market credit ratings may conceivably impose a comparable discipline in the future). Members of a society can rarely, if ever, exercise the degree of influence on a board which a major shareholder can on that of a company. Finally, and particularly important for a financial institution, the board cannot quickly raise additional capital if it has inadequate reserves for its business.

5.29 The Government has no wish to insulate the societies from competition but does not accept that such a change is needed. Since 1980, societies have been exposed to greater competition for both their savings and their loan business. Their reaction has led to much greater competition between societies, and with other institutions. The pace of innovation in the services provided to members has accelerated considerably. A further consequence of this greater competition has been that some societies are recognising the importance of control over management expenses and seeking ways of reducing costs while maintaining services to members. The ratio of management expenses to assets, which had doubled over the past decade now shows signs of falling, albeit helped by the real growth of societies in the last two years. Those societies which have not yet begun to tackle their management expenses will find themselves exposed in the more competitive environment and forced to adjust their policies.

5.30 It is however wrong that a society cannot turn itself into a company if its members so wish. The Government therefore intends to provide for this in new legislation.

Although there are no signs that many societies will wish to become companies in the near future, this will provide greater flexibility, for example for a society considering linking with another institution. It would also provide a means by which a society which wished to diversify radically could acquire the necessary increase in its capital base reasonably quickly.

5.31 Any proposal for conversion into a company would need to be approved by the members in a similar procedure to that required for mergers, although there might need to be greater protection for particular groups, notably borrowers. The conversion itself would generally involve:-

(a) a scrip issue of company shares to existing shareholders with holdings above a certain threshold, with the conversion of their existing shares into deposits;

(b) the issue of further shares, by a rights issue or otherwise, to secure additional capital.

5.32 A society which followed this procedure would become a company like any other. It would have to stop using the words "building society" in its name. Perhaps most important, if it wished to continue to take deposits, as it presumably would, it would require a licence from the Bank of England under the Banking Act. It would need at an early stage to seek an assurance that the Bank would be minded to grant a licence when it converted into a company. The Bank would be particularly concerned to ensure that the new company would have the requisite capital liquidity and mangement skills for the business it was contemplating.

CHAPTER 6 - THE FINANCIAL ENVIRONMENT AND INTEREST RATE ARRANGEMENTS

6.1 Building society interest rates are of considerable economic and financial importance. Mortgage interest is an important element in many households' costs. Mortgage rates affect both the retail prices index and demand for mortgage finance. The general level of building society rates relative to other interest rates has a pronounced effect on the volume of lending and on matching supply to demand for mortgage credit.

6.2 For several years up to 1980, there was relatively little competition for the supply of mortgage finance, except for a period of increased lending activity by local authorities during 1974 and 1975. As a result, building societies acting together were able to maintain the mortgage rate at a level lower than that necessary to meet demand, hence rationing the supply of mortgage finance. At the same time, the difference between the share rate and the mortgage rate was set at a level acceptable to all societies. In principle, this could have enabled inefficient societies to continue in operation with no spur to improve their efficiency while the more efficient societies would have the resources to indulge in non-price competition, for example through a proliferation of branches. During the 1970s, there are strong indications that this was happening.

6.3 More recently, however, the competitive environment has changed quite fundamentally. The abolition of corset controls in 1980 led to the entry of the banks into the mortgage market in 1981 and a new period of competition in mortgage lending. For a time the banks took over 40 per cent of new mortgage business, and, while they have subsequently cut back, they retain a market share of about 25 per cent. Potential borrowers have had access to more sources of funds and have no longer had to tolerate mortgage queues. On the lending side of their business, therefore, there is no longer the traditional presumption that a prime objective of building societies should be to keep mortgage rates down. There has also been increased competition among building societies and with other institutions on savings as well as mortgages. The societies have put more emphasis on premium accounts, and over half of the money in building societies shares and deposits is now in accounts which pay interest above the ordinary share rate. There is also considerable diversity now on the structure of mortgage interest rates, although most societies currently charge a premium for larger mortgages. This has however tended to cost them market share among larger borrowers, as the banks have been able to take advantage of the administrative economies of scale in a smaller number of larger loans and of the good credit standing of many larger borrowers.

6.4 Partly as a result of these developments, building society interest rate behaviour appears to have changed. The societies have effectively set their rates for the last year or more at levels intended to raise sufficient funds to meet demand. This policy however runs

the risk that rates may settle above that level. This might encourage the societies to diversify into lending on mortgage for non-housing purposes, whether directly (with or without tax relief) or indirectly by withdrawal of equity now held in property. It is true that most equity withdrawal is simply the natural counterpart of mortgage lending: every housing "chain" begins with a new owner-occupier and ends either with the purchase of a new property or with somebody leaving the owner-occupied sector, he or his estate retaining the proceeds of the sale. But, as indicated in the introductory chapter, the Government cannot ignore the scale of mortgage lending in the context of monetary policy.

The interest rate cartel

6.5 Since 1939, the BSA has recommended interest rates to building societies generally. Until October 1983 these arrangements consisted of two different agreements.

(a) The recommendation of basic rates of interest to be paid on building society investments and charged on mortgages.

(b) An undertaking by participating societies to give 28 days' notice of variations from the recommended rates.

6.6 While most BSA member societies followed the recommended rates in practice, their observance was not a condition of BSA membership. A good many smaller societies kept a fixed differential over the BSA recommended rates, so that the recommended rates in practice determined theirs. More recently, however, there has been a growth in the number and types of premium share accounts, with considerable variation between societies. The interest rate behaviour of societies has thus become much less uniform.

6.7 On 21 October 1983, the BSA announced new arrangements, as follows.

(a) The replacement of the recommended rates by advised rates for ordinary shares and mortgage loans.

(b) No requirement to give notice of changes, but the largest societies have indicated a willingness to discuss changes in their basic rates with other BSA members, implying they will give some notice of their intentions.

(c) An information agreement under which societies may be notified of each other's rates.

6.8 When the restrictive trade practices legislation was extended to services in 1976, agreements between building societies relating to interest rates were specifically exempted. Neither the old recommended rate system nor the new arrangements have therefore had to be registered by the Director General of Fair Trading as restrictive practices, so they are not open to legal challenge on those grounds. The reason for the 1976 exemption was the

existence of the system operated through the Joint Advisory Committee of BSA and Government representatives for setting "guidelines" for building society lending. The interest rate agreements were essential to the successful operation of such a system, since they provided a mechanism for putting the agreed guidelines into practice. But the ending of the guideline system in 1980 has removed the original rationale for exempting the building societies from the legislation.

6.9 Time has eroded both the operation of the interest rate arrangements and the reasons for their exemption. In principle, arrangements of this sort are anti-competitive and undesirable. They mean that the building societies in practice operate a cartel. As long ago as 1967, the National Board for Prices and Incomes recommended its abolition, as more recently have the Committee to Review the Functioning of Financial Institutions (the Wilson Committee) and the National Consumer Council. By withdrawing its exemption from the restrictive trade practices legislation, the Government could open it to legal challenge by the Director General of Fair Trading as being contrary to the public interest. If such an action were mounted and were successful, building societies would have to settle their own rates independently in the light of market conditions without central guidance from the BSA. This should encourage further competition between building societies, a greater range of choice and a better service to building society members.

6.10 The transition to a fully competitive system would need to be handled carefully. Too abrupt a change might give rise to problems in the short term in managing interest rate changes, particularly when market conditions indicated a fall in rates. Without a collective mechanism, a general fall in rates would need to be triggered by one society stepping out of line and placing itself at a temporary competitive disadvantage in relation to others. While, in the long run, rates could be expected to adjust to market conditions, there might be problems until the societies got accustomed to the new system. This problem was experienced in Australia after collective arrangements for determining mortgage interest rates were abandoned there. A further possible worry would be the position of borrowers if some societies decided to go for a new high interest rate policy following a sudden change, in view of the difficulty and, frequently, expense of switching a mortgage from one lender to another. Finally, all changes are riskier if they are uncontrolled, so that gradual change is better in prudential terms than a step change.

6.11 Nevertheless, the present collective interest rate arrangements inhibit the free play of market forces which would ensure the best deal for savers and borrowers. There needs to be a phased, orderly transition to a more competitive regime. The change in October 1983 was the first step in this process. The withdrawal of the exemption from the Restrictive Trade Practices Act would be the logical next one. The procedures under the Act would allow ample time within which the societies could consider the future of the agreement

themselves before any statutory action was set in train, thus ensuring an orderly transition. It is therefore proposed that the exemption from the restrictive trade practices legislation should be withdrawn at the same time as new legislation comes into effect.

Taxation of building societies

6.12 Tax is a further important aspect of the financial environment within which building societies operate. Although this paper does not offer any new proposals, there have been several recent changes.

6.13 As part of the Chancellor's strategy of removing distortions in saving and investment, the 1984 Budget included several measures promoting a more even-handed treatment of the relevant institutions. There were two major differences in the taxation of building societies and banks. The first was that building society interest was paid net of a composite rate of tax, slightly lower than the basic rate, whereas banks paid interest on deposits gross. This was frequently held to confer a competitive advantage on building societies, because taxpaying investors were marginally better off as a result of the composite rate being less than the basic rate, and also because they were likely to find it a convenience not to have building society interest taken into account for tax purposes, so long as they were liable to income tax only at the basic rate. By extending the composite rate arrangements to bank deposits, this anomaly will be removed from April 1985. There remain some differences of treatment between the two types of institution, but these are now the subject of discussions between the BSA and the Inland Revenue.

6.14 The second main difference was in the rate of corporation tax. Banks paid at the full rate of 52 per cent while building societies paid at a special rate of 40 per cent, a concession which had been granted to them and to some other mutual organisations to prevent their being disadvantaged on the change to the new imputation system of corporation tax. Their inability to pay dividends meant that they could not benefit from that system's partial relief for distributions. On the other hand, the banks were able to reduce their corporation tax liability through their leasing operations. The balance between these two factors was complex and contentious. Changes in the 1984 Budget - the phasing out of the first year allowances which will reduce the tax advantages of leasing, and the progressive reduction to 35 per cent in the rate of corporation tax, so that the special rate will no longer exist after 1985 - will introduce a better balanced regime.

6.15 A further recent change was the decision by Ministers (announced by the Inland Revenue on 23 February 1984) that the profits which building societies realised on disposal of gilt-edged and certain other stock would henceforth be treated as trading income rather

than capital gains. This change, made following legal advice the Revenue had received, had the effect of bringing the societies into line with what had been the treatment of banks for many years.

Appendix 1 Building Societies: Selected Statistics

Sources

Statistics provided by the Registry of Friendly Societies are compiled from annual returns and accounts submitted by societies. The majority of societies, but by no means all, make up their returns to 31 December. The statistics for a year are aggregated from returns for financial years ending between 1 February and 31 January. This means that the aggregates do not correspond exactly to the aggregates for the end of the calender year published in Financial Statistics and elsewhere.

Glossary of terms

Asset size groups: The asset size groups A to F used in tables _____ and _____ group building societies by asset size as follows:

Group	Societies the assets of which as a percentage of total assets of all societies are each:	Group limits based on 1983 assets £m
A	10% or more	8587 or more
B	1% to 10%	859 - 8587
C	0.1% to 1%	86 - 859
D	0.01% to 0.1%	8.6 - 86
E	0.001% to 0.01%	0.9 - 8.6
F	Less than 0.001%	Less than 0.9

Wholesale funds: Include certificates of deposit, negotiable bonds, bank loans and time deposits.

Reserve ratio: Ratio of reserves to total assets.

Free reserve ratio: Ratio of (reserves less fixed assets) to (total assets less fixed assets).

Table A.1 Building Societies 1900–83

Year	Number					Assets	
	Societies	Branches	Staff	Shareholders 000's	Borrowers 000's	Total £m	Total at 1983 prices £m
1900	2,286	na	na	585	na	60	na
1910	1,723	na	na	626	na	76	na
1920	1,271	na	na	748	na	87	1,000
1930	1,026	na	na	1,449	720	371	6,000
1940	952	640	na	2,088	1,503	756	9,000
1950	819	650	na	2,256	1,508	1,256	13,000
1960	726	985	na	3,910	2,349	3,166	22,000
1970	481	2,016	25,166	10,265	3,655	10,819	49,000
1975	382	3,375	34,949	17,916	4,397	24,204	57,000
1980	273	5,684	52,727	30,636	5,383	53,793	67,000
1981	253	6,162	55,377	33,388	5,490	61,815	69,000
1982	227	6,480	58,149	36,607	5,645	73,033	77,000
1983	206	6,672	61,192	37,707	5,928	85,869	85,869

Source: Registry of Friendly Societies

Table A.2 The Degree of Concentration in the Movement 1930–83

Year	Share of total assets by the top 20 societies				
	Largest 5	Next 5	Largest 10	Next 10	Largest 20
	%	%	%	%	%
1930	39.1	14.3	53.4	11.6	65.0
1960	45.3	11.6	56.9	11.7	68.6
1980	55.4	15.7	71.1	13.3	84.4
1983	55.7	17.5	73.2	13.8	87.0

Source: Registry of Friendly Societies

Table A.3 Building Societies in 1983 analysed by asset group

Asset size Group	Societies	Assets £m	Share of total %	Cumulative share of total %	Number Branches	Number Shareholders 000's	Number Borrowers 000's	Advances during year Number 000's	Advances during year Amount £m
A	2 societies:								
	Halifax	16,782	19.54	19.54	634	6,762	1,182	302	3,731
	Abbey National	14,312	16.67	36.21	676	8,112	907	252	3,242
B	14 societies:								
	Nationwide	7,348	8.56	44.77	517	3,164	486	120	1,511
	Leeds Permanent	4,823	5.62	50.39	459	2,061	353	93	1,129
	Woolwich Equitable	4,542	5.29	55.68	380	2,328	317	78	1,052
	National and Provident	3,918	4.56	60.24	337	1,356	286	65	804
	Anglia	3,202	3.73	63.97	376	1,692	261	65	751
	Alliance	2,791	3.25	67.22	203	846	176	47	666
	Bradford and Bingley	2,687	3.13	70.35	230	1,299	188	50	531
	Leicester	2,477	2.88	73.23	243	1,042	181	42	526
	Britannia	2,376	2.77	76.00	239	951	165	34	460
	Cheltenham and Gloucester	2,042	2.38	78.38	135	587	114	40	596
	Bristol and West	1,574	1.83	80.21	158	609	84	22	287
	Yorkshire	1,214	1.41	81.62	151	479	94	21	262
	Gateway	1,138	1.33	82.92	144	431	76	17	236
	Northern Rock	1,064	1.24	84.19	124	457	80	20	232
C	42 societies	10,753	12.52	96.71	1,389	4,415	757	189	2,656
D	78 societies	2,675	3.11	99.82	268	1,054	207	51	641
E	31 societies	144	0.17	99.99	9	58	13	3	32
F	39 societies	7	0.01	100.00	–	4	1	0.2	1
All societies		85,869	100.00		6,672	37,707	5,928	1,511	19,346

Source: Registry of Friendly Societies

Table A.4 Building Societies Assets and Liabilities 1983

Liabilities	£bn	Per cent of total	Assets	£bn		Per cent of total
Shares	75.2	87.5	Mortgages		67.5	78.6
Deposits and loans	3.6	4.2	Liquid assets:		16.9	19.7
			cash and bank deposits	3.7	4.3	
Wholesale funds	2.0	2.3	listed securities	10.1	11.8	
			other securities	3.1	3.6	
Tax and other Liabilities	1.6	1.9	Fixed assets:		1.1	1.2
			premises	0.9	1.0	
			other	0.2	0.2	
Reserves	3.5	4.1	Other		0.4	0.5
Totals	85.9	100.0			85.9	100.0

Source: Registry of Friendly Societies

Table A.5 Building Society mortgages advanced during 1983

	Number 000's	Amount £m	Type of property		
			Dwellings		Business and other properties
			wholly owner occupied	other(1)	
			%	%	%
Advances in respect of new mortgage loans agreed to:					
Up to £15,000	422	4,315	99.5	0.2	0.3
15,001 - 30,000	501	10,705	99.4	0.1	0.5
30,001 - 45,000	66	2,126	98.5	0.3	1.2
45,001 - 60,000	16	556	96.2	0.7	3.1
Over 60,000	1	116	60.3	25.0	14.7
Further advances on existing and instalment mortgages	505	1,528	98.2	1.2	0.6
All mortgages	1,511	19,346	98.9	0.4	0.7

(1) Includes advances to Housing Associations
Source: Registry of Friendly Societies

Table A.6 Building Society Reserve Ratios 1983

Asset size group	Number of societies	Total assets £m	Reserve ratio	Free reserve ratio	Number of societies with free reserves over £3m
A	2	31,095	3.63	2.82	2
B	14	41,195	4.11	2.76	14
C	42	10,753	4.79	3.29	35
D	78	2,675	5.31	4.04	5
E	31	144	5.74	4.58	-
F	39	7	13.24	12.91	-
Total	206	85,869	4.06	2.89	56

Source: Registry of Friendly Societies

TABLE 7 MORTGAGE LOANS FOR HOUSE PURCHASE

£ million
(per cent)

Net advances during	Building societies	Monetary Sector	Local authorities	Other public sector	Insurance companies and pension funds	Total
1979	5271 (81.6)	597 (9.2)	293 (4.5)	74 (1.1)	227 (3.5)	6462 (100.0)
1980	5722 (78.5)	593 (8.1)	461 (6.3)	251 (3.4)	264 (3.6)	7291 (100.0)
1981	6331 (66.8)	2447 (25.8)	268 (2.8)	346 (3.6)	88 (0.9)	9480 (100.0)
1982	8147 (57.7)	5078 (36.0)	554 (3.9)	329 (2.3)	6 (-)	14114 (100.0)
1983	11041 (75.0)	3602 (24.5)	-292 (-)	217 (1.5)	153 (1.0)	14721 (100.0)
Balance outstanding at end 1983	68227 (75.2)	14238 (15.7)	4184 (4.6)	1717 (1.9)	2364 (2.6)	90730 (100.0)

Source: Financial Statistics

TABLE 8 SELECTED LIQUID ASSETS OF THE PERSONAL SECTOR

£ billion
(per cent)

Amount outstanding at end year	National savings	Monetary sector deposits	Building societies	Other	Total identified
1979	10.7 (11.7)	37.7 (41.3)	42.4 (46.4)	0.5 (0.6)	91.4 (100.0)
1980	12.1 (11.3)	45.1 (42.0)	49.6 (46.2)	0.6 (0.6)	107.4 (100.0)
1981	18.2 (14.8)	47.6 (38.8)	56.7 (46.1)	0.3 (0.3)	122.9 (100.0)
1982	21.7 (15.4)	51.6 (36.7)	67.0 (47.6)	0.4 (0.3)	140.7 (100.0)
1983	24.6 (15.6)	54.8 (34.8)	77.5 (49.3)	0.4 (0.3)	157.3 (100.0)

Source: Financial Statistics.

TABLE 9 BUILDING SOCIETY MORTGAGES AND OWNER OCCUPATION

	1938	1953	1961	1971	1982
All dwellings (000)	11400	12745	16270	18830	21320
Owner occupied dwellings (000)	3700	4400	6890	9430	12560
Owner occupied dwellings as per cent of total	32.5	34.5	42.3	50.1	58.9
Building society borrowers (000)	1405	1670	2425	3895	5645
Building society borrowers as per cent of owner occupied dwellings	38.0	38.0	35.2	41.3	44.9

Source: Department of the Environment

Note: Figures for 1938 and 1953 refer to England and Wales only; those for 1961 and later to Great Britain.

Investor Protection: Duties of Directors and Powers of the Chief Registrar

It was emphasised in chapters 1 and 2 that the development of societies' business must be consistent with their remaining a safe home for investors' money. This will require a combination of due care by the boards of societies, of statutory limits on the use of some of the new powers which involve a greater element of risk and of increased powers of supervision by the Chief Registrar of Friendly Societies. This Appendix develops more fully the points made in chapter 2 on the existing prudential framework, on recent developments to it, and on how it is envisaged that it should be developed further.

The Elements of the Existing Framework

2. The primary responsibility for the safety of funds placed with a building society, lies with the board. But, as with all deposit taking institutions, there is a need for a system of prudential control and supervision to ensure that boards do what is necessary to protect investors and, in the rare last resort, to intervene to stop the society taking investments.

3. The present record of building societies for protecting investors' money rests on six main elements:-

(i) building societies may only do those things which statute provides that they can do. The 1962 Act confines societies to a narrow range of relatively low risk activities;

(ii) these statutory limitations have been re-inforced by societies' general practice of concentrating on the finance of owner-occupied residential property: such loans have a high degree of capital certainty;

(iii) the quality of assets has been reinforced by positive statutory requirements, for example for independent valuation of each property taken as security and for systems of financial control, which are not matched in the legislation for any other major financial institution;

(iv) societies must provide information to investors, so that they can make an informed decision about where to place their money;

(v) monitoring by the Registry of Friendly Societies, with statutory powers to intervene if the Chief Registrar considers it necessary in the interests of investors;

(vi) finally, the presumption created by experience in recent years, that if a building society does get into difficulties other societies will come to the rescue either to make good, or at least to mitigate, the loss which would otherwise be borne by investors. This is now codified in the Investors' Protection Scheme, introduced on a voluntary basis by the Building Societies Association in March 1982.

4. The security of building societies has been achieved despite two features of their financial activities which would tend to make them riskier, rather than safer, than other financial institutions. First they have borrowed short and lent long to a far greater extent than other financial institutions, such as banks. They have managed this successfully by issuing mortgages with variable interest rates; they have thus been able to afford to pay investors rates which have fairly closely matched market interest rates, even when the latter have increased sharply. They have so escaped the problems which have faced the Savings and Loans Associations in the United States.

5. Second they have operated with a far lower capital base than other types of deposit takers. For building societies the capital base consists solely of the reserves because there is no shareholders' risk capital. The average level of reserves in building societies is currently about 4% of total assets: their 'free capital' ratio, which is generally a better measure, is on average about 2½%. These ratios are distinctly lower than broadly comparable measures of the capital adequacy of other financial institutions. This relatively low level of capital has been sufficient while societies' funds have been concentrated in low risk types of asset and they have been able to match closely variations in the interest rates which they have to pay with variations in the rates which they receive from borrowers.

The Present System of Supervision by the Chief Registrar

(a) <u>The Reactive Framework</u>

6. The framework of supervision has historically been essentially reactive. There has been a presumption that societies are acting prudently and within the legal constraints until the contrary is established. The Registry has monitored their activities for the most part from returns. It has intervened when it appeared that the board's policies had put investors money at risk, or might well do so in the foreseeable future. Such intervention is usually at first informal. On occasion that has to be followed by use of a statutory power to restrain the society in some way in the interests of investors.

7. For this purpose, the Chief Registrar has two principal statutory powers. They took their present form in the Building Societies Act 1960 and are now in sections 48 and 51 of the 1962 Act.

8. Section 48 empowers the Chief Registrar to make an order, with the consent of the Treasury, to prohibit a society from taking further investors' money if he considers it expedient in the interest of existing and future investors. The exercise of this power usually means the end of the independent existence of the society concerned. Moreover it may cause damage, at least in the short term, to existing investors, because there will almost inevitably be a period in which payments are suspended after the order is made. This means that the Chief Registrar, when considering whether to make such an order, may be faced with striking a difficult balance between the potential risk to present and future investors if he does not intervene and the society continues with its present management and policies, and the more limited short term effect on existing investors which will result from making the order. Such an order has to be regarded as a last resort, if it is used against an active society.

9. Section 51 gives the Chief Registrar power, with the consent of the Treasury, to prohibit a society either from advertising altogether or from issuing certain types of advertisement if he considers it expedient in the interest of future investors. Such an order does not have to be published so it may be possible in at least some cases to make one without risking a run on the society, with the adverse impact on the interests of existing investors which results from published orders.

(b) Positive Approach

10. There have been two legislative changes which have introduced some shift towards positive approval of societies by the Registry, rather than just reaction to events. First section 1 of the House Purchase and Housing Act 1959 provides for designation of

building societies by the Chief Registrar. Those trustees whose powers are defined by the Trustee Investments Act 1961 can place funds with a society only if it is so designated. A society wishing to be designated has to meet the requirements specified in Designation Regulations made by the Treasury. These include provision for the minimum levels of reserves (a sliding scale from 2½% for the smaller societies to just over 1% for the largest) and of liquidity (7½%) and for a minimum asset size (currently £10 million). The Chief Registrar has discretion as to whether or not to designate a society which meets those criteria.

11. Most societies of any size were designated in 1959. But criteria for applications from other societies were further developed over the years. In 1981 the Registry said that it expected a society to show that it was, and was unequivocally recognised as being, a stable, mature, efficient and independent society of such size as to command general confidence, with the resources to weather the economic and other vicissitudes which could be expected over a long period. In other words it had to be a suitable home for the funds of trustees.

12. However designation was regarded very much as a once and for all exercise. So, as with the powers under the 1962 Act, the Registry subsequently intervened if, and only if, it became aware that something might be amiss. Failure to meet one of the requirements specified in the Designation Regulations did not lead to automatic revocation, but the Registry required the society to take action to remedy the position. Before the New Cross case last year, one society had its designation revoked in 1963 and another in 1975.

13. Second, the Building Societies (Authorisation) Regulations 1981 were made to give effect for building societies to the First Council Credit Institutions Directive of the European Communities, including the requirement that there should be for the first time a system of positive authorisation. A new society has to satisfy the Chief Registrar that it has, in particular, the necessary capital and management resources necessary to run the society before it is authorised to take money. However, the full rigour of positive authorisation only applied to new societies, which are rare. Existing societies were automatically authorised from 1 December 1981, with limited exceptions in relation to societies which were moribund. The initiative for revocation lies with the Registry, and could only be taken on grounds of inadequate capital or management after 1 June 1983.

14. The Registry has recently started a programme of reviews of societies in relation to these capital and management requirements. The latter involves visits by an inspection team from the Registry to each society concerned: this is a development of the earlier series of visits which had been specifically directed to the financial control systems of the smaller societies, following the collapse of the Grays Building Society in 1978.

(c) Other Recent Developments

15. The supervision of societies by the Registry has been developed progressively over the last decade or so. In 1973, monthly monitoring returns, primarily directed to the cash flow and liquidity position were introduced. Then in 1979 the Registry began the programme of inspection visits to societies directed to financial control systems just referred to. In 1982 the financial reporting system was extended, in response to the increased competition which building societies faced, with expanded monthly returns and the introduction of quarterly returns covering both the recent revenue out-turn and revenue projections for the rest of the financial year.

16. The then Economic Secretary announced in February 1983 the completion of a review by the Chief Registrar of the management and staffing of the Registry. Steps were to be taken to increase the professional expertise of the Registry, particularly that directed to the supervision of the middle and larger sized building societies, in the more competitive climate. A series of management studies were to be undertaken directed to improving the efficiency of the Registry. In particular, provision was made for the introduction of a computer system for the analysis of monitoring returns, amongst other things.

17. Perhaps more important, arrangements have been developed under which societies discuss with the Registry the prudential aspects of major new proposals - for example for mergers, innovations in business, in technology and in tapping new sources of funds in the money markets. These forward looking discussions have been directed to ensuring that the societies concerned have thought through all the potential implications of what they are minded to do and were aware of the possible consequences, not only if things went as expected, but also if the unexpected occurred.

Future Development of the Prudential System

18. These recent developments need to be carried further to reflect the competitive and technological changes affecting societies and the markets in which they operate. The wider powers now envisaged add to that need and affect the form which it should take. Their use will increase the load on the managements of societies, requiring new skills, and will bring new risks.

19. Most of the additional types of assets may involve a greater degree of risk than societies traditional low risk business. In particular, direct ownership of property - whether to rent or for resale - is much riskier than loan business: there is a risk of fluctuation in the capital values and the stream of income generatedwill not be a matched at all closely to the cost of raising capital. Indeed, because of this banks rarely engage in direct investment in property: to the extent that they do so, they are expected to devote a higher proportion of capital to cover the risks than would be appropriate for conventional lending. A similar point arises on the purchase of the whole or part of the equity in a company. The good repute of the society as a financial institution of standing would require it to stand behind a company in which it had, or shared, a controlling interest. It could not rely on limited liability. In this case it would be necessary for the prudential position to be looked at on a consolidated basis so as to take account of that contingent obligation.

20. Some of the new services may also bring risks of their own, and all will require considerable management effort, which must not be at the cost of the prudent running of the mainstream business.

21. The Government envisage that the components of the revised prudential framework would include:-

i. the asset and liability limits in chapter 3. Though these are primarily directed to ensuring that building societies retain their present nature, this will also contribute considerably to their prudential strength;

ii. a redefined series of duties on boards. Guidance on some of them, for example capital adequacy, would be issued by the Registry, after the appropriate consultation;

iii. strengthened arrangements for monitoring by the Registry, and also more systematic arrangements for discussions between the Registry and societies about future plans;

iv. a rationalisation of the present combination of procedures for authorisation and designation of societies on the one hand, and the statutory intervention to stop advertising or taking of money on the other;

v. the placing of the investor protection scheme on to a statutory basis.

The first was discussed in Chapter 3. The rest are now discussed in turn.

Duties on Boards of Directors

22. Legislation would place on boards of directors of building societies a series of duties, intended to protect the interests of investors. They would be:-

i. to maintain adequate reserves, and more specifically free reserves, for the nature of the business which the society was carrying on, and particularly for its structure of assets and liabilities;

ii. to maintain adequate liquidity in relation to the nature of the business it was carrying on;

iii. to observe the upper limit of 5% on the proportion of total assets represented by class 3 assets;

iv. to have adequate management for the types of business the society will be undertaking; and to carry on that business with integrity and prudence and with those professional skills which are requisite for the range and scale of the society's activities. To comply with the First Council Credit Institutions Directive the direction of a society will have to be in the hands of individuals of sufficiently good repute and sufficent experience to perform their duties, and who are at least two in number;

v. to maintain adequate internal systems of financial control and inspection;

vi. to have adequate arrangements for the independent valuation of mortgaged property;

vii. to prepare and publish accounts which must be audited by professionally qualified auditors;

viii. to satisfy the Chief Registrar that the board is carrying out these requirements, and more generally to provide him with such information as he may consider necessary for carrying out his functions under the Act, whether in general or in relation to the affairs of the particular society.

23. Apart from the third, which relates to the new powers of societies, these either broaden or continue duties which are already implicit, if not explicit, in the present legislation. For example, the first two requirements would replace the minimum ratios now prescribed in the Designation and Authorisation Regulations. The new specifications recognise that societies already generally require, and have, reserves and liquidity significantly in excess of those minima, the need for an individual society depending on the particular nature of its business. The variations in the needs will be greater as societies make varying use of the new powers.

24. Failure of the board of a society to meet one or more of these requirements would be recognised explicitly as a ground for the Chief Registrar to exercise one of his discretionary powers. Some of the present requirements which these would replace, and indeed other requirements of the 1962 Act, are subject to criminal sanctions. The Government will be considering in which cases it is appropriate to continue such sanctions. In general, they would be justified, for example, in relation to fraud, or other misappropriation of society property, the wilful making of false statements in statutory documents, or failure to submit statutory notices and documents and similar breaches of truth or duty. But generally, the remedy for lapses in prudential standards without criminal intent or recklessness, should be correction at the behest of the Chief Registrar, including where appropriate changes in board and management and possibly disciplinary proceedings by a professional body, rather than prosecution in the Criminal Courts.

Guidance by the Registry

25. The Chief Registrar will issue, in the first instance in the form of a draft for general discussion, guidelines for assessing the reserves and liquidity requirements of societies. The general guidance will be supplemented by discussions with individual societies on how such guidance should be applied in their case. The Registry may also issue general guidance on some of the other duties, as it has already done for example in relation to systems of financial control.

26. The Registry will also develop the arrangements for monitoring societies activities. The shift in emphasis from monitoring events in arrears to considering innovations, plans and budgets will be taken further. It is envisaged that there might be regular prudential review meetings, probably annually, between the Registry and each society of any size to go over the society's future plans and the whole range of prudential matters.

Powers of intervention of the Chief Registrar

(a) Authorisation and Revocation

27. The present structure of the powers of the Chief Registrar will be rationalised. The main statutory power should be that of granting, withholding and revoking authorisation. This would meet the continued obligation to apply the First Council Credit Institutions Directive to building societies. Any society wishing to be authorised would have to satisfy the Chief Registrar that it would be able to safeguard the funds placed with it, and in particular that the board would be able to meet the [redacted] specific duties placed on them listed above. There would a minimum capital requirement for establishing a new society. As now, that could be met for an initial period by 'deferred shares'. It will be for consideration at the time that the legislation is introduced whether the minimum capital required should be raised from the present level of £50,000.

28. The 'last resort' control power for the Chief Registrar would then be the revocation of authorisation: it is unnecessary to continue the virtually identical powers under section 48. There would be certain circumstances, such as the society having ceased to do business, under which revocation would be automatic. Otherwise, the Chief Registrar would generally have power to revoke authorisation if, and only if, he was satisfied that that was in the interests of present and future investors - essentially the criterion which at present applies to a section 48 order. Failure of the society to satisfy the Chief Registrar that the board and management were doing what was necessary to meet one of the duties imposed on the board in order to protect investors would be a ground which the Chief Registrar could cite for revocation. But the Chief Registrar would not be limited to those grounds and would be able to cite any other grounds which were relevant to the view that revocation was in the best interests of present and future investors.

29. This width of the grounds on which the Chief Registrar could exercise his power follows the present position under section 48. It is clear from the debates in 1959 and 1960 that Parliament then considered it right that the Chief Registrar should be able to take anything relevant into account: it is not possible to anticipate in advance, and then specify in statute or regulations, all the ways in which the board of a society might put investors' money at risk. It would negate the whole purpose of the prudential supervision if the Chief Registrar were to find himself in a position in which he considered that there was a clear case for revoking authorisation in the interest of investors, but he

could not do so because it did not fit one of the pre-ordained categories. The Court of Appeal recently ruled in the case of Regina -v- Chief Registrar of Friendly Societies (ex-parte New Cross Building Society) that the width of the existing discretion was to be construed in this way. The Government considers that it is right that it should continue to be in this form.

30. The exercise of the discretionary power to revoke authorisation (and the present power to make section 48 orders) is subject to safeguards for the management of the society. Existing legislation requires the Chief Registrar to give notice of intention to revoke authorisation, stating his reasons, and to allow an opportunity for representations, both written and oral. He has to seek Treasury consent: Treasury Ministers need to be satisfied in each case that the decision is one that they would be ready to defend to Parliament as being reasonable. Any order is subject to the normal procedure for judicial review. It would be struck down by the Court if the Chief Registrar had failed to observe the principles of natural justice, if any of his grounds were wrong in law, and this materially affected his decision, if he could be demonstrated to be materially wrong on fact, if he took into account grounds which were not relevant to the interests of investors, or ignored ones which were, or if he appeared to have acted unreasonably. This imposes a real and exacting discipline on the Chief Registrar, and so protection for the management of a society.

31. The Government will be considering further whether in the new framework there would, on balance, be advantage in any modification of the existing safeguards of Treasury consent and judicial review. For example, an arrangement for appeals to a panel reporting to the Chancellor, analogous to that under the Banking Act, would be possible. But it could not be combined with the present requirement of Treasury consent, which provides a somewhat different safeguard at an earlier stage. Whatever procedure is adopted for both the original revocation order and its subsequent review must not involve extensive delays or otherwise risk further damage to the interests of investors.

32. But inevitably there will remain some conflict between the need to protect the interests of investors - particularly new investors - and allowing adequate time for both the original procedure and any review to do justice to the present board and management of the society. One way of partially reducing this conflict is for the payment of new monies received into Court. Following the comments of the Court of Appeal on this in the New Cross case, the Chief Registrar would now normally expect to follow any application by a society to the Court for judicial review of revocation of authorisation with a request to

the Court for a timetable order and for an order directing funds to be paid into Court. The Government will be considering the possibility of going further and empowering the Chief Registrar to make a direction requiring a society to pay new funds into a separate trust account (held with the Bank of England) from the time of his first serving notice of his intention to revoke authorisation. If the authorisation was then revoked the funds held in the trust account would be available solely to repay immediately the investors concerned.

(b) Intermediate Powers

33. As already explained, one difficulty with the present section 48 power, and equally with revocation of authorisation, is that such a measure intended to protect future investors tends to damage existing ones. In some circumstances, the present power under section 51 to give directions relating to advertising can avoid this difficulty since such a direction does not have to be published. So it could conceivably be used, for example, to limit a society's ability to grow while the board put its house in order. But it is not particularly well suited to this role. It is often not possible for a society to stop all advertising without there being a substantial risk that the fact would become known, and so cause a loss of confidence and a run on the society. Moreover, the restriction on advertising would probably not go to the heart of the problem with the society.

34. The Government therefore consider that there is a case for giving the Chief Registrar an intermediate power, namely one to make continued authorisation subject to specific conditions. The existence of such conditions would not be made public. Such a power would be comparable to that which the Bank of England has under the Banking Act. It would make it possible to put on a more formal and satisfactory basis the arrangements which are already sometimes achieved ad hoc by which the Chief Registrar agrees not to make an order against a society on the basis of assurances given by the board about future conduct and policy. The Chief Registrar would, in such an intermediate case, be deciding that he considered the society was a safe home for investments provided that it abided by the conditions, and therefore that it could continue on that basis so avoidingthe ill-effects for existing investors of revocation. This arrangement would have the advantage for the management of the society that it would have the protection of the Chief Registrar being required to observe the statutory procedures. It would have the advantage for the Chief Registrar that failure to comply with a condition would be sufficient ground by itself for complete revocation - if factually upheld following the normal procedures. While it would not be mandatory for the Chief Registrar to revoke authorisation if this happened, he might generally be expected to do so unless, say, the society was already negotiating for a merger since the board would have lost its credibility.

35. The section 51 power to make a direction on advertising would then be retained to be used for those cases where it was appropriate, for example to deal with advertisements of a particular type of investment, or to hold the situation, possibly in conjunction with a direction for new money received to be paid into a trust fund, while the full procedures for revocation of authorisation were pursued.

(c) Trustee Designation

36. The present arrangements for designation of societies for investment by trustees were introduced in 1959, long before the authorisation system was introduced. Now that system is in place, a completely separate system for designation for trustee status seems otiose. If a society meets the standard for authorisation, then subject to one proviso it should be providing a safe home for the funds of trustees. The proviso is that trustees should be looking for greater assurance about the repute stability and continuity for their investment than may be applicable to the general investor. There is a good case for providing that a newly authorised society should not be able to take trustee investments until it has established itself sufficiently for it to be reasonable to expect that it will continue as a strong and active society. It is therefore proposed that in future a new society should have built up its free reserves to £1 million, and should satisfy the Chief Registrar as to its ability to maintain such reserves, before it can take the funds of those trustees whose investment powers are prescribed by the Trustee Investments Act 1961. The same arguments would also point to phasing out the designation of any societies now designated which do not meet this criterion.

Investor Protection Scheme

37. The present Building Societies Investor Protection Scheme, sponsored by the Building Societies Association but not confined to its members, is a voluntary one. It underwrites deposits in all societies a hundred per cent, shares in participating societies up to ninety per cent of their value, and shares in other societies up to seventy five per cent of their value. This last corresponds with the protection afforded by the compulsory Deposit Protection Scheme under the Banking Act 1979. At the end of March 1984 £167 out of £196 authorised societies were in this scheme. The former accounted for 99.9 per cent of the total assets in building societies. The scheme takes advantage of a permissive provision in section 43 of the 1962 Act, although that is not very well suited to its purpose. The Association said in 1982 that the scheme was a stop-gap until there was legislation.

38. The Government agree that there should be legislative provision for such a scheme, to which all societies have to contribute. It would follow in general the structure adopted for the deposit protection scheme for banks and licensed deposit takers in the Banking Act including the limitation to £10,000 of the obligation to any individual. It would however provide for 75% minimum cover for shareholders, and 100% cover for depositors. This reflects the different capital structure of building societies and banks. There would be a limit on compulsory contributions of 0.3% of total assets.

39. The scheme for building societies would, however, include a provision which would enable societies, if they so wish, to give a greater degree of protection, say the 90% protection without individual limitation, which they currently give. As at present the higher scale of protection could be confined to investors in those societies which are prepared to contribute to that extra degree of protection.

40. One advantage of a statutory scheme would be that it could be brought in at a far earlier stage in a crisis, and indeed before it was certain whether there would be a loss or not. For example, in the recent case of the New Cross it would have been possible for the statutory scheme to have underwritten repayments to shareholders who so wished of 75% of their investment as soon as the Court of Appeal had agreed to publication of the orders. If, as happened in that case, there was ultimately no loss to be borne the scheme would be repaid in full, so there would be no net charge on the contributing societies.

Other Changes

41. A number of the recommendations of the Inspectors into the Grays Building Society have been adopted without legislation. Once the consultations on the main framework outlined in this Green Paper have been completed, the Government will reconsider those recommendations which would require legislation in relation to what it then decides on the new framework.

THE BUILDING SOCIETIES ASSOCIATION
3 Savile Row, London W1X 1AF
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9 July 1984

Dear Mr Turnbull

I enclose a list of hosts attending the lunch on Wednesday 1 August, 12.45 for 1.00pm.

Mr Herbert Walden will let you know the topics to be discussed when he meets you on the 23 July.

Yours sincerely

Sallie White

Sallie White

Andrew Turnbull Esq
Private Secretary

THE BUILDING SOCIETIES ASSOCIATION
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LUNCH - WEDNESDAY 1 AUGUST 1984

Hosts:

The Duke of Norfolk
President of the Association

Mr Herbert Walden
Chairman of the Association
also Director, General Manager and Secretary
Heart of England Building Society

Mr Roy Cox
Deputy Chairman of the Association
also Director and Chief General Manager,
Alliance Building Society

Mr Alan Cumming
Past Chairman of the Council, and still a member
also Director and Chief General Manager
Woolwich Equitable Building Society

Mr John Ellis
Member of the Council of the Association
also General Manager
Abbey National Building Society

Mr Cyril English
Member of the Council of the Association
also Director and Chief General Manager
Nationwide Building Society

Mr Peter Hemingway
Member of the Council of the Association
also Director and Chief General Manager
Leeds Permanent Building Society

Mr John Spalding
Member of the Council of the Assocation
also Director and Chief General Manager
Halifax Building Society

Mr Frank Strickland
Member of the Council of the Association
also Director and General Manager and Secretary
Sunderland & Shields Building Society

Mr Richard Weir
Secretary-General of the Association

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RM

FILE

B/C: N. OWEN

10 DOWNING STREET

From the Private Secretary

2 July, 1984

BUILDING SOCIETIES GREEN PAPER

The Prime Minister has seen the draft Green Paper which was attached to the Chancellor's minute of 29 June. She is content with the general shape of the proposals but feels the document would benefit from having a short Ministerial foreword highlighting the main themes. She is also content that the Green Paper should now be circulated to colleagues for clearance with the aim of publishing it on Monday, 23 July. The Prime Minister is meeting the Building Societies Association for lunch on 1 August.

I am sending a copy of this letter to Callum McCarthy (Department of Trade and Industry), John Ballard (Department of the Environment) and to Richard Hatfield (Cabinet Office).

(A. Turnbull)

D. Peretz, Esq.,
HM Treasury.

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PART 1 ends:-

AT to PM 29.6.84

PART 2 begins:-

AT to HMT 2.7.84.

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