House of Commons

Treasury Committee

Oral evidence: The future for Mutuals, HC 883

Wednesday 24 November 2021

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Anthony Browne; Gareth Davies; Dame Angela Eagle; Emma Hardy; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 89

Witnesses

I: Martin Shaw, CEO, Association of Financial Mutuals; Mike Regnier, CEO, Yorkshire Building Society; Lucky Chandrasekera, CEO, London Mutual Credit Union.

Examination of witnesses

Witnesses: Martin Shaw, Mike Regnier and Lucky Chandrasekera.

Q1 **Chair:** Good afternoon and welcome to the Treasury Select Committee and our inquiry session on mutuals. I am very pleased to be joined by three expert witnesses this afternoon. I am just going to ask them very briefly to introduce themselves to the Committee for the public record.

Martin Shaw: Hello. I am Martin Shaw, chief executive of the Association of Financial Mutuals.

Mike Regnier: Good afternoon. My name is Mike Regnier. I am the chief executive of Yorkshire Building Society.

Lucky Chandrasekera: Hi. My name is Lucky Chandrasekera. I am the chief executive of London Mutual Credit Union.

Q2 **Chair:** Welcome to all three of you. Can I start with a question to all of you, just by way of background? What is your current assessment of the mutuals sector and how are mutuals performing compared with other non-mutual companies at the moment?

Martin Shaw: In terms of context, my members are friendly societies, small mutual insurers and not-for-profit healthcare providers, so from that perspective those are organisations that offer investment products, protection and healthcare. They tend to specialise in relatively small-premium smaller products.

What we tend to find, which was very apparent in the financial crisis of 2008 and 2009, is that mutuals fare very well in adverse market conditions. That is partly because their products are designed to appeal to everybody and partly because they do not rely on high profit expectations, so they are able to maintain product in an environment that other insurers might decide to withdraw from.

In the recent past, and in 2020 in particular, many of our members saw growth in their business, notwithstanding the pandemic and the general shutdown. In particular, investment-led friendly societies saw rapid growth, with an average of 11% growth in their business in 2020. That compares to a general market that fell by 1%. On the non-life side, so protection and healthcare products, which is more sensitive to the economy and to the fact that many businesses were closed, our members saw a fall in premiums of 7%, but that compared to a general market trend of 14% down. Our immediate experience over the last 18 months has been relatively positive and, indeed, over the last five years we have seen, in an insurance market that is fairly flat overall, our members continue to grow market share over that period.

Q3 **Chair:** On the market share point, why is it that UK mutuals have a lower market share than is the case overseas typically? What is the reasoning behind that?

Martin Shaw: It was not always like that. In 1996, for example, 25 years ago mutuals accounted for 50% of the market in the UK. When you compare that to the markets today in Germany, France, Japan and the US, mutuals still account for 30% to 50% of the markets there. Part of the reason for that is the lack of protection for mutuals in the regulation and legislation in the UK. For example, the Friendly Societies Act has not been updated since 1992. We wrote to Treasury over the summer with quite a long list of recommendations for improvements that would help mutuals perform on a more equal footing. It is that history of benign neglect and the challenge, therefore, for mutuals to continue to grow and compete effectively with their non-mutual counterparts.

Q4 **Chair:** We will probably come on to this in a little more detail later in the session, but can you just give us a flavour of the recommendations? What are the top two or three things that you would propose?

Martin Shaw: It ranges across everything. There are the difficulties in facilitating transfers. If two mutuals want to merge together, there are significant steps to achieving that. We wrote to the PRA on that a couple of years ago and are still awaiting a response, but, in effect, that stifles the capacity for transfers. We also see barriers to entry. It is incredibly difficult to establish a new mutual or friendly society in the UK. By comparison, it is relatively easy to demutualise one. That remains a problem.

From a legal perspective, the rules around the age restrictions on directors are in conflict with the Equality Act, which applies to building societies as well. There are lots of reasons why we would like to see the legislation updated, not least of which are the areas that do not comply with other legislation.

Q5 **Chair:** Mike or Lucky, do you have any observations on anything we have touched or anything you want to add?

Mike Regnier: If you would like me to give you my perspective, I can tell you a bit about the building society. To answer your question, Chair, about how the sector is doing, let me give you the view from the building society sector. As a whole, building societies, with a few exceptions, tend to focus on providing mortgages for homes and looking after people's savings to help build financial resilience across the UK, so, typically, those are the two sides of the balance sheet.

The sector as a whole has been growing. Since the financial crisis, the share of the mortgage market that the building society sector makes up has gone from 18% to 23% and the share of savings has remained flat at around 18%. We are seeing a relatively stable share in savings and a growing share of the mortgage market. The reason for that is that building societies tend to focus on niche parts of the mortgage market that other larger lenders would struggle to lend to because they cannot do that at the scale that would be sufficient for them. They can cherry pick those parts of the market that tend to be underserved in the main and those have been growing, hence the growth in market share.

The sector is strong overall. The core equity tier 1 ratio across the sector is 20.6 compared to 16.1 for the large banks in the UK. Customer satisfaction tends to be a little higher for building societies as well. Some YouGov survey data that was recently commissioned by the Building Societies Association asked 2,000 people about the customer service that they experience from their bank or building society. In the latest data from July, 88% of customers said that their provider provides good customer service, which compares to 79% for banks, so typically a better service.

The other important thing is that buildings societies can reinvest some of our margin in providing better value for our members rather than in taking that right through the P&L to dividends, which then go back to the shareholders. We provide that value directly back to members. Over the past three years, building societies have paid an additional £2.4 billion of interest to their members, their owners, in the form of interest relative to what the average rate paid by the larger banks was. You have a growing sector adding extra value for members and providing fantastic customer service.

Q6 **Chair:** What is your expectation of the trend over, say, the next five years in terms of share of the mortgage market, for example? Do you think that it will continue to grow?

Mike Regnier: It is quite difficult to predict that. Since the Covid crisis started, partly because of the impact of the ring fence, we have seen an additional £200 billion of deposits within the ring-fenced banks compared to the situation before the pandemic started and, by nature of the ringfence, the only market that is really big enough to be able to absorb anything like £200 billion of excess liquidity, given that the banks cannot use that in other markets outside the ring fence, is the UK mortgage market.

Over the last six months in particular, we have seen a very marked drop in mortgage margin, largely driven by the big banks, which are the price setters in our mortgage markets. That is because they are desperate to lend this additional cash that they have in their current accounts from their depositors in the main, because people have not been spending as much and because other sources of funding have been made available as well.

That is providing a lot more intense competition in the market and building societies have the luxury of being able to decide whether they want to compete when returns get a little tighter. They can decide to sit out if they are not happy with returns that they are getting; they are not forced to grow because there is no equity story that they are chasing. We might see some of that. It is difficult to say, but, as I say, competition has heated up a lot since that.

Q7 **Chair:** You touched there on the additional savings that people have made as a consequence of the pandemic. So-called enforced savings might be £170 billion or thereabouts by some estimates. Do you have a view as to the likely rate at which individuals are going to spend that money? The OBR has its own view of that. Do you think that quite a lot of that money has gone into assets like property and to what degree do you think it has driven property price increases? Do you have a sense of those questions?

Mike Regnier: There are two questions there. The £170 billion number—you are right—is the figure that has been published. The £200 billion figure that I referred to is, if you look at just the ring-fenced banks in the UK pre and post pandemic, the movement in their overall levels of funding that they have; that has gone up by £200 billion. That has not been invested in assets. That is cash sitting on deposit in those ringfenced banks, either in savings accounts or in current accounts. A lot of that is in current accounts and a lot of the excess has been in SME current accounts, which have benefited from CBILS, BBLS and other schemes like that.

It is difficult to know. I do not have my own house view as to how quickly people will spend that money and how much of that will get reinvested effectively in driving economic output. The OBR is probably a much better source of estimates on that than we are, but £200 billion is an awful lot of growth in the mortgage market, given that gross lending into the mortgage market is probably in the region of £200 billion and net lending is significantly smaller than that in any year. It will take many years for this excess cash to be put to use by the big banks.

Q8 **Chair:** Lucky, did you want to contribute on the credit union side?

Lucky Chandrasekera: The credit union sector is doing really well. Apart from during the Covid time, we were experiencing high liquidity and less borrowing. You can understand, but apart from that savings are growing. Right now people are starting to borrow money and all the liquidity is going.

The sector as a whole increased our membership to 2 million in the UK and Northern Ireland. Deposits are also growing. There is about £4.3 billion in deposits in the UK. The sector as a whole is growing, but there are some challenges. We need to address the legislation limitations that we have right now. There are a few things and then the technology as well. That is going to play a huge part in our growth.

We are always keeping the link with the USA credit union sector, which is very large. About 60% of the USA population now is with a credit union, so we have links with them, and we learn a lot from them in how we get their products, services and knowledge transferred into the UK credit union sector.

Q9 **Chair:** Thank you very much, Lucky. That is very helpful. I have a final question before I hand over to my colleague, Rushanara. It is a really basic question. Could you just set out what the tangible differences are between the way in which the mutual and non-mutual firms operate? I wonder whether, Martin, you might be in a good position to tackle that, just to get that clear and on the table.

Martin Shaw: Leaving aside the obvious point of ownership, where we see the difference for mutuals is that they are very often specialists in a single product line, whether that is protection, healthcare or investments. Therefore, they are much closer to the affinity groups that many of our members operate with a specific focus on, say the police force, bus drivers, Cornish farmers or whatever. Because they are close to their market and because their customers are members, then by necessity their primary focus is on getting a good deal for their members.

They do that both through product features, which are enhanced to support the needs of their members, and via the benefits package that they put together. That might include in some cases an annual bonus that is paid out to reward loyalty among members. It might be specific benefits that they have integrated into the overall business. For example, last year many of our members introduced a 24-hour GP service, so that their members who could not get to their usual GP were able to have access to a free service online.

They continually look, therefore, to innovate the products to meet the needs of not just their customers, but the communities that they serve. They do that in way that is very authentic and very consistent with the way that they operate, and they have been doing that for 200 years. It is not the recent trend in looking to best articulate what customers are looking for. It is deeply engrained within the business and among the employees.

Q10 **Rushanara Ali:** Good afternoon. I have some questions about demutualisation. Can each of you talk us through what you think the consequences of demutualisation are on the wider mutual sector?

Martin Shaw: In insurance, as in building societies, there has been widespread demutualisation over many years. I mentioned before that we moved from 50% market share in 1996. What we have seen through those demutualisations is that the members of the business who are paid a single bonus at the point where the demutualisation happens pay for that over the longer term. For example, they may receive a bonus at that date, but then the investment returns they receive in the future drop away very significantly and more than outweigh the small lump sum initially.

They will also see a fall-off in the level of service. Organisations that were once stalwarts for good customer service quickly realise as they demutualise that they have to cut costs and simplify their commitment. I say this, by the way, as somebody who worked for a building society that demutualised and saw very significantly the whole change in culture in the business, and the focus on the next set of quarterly results rather than the best interests of customers.

Q11 **Rushanara Ali:** What about the impact on the wider sector?

Martin Shaw: Every demutualisation is another cut. It is another wound in the sector, and it makes it much more difficult as the sector potentially shrinks to argue the case for changes in regulation and legislation. As there are significant barriers to entry, we tend to find within our sector particularly that we are constantly having to retell the story about why mutuals are important elements of the financial services sector. We constantly have to re-educate regulators about the differences in business model and what kinds of consequences there are for new rules. While individual businesses will continue to operate unaffected, there is a morale issue for the sector when you see a demutualisation and realise that it is a one-way street.

Mike Regnier: In the building society sector the demutualisation push came several years ago now and, frankly, since the protections were put in place to prevent societies from being carpetbagged, as a number of them were in the latter stages of that, there has not been any more demutualisation.

In the run-up to and through the financial crisis we saw a number of mergers, but they were all within the sector. In the case of Yorkshire, for example, we merged with the Barnsley Building Society, the Chelsea Building Society and the Norwich & Peterborough Building Society during that time, so all of those members remain members of a building society. It is just that they became members of a bigger building society, but they could retain an independent future as a mutual, as a member of a bigger and stronger society. Since then we have seen only one society merger, which was a very small one with a single branch that merged into the Skipton.

Everything that my colleague to the right of me just mentioned I would agree with. In terms of the broader consequences of demutualisation on the wider sector, what you see is fewer competitors focusing on slightly different areas of the market. You lose that rich tapestry when you see more firms disappearing and consolidating.

Lucky Chandrasekera: It does not affect the credit union industry that much, because our legislation is really protected on demutualisation. There are two things that can happen. A credit union can go down because it did not manage well or the capital is low, or it can merge with another credit union. In the last 10 years or so we merged with about five different credit unions. As Mike said, we are keeping the membership within the credit union industry and all that. There is no legislation right now that allows for us to demutualise.

Q12 **Rushanara Ali:** My next question is about the current proposed sale of LV= to Bain Capital. Would that sale upset the critical mass of mutual insurers required to provide meaningful diversity in the insurance sector?

Martin Shaw: At one level, no. A few years ago Liverpool Victoria was a very successful general insurance business as one of the top three general insurers in the UK and, therefore, did have a very significant competitive position. It has since sold the general insurance business and what remains is a relatively small life and pensions business, which, therefore, accounts for about 0.5% of the UK insurance market. In overall terms, the answer would be no.

Q13 **Rushanara Ali:** If you look at the comparison in the insurance market with the US, where mutuals and co-operatives play a part, the USA is 39.9%, Japan is over 40% and France is over 50%, but in the UK it is just over 10%. It seems like it is going the other way. Why is this happening, given the UK has had a long history going back to the 17th or 18th century?

Martin Shaw: There is a history in businesses of turnover, change, business disappearing, merging and whatever.

Q14 **Rushanara Ali:** How much of that is because there is a policy direction over recent decades that has led to it? To what extent is it that rather than the business cycle?

Martin Shaw: Leaving aside the business cycle, the benign neglect of the mutuals sector in Government and in regulation has made it more difficult to maintain a mutual organisation. The barriers to entry mean that where one disappears it is very difficult to replace any others. For example, the start-up units in the FCA and the PRA, which the regulators are rightly proud of for introducing new competition, have never had a mutual start-up go through them. Those barriers mean that it is only ever going to be a diminishing circle.

Q15 **Rushanara Ali:** What are the specifics that would need to be introduced to reverse that trend and some of the other points that were made earlier about the cost to customers of demutualisation, the quality of service and so on? What would need to be done to stabilise the situation?

Martin Shaw: If it was a much easier process to create a new mutual, then we would find much more significant demand. For example, with the credit union sector, there is an easy entry level for very small businesses that does not exist in insurance or, indeed, in lending. If there was a more open approach, that would help.

I talk to lots of people who are keen to establish a mutual. There are lots of businesses that want to set one up on a collaborative basis within their sector and that is because they see that the current insurance market is not serving their needs well. They are paying very high premiums and finding it difficult to make claims. The business interruption insurance problems from last year are a good example of that. Those people look to see if they can establish a mutual within their own industry and are quickly discouraged because of the high costs and complexity of doing so. Very much on the one side, establishing new mutuals is difficult.

Avoiding demutualisation is another challenge, because at the moment it is too easy for an organisation to go through that process. If you buy and sell shares in a plc business, there are lots of regulations around that, protecting consumers. There is next to no consumer protection for members of mutuals that are faced with a demutualisation.

Q16 **Rushanara Ali:** If the majority of a mutual's members want to change the organisation's ownership structure or receive a windfall payment by demutualising, do you think there should be limits on whether they can do so? You have talked earlier about how people ultimately end up paying back, in a sense, for what they get. Should there be a limit? You can see the incentives for people wanting to do that at the outset, but how do you avoid that? It seems like there is an inevitability to some of this otherwise.

Martin Shaw: Again, it depends on the regulation and rules around it. If you look in the case of the UK, regulation determines that all the money that rests within the mutual belongs to the current set of members. In the case of Liverpool Victoria, that capital and inherited estate has been generated from 180 years of profits and, therefore, saying it is appropriate to hand over that money to today's members, simply because they are lucky enough to be in the draw when the lottery begins, does not seem right. It is not the ethos that the mutual was created by. It is not the basis by which generations of members have invested their money into a mutual. For me, there is a failing in the regulatory environment that makes it too easy for that money to be lost from the business.

Q17 **Rushanara Ali:** Should it be prevented?

Martin Shaw: Yes and, again, in other countries there is this form of disinterested capital, which allows for a separation between the interests of members and the interests of the long-term perpetuity of the business, in the same way that, if you left your local golf club, you would not take away your square of turf from the fairway, because it belongs to future generations of players.

Mike Regnier: To answer that question specifically, the thing that is maybe a little different in the building society sector, because we had to deal with this run of carpetbagging that went on where people were joining building societies and forcing a vote effectively, is that most building societies, if not all of them, introduced this idea of charitable assignment. That basically means that, for a period after joining, new members do not benefit from any windfall that they might gain from a demutualisation and that effectively went to a charity instead. That then put the brakes on this activity going on and, since then, that pressure has receded. From our perspective, we are very proud to be a mutual and we would not see any reason why would want to demutualise. We discuss it regularly as a board and it is a very simple discussion.

Q18 **Rushanara Ali:** If I understand this correctly, there are certainly lessons that could be learned from your sector and could be transferrable to the insurance mutuals. They have not been learned yet.

Martin Shaw: They were adopted and learned within one friendly society in the mid-1990s, which decided to introduce what I would describe as a mutual lock. Essentially, no vote for demutualisation could take place unless 50% of the members of the business were party to the vote. That was on the basis that that was conceived never to be possible, so you would never have half of your members turn up and vote. That business was Liverpool Victoria, so the only mutual insurer to have taken that protection out is now the only one that is looking to circumvent it.

Rushanara Ali: Lucky, did you want to come in on any of that?

Lucky Chandrasekera: As I said earlier, it is not really applicable to us, because we are insulated from the legislation on demutualisation.

Q19 **Rushanara Ali:** Do you have a view on the subject matter? No worries if you do not.

Lucky Chandrasekera: I would like to keep away from that because I am not expert in that area, but demutualisation overall is not a good idea.

Q20 **Siobhain McDonagh:** Taking on from where Rushanara left off, I would like to ask some questions about LV= and the proposed sale to Bain Capital. Was it appropriate for LV= to put the business up for sale without telling members in advance?

Martin Shaw: There are a number of shortcomings in the approach, and I am sure that, if the directors had their time again, they would improve the quality of communication throughout. As a business, you have to make commercial decisions on behalf of your members, but within a mutual it is very important that you keep your members actively involved in your strategy. Within the corporate governance code that we maintain we actively encourage our members to share on a regular basis changes in strategy and the direction of the business, so that members are actively involved.

A good question is whether or not LV= should be up for sale, and what has become more apparent in the last week or so is the basis by which the board was faced with that decision. That is a combination of very dramatic falls in membership and a strain on its capital position. All of that meant retaining its independence was going to be well-nigh impossible for the future. It is an unfortunate and sad position that it finds itself in. Certainly, the decision to sell I would recognise as being consistent with the challenges within the business, but not necessarily the late basis by which it communicated that to members.

Q21 **Siobhain McDonagh:** Whatever the difficulties, surely the point of being a mutual requires some mutual trust, understanding and involvement.

Martin Shaw: Yes. Part of the difficulty lies in the fact that there has been a stream of structural change within the business over a number of years. For example, as I mentioned, five years ago LV= was one of the strongest general insurers in the country. It then sold that business to Allianz for over £1 billion. Having made that strategic decision, it then made the strategy decision to change its structure from being a friendly society to a mutual insurer, and it then concluded that it needed to sell the business.

There have been a series of strategic decisions made within the business, drawing back to that point that as an independent entity it was probably not in a position to continue. What transpires from what they have said recently is that they knew that back in 2016 and 2017 when they started those structural changes within the business. If it has only just become known to members now, then, clearly, that is a failure in the basis of keeping customers properly informed of what is happening.

Q22 **Siobhain McDonagh:** Is it right that the chief executive of LV= should lead negotiations in the proposed takeover, given that he stands to benefit significantly if the deal goes through?

Martin Shaw: Clearly, the chief executive and the chairman have to lead the process. The difficult position they find themselves in is that they are also looking to maintain their roles in the future. If they were simply stepping aside, it would be a black and white position of saying, "They have led the negotiations in, but they step aside afterwards", and we have seen that in many examples of transfers within the industry. It does tend to remove concerns over conflicts of interest, but there is a potential conflict there. In effect, the proposal is to sell the business to people who do not know how to run a UK life insurance business, so you need some kind of continuity in place to be able to have credibility if the business is sold to Bain.

Q23 **Siobhain McDonagh:** Under the proposed LV= sale, non-profit members are set to receive up to £100 and with-profit members will receive a further 0.1% enhancement for every year that they have been a member. Does this represent a fair price for the mutual and how does the payment compare with previous demutualisation offers?

Martin Shaw: If I take the second point first, on previous demutualisations within our sector, at the largest end, £6,000 was paid to Scottish Widows members in 2000. The most recent demutualisation before now was Standard Life, which paid £1,250 to its members and, therefore, the £100 seems like a very small amount by comparison.

If I can indulge you for two minutes with a bit more explanation, where I have read into the brochure I have a better understanding of why that figure of £100 is where they have arrived at. Whether or not it is fair is another issue. The brochure itself makes the claim that £100 is the minimum amount it is reasonably credible to offer.

That sounds like they are trying to pay the least possible but, if I can explain from my understanding why that is a credible offer in the view of the board, the non-profit members are not participants in the overall profit success of the business. That falls to the with-profit members, whose money is held in the with-profit fund, which also holds all of the accumulated profits and reserves that have been generated over the years. In effect, it is the with-profit members who are the ordinary beneficiaries of any money that is shared out with members.

In effect, therefore, the proposal to pay money out to the non-profit members is not something that we would have seen in other insurance companies that have demutualised. In effect, therefore, it represents the amount that the with-profit committee believes is—

Siobhain McDonagh: The amount they can get away with.

Martin Shaw: —the smallest fair amount that they can give up to incentivise the non-profit members to vote in favour of the deal.

Q24 **Siobhain McDonagh:** The interests of consumers and members in the demutualisation and proposed takeover are also supposed to be examined by an independent expert specially appointed to do so. Given that the experts in the LV= case have been chosen by LV=, briefed by LV=, paid for by LV= and work in the same lobbying firm that is lobbying for the deal, do you think the independent expert possesses any form of credibility?

Martin Shaw: I do not know the individual, but I do know that those people are appointed on the basis of their professional skillset, so I would like to assume there is no ambiguity over their role.

Q25 **Siobhain McDonagh:** Do you think it is a good idea to have somebody who has so much skin in the game? Where is the independence and where can the members have any confidence that they will get completely straight advice?

Martin Shaw: The shortcoming and one of the things we have put to the regulators is that if you have an independent expert who is asked to offer an opinion on only one deal—

Q26 **Siobhain McDonagh:** The person may be an expert, but they are not independent, are they?

Martin Shaw: No, but, if they are asked to review one deal only, it is a simple of question of whether that has been conducted in a legal process. There is no weighing up of whether that deal is better than the organisation remaining independent or better than using an alternative deal that is put forward to them. For me, if there was more of a question of weighing up rather than a black and white view on whether this is a legal approach, it would be beyond some of the scrutiny that you are suggesting it should be.

Q27 **Siobhain McDonagh:** Are you convinced that the FCA and PRA have done all that they might to stand up for the consumer or members' interests?

Martin Shaw: No. The FCA wrote to Liverpool Victoria last month and it stated that, in effect, Parliament has never given it the powers to offer an opinion on whether a sale of a mutual business to another business type is appropriate. That is not right. There is sufficient scope within the powers for the FCA to reinterpret that. In fact, the law was changed in 2016 through the Bank of England Act to introduce a clause on corporate diversity. I have not seen the FCA or PRA actively act on that, but my interpretation of that would be that it is within the powers of the FCA to take a more robust view on ownership as one of the issues it considers in relation to consumer protection.

Q28 **Siobhain McDonagh:** Is it clear to you why the board of LV= rejected the Royal London bid, which we know now offered more money, and instead accepted the Bain bid?

Martin Shaw: I have not seen evidence of, first of all, how the deals differed, but I do know that Royal London has a strong pedigree in working with other businesses and taking in transfers. It took in Police Mutual last year and over the years there has been a stream of businesses that, in effect, have seen Royal London as a white knight within the sector. It has all the capabilities. It has deep capital pockets and, from what I have read in the media, it has a leadership that is genuinely interested in taking the issue forward, but I have not seen anything more than that I am afraid.

Q29 **Siobhain McDonagh:** This is my final question. Sorry, Chair, I know I am running over slightly. Do you think it would be helpful for members if both the Bain bid and the Royal London offer were now published in full, so members can make their own minds up as to whether they wish to vote or how they wish to vote?

Martin Shaw: Members have decisions at the moment based on incomplete information. It would be nice if they had more information, but I am acutely aware that the prospectus that has been given to them already is about 50 or 60 pages long and even that does not give you a full picture of what is proposed. It would have been nice early on to see a better weighing up of the different offers that were made available. That has not been the case and I would like to think, with two weeks to go until many members vote, that there is still time to be more transparent.

Q30 **Siobhain McDonagh:** Mr Regnier, would you like to see the Yorkshire Building Society act the way LV= has?

Mike Regnier: We have no plans to demutualise, so it is not really a question that is that relevant, unfortunately, and it is a different sector as well to ours.

Julie Marson: I have some questions specific to building societies, so, Mike, I am going to direct my questions to you.

Mike Regnier: Please do.

Q31 **Julie Marson:** Thank you. The story, like you say, over the past few years for building societies has been demutualisation and yet we have seen challenger banks. Why have we not seen challenger building societies? The last building society to be established was 1981.

Mike Regnier: It was.

Julie Marson: Why is that and what would you say are the barriers that mean we have not seen that?

Mike Regnier: It is a very good question and—you are right—the last building society was the Ecology in 1981. Since then there have not been any new ones. The reason that there have not been more new building societies is that you need a certain type of capital really to set up a building society.

You need quite a lot of it, and you need it from investors that are prepared to see very little return on it for a very long time, because really the only way you can be remunerated is if you put in a CCDS structure as part of the capital stack and that pays out over a very long time period. If you are an investor and you are trying to set up a financial services organisation, you probably want to set up a small bank, because you can get your capital out more easily and, if you can grow that business, it is much easier as an investor to make a return on that.

The reason the Ecology was set up was that the members who originally established that felt very strongly that there was a particular area of the market that they did not feel was well served. The Ecology business model is all around sustainable construction, sustainable ownership of different types of property and sustainable renovation. The members who originally set that up felt passionately that that was an area they wanted to see more development in, and so they put their capital up to make that happen. If there was another area like that that parts of society felt was underserved, then there is nothing stopping them from setting up a building society in the same way.

Q32 **Julie Marson:** That is interesting. The mutual structure is an issue, clearly, from what you say. Are there any niches? You mentioned niches earlier. Can you see in the future any drivers that might be an incentive? For instance, we see ESG and different motivators for investing in financial structures. Do you see any driver for that in the future?

Mike Regnier: I do not see any now, but there might be, because there has been in the past. Building societies in the main were set up over 150 or 160 years ago now for a very specific reason of helping people out of poor-quality rented accommodation into homes of their own. The model has evolved since then but, ultimately, that is still the main purpose that most building societies are around for. It is to help people into homes of their own and help people save. The Ecology was a very nice unique case. I do not know. I would love there to be more. It would be lovely to see another birth of a building society after 40 years, but I cannot see it right now.

Q33 **Julie Marson:** You gave us an overview and a picture of how building societies have performed. If you could put that perhaps into a bit more context, say, since the financial crisis, how have the building societies' performance compared with banks over that period?

Mike Regnier: The main measures really are market share, customer satisfaction and value, ultimately. As I mentioned, market share in mortgages has gone up for the sector since the financial crisis. There have not been any new entrants. There have been some mergers, but all of those members have remained members of a building society during those mergers and the building society sector's proportion of the mortgage market has gone up by 5% to 23% over that period. The share of deposits has remained flat at about 18%. Customer satisfaction is higher, and we have given billions of pounds of additional value back to our owners.

Q34 **Julie Marson:** One of the areas where you compared very well is the closure of bank branches. As constituency MPs, we see the difference and, clearly, there have been much fewer closures of building societies. Why is that?

Mike Regnier: There have been some closures of building society branches as well and, unfortunately, we made the decision last year to close 10 of our building society branches this year too. Unfortunately, there is a certain inevitability where we are seeing footfall dropping in traditional bank branches and that makes it hard to sustain the service. If people do not want that service anymore because they are not using it as much as they were, there comes a point where it becomes quite difficult to sustain that.

What you have to remember about our model as a building society is that, if we are effectively running loss-making parts of an organisation, our members are cross-subsidising those loss-making parts of the business. As a mutual, one of the things that we have done recently, for example, was to close our current account business that we inherited as part of one of our mergers about 10 years ago. We closed the current account business four or five years ago and we did that because we did not think it was right for our member to cross-subsidise others to such an extent, as it was subscale and very expensive to run that. We made that decision, and it is unfortunately the same thing with bank branches.

The difference with building societies, though, is that a lot of the funding that banks attract is through either the current account relationship or savings that are linked to that current account relationship in the main. That is how the banking models tend to work, whereas building societies compete for savings in the secondary savings market, traditionally through best-buy tables in the newspaper, as was, or online now. Certainly in our case, a very high proportion of those savings customers are still walking into branches to open their savings account, whereas for the banks a much higher proportion are done on mobile or through a website, and that is how the deposits come in. For us as a sector, having branches is still very important because it is our main source of funding.

Q35 **Julie Marson:** How important is the culture of a building society compared to a bank—the community focus and the whole ethos that you have lived with for many years?

Mike Regnier: Every organisation's culture is really important to it. They are just a bit different. I have worked in banks and I have worked in building societies. I have only worked in one building society and a couple of banks, but from my experience there is a certain different culture about it for sure and, in the case of the Yorkshire Building Society, a very strong focus on doing the best thing we can for all of our members, because, ultimately, they are the owners of the business and what we are here for is to represent those members and do the best job we can for them. That is a very strong feeling right the way through the organisation, for sure.

Q36 **Julie Marson:** Does the culture and the ownership model have a downside in terms of maybe a lack of impetus for innovation, for example, or creativity in that market? How do you think about that?

Mike Regnier: You always see that overplayed elements of culture can be things that get in the way and, yes, that is probably true to an extent. Typically, building societies have been very conservative because it is the members' money that we basically have the privilege of looking after for a few years. Then we hand over to someone else and it is their privilege to look after it. For board members, it is exactly the same thing.

That can probably stifle more aggressive risk taking because people are nervous about that, as they are not trying to make a return; they are trying to protect the organisation's long-term sustainability. That possibly means that you get a bit less innovation, but in other areas it is the opposite. As I have mentioned earlier, helping identify underserved parts of the market requires in many cases quite interesting and innovative things. Ecology was one example, but there are lots of things that the sector has done to try to encourage innovation in things like intergenerational lending. A lot of those innovations came from the building societies rather than the banks, because they understand the needs of the customer they are trying to serve and they can build very specific solutions for them.

Q37 **Julie Marson:** What are the big opportunities for building societies over the next five or 10 years?

Mike Regnier: Just keep doing what we do really well, which is put the members' interests at the heart of every decision that is made within the organisation and make sure that we continue to run businesses that are sustainable for the long term. That is how we operate.

Q38 **Dame Angela Eagle:** You have described quite vividly the fact that there is benign neglect of the sector because there are barriers to entry. It is hard to have new start-ups of mutuals and yet it is too easy to demutualise. Is that not a recipe for something that works out as an existential threat to the mutuals sector, which can only ever get smaller the more that these corporate carpetbaggers, or whatever we want to call them, in search of the quick profits of demutualisation, can keep having a go at what is left of the sector?

Martin Shaw: If you look at the reason why a lot of organisations that demutualise declare that they are going to, it is about access to capital and that is about finding the capital they need to grow the business more quickly. It is certainly true that, where we have seen demutualised businesses, they have been able to generate interest from institutional investors, which is not possible as a mutual organisation. Any mutual is to a certain extent limited by the amount of capital that it has.

Many of our members have wide and deep pockets in terms of their capital, which is therefore a generator for growth. The challenge they have is to find ways to be constantly innovative and competitive. Typically, as smaller businesses, that can be a challenge in an increasingly digital world with increasingly large-scale competitors. The challenge that our members have is finding the right niches by which their products remain competitive, but where they can also serve a particular target market really well.

Q39 **Dame Angela Eagle:** Other countries have much larger mutual sectors in these kinds of areas. How do they do it if we are in this situation where we are increasingly moving to a monoculture of plc and shareholders, which, as you have explained and as we all recognise, does not always serve the economy well, especially, as you were pointing out at the beginning, in adverse market conditions? It makes us less resilient in many ways.

Martin Shaw: Exactly. We always worry when the markets flatten out and people forget the bad times that they may then forget the mutual sector. In countries like France, where mutual governance is very particular and the French style of Government is different anyway, they fully respect and embrace mutuality. They have introduced structures that make it possible for small mutuals to thrive and operate in conditions that would not work in the UK because of the more inherently competitive marketplace that we live in. That is one example.

Very often people are surprised that there is such a strong mutual sector in the US, but that is largely drawn by the capacity for organisations to get bigger because there is better access to capital. Some of the instruments that we have looked at in the UK and have not delivered here are available in the US.

Q40 **Dame Angela Eagle:** Such as?

Martin Shaw: Mike mentioned core capital deferred shares in building societies. In the UK we looked at mutual deferred shares a few years ago. Parliament passed the Act for that, but the secondary legislation was not passed because of a contradiction between, in effect, the expectations of how the Act would generate new shareholdings within mutuals and the expectations HMRC had about the tax treatment of that business.

Q41 **Dame Angela Eagle:** That has effectively been stymied because nobody has been able to iron out some of those technicalities.

Martin Shaw: Exactly, yes.

Q42 **Dame Angela Eagle:** When I asked the Minister about the LV= takeover and whether he was concerned, he kindly wrote back to the Committee basically throwing the ball to the FCA about particular issues and the FCA appears to be hands-off as well, so there is nobody positively looking after the sector to prevent it being shrunken further by corporate predators, is there? Everyone says mutuals are lovely, but nobody seems to want to do anything to help preserve what is already there, much less grow it.

Martin Shaw: At one level, you are right. I am really pleased to see that the media has got behind this story and we have seen lots of stories investigating this particular case, but also beginning to think about the broader consequences for mutuality. At one level as an industry and representing mutuals, we need to do more to represent the good things that mutuals do. We need to be more strident in taking forward some of the ideas we have of how mutuality makes a difference.

Q43 **Dame Angela Eagle:** Perhaps you would write to us with some thoughts that would deal with this crease that you were just talking about between HMRC and the Act of Parliament that was passed that would have allowed you to have a slightly diverse share. That would be helpful, because at least then we would see if there were policy things we could start talking about.

Martin Shaw: There is a great case study from Australia, which introduced a very similar piece of legislation to the Mutuals' Deferred Shares Act in 2019 and specifically removed that tax risk. I can give you more information.

Q44 **Dame Angela Eagle:** That would be helpful. Mr Regnier, do you think that an American private equity firm—a hedge fund—is an appropriate business to take over LV=, which manages the savings of thousands of

British families?

Mike Regnier: I cannot really comment on LV= because I am not a member of LV=. I do not have the prospectus. I have not seen anything other than what I have read in the press about it, but certainly, for us, we would never, while any of the current board members are on the board, because we discuss it regularly, consider demutualising. It is just not what we are here for.

Q45 **Dame Angela Eagle:** Martin, looking at what happened to LV=, it seems that, first, they dispose of the bigger side of the business for £1 billion. Then they discover that what it is left with is not really viable and, because it is so small, people start leaving. Then they decide they are going to demutualise and get rid of the rest of it. I am a chess player. I would see that as a kind of three-move shift to get myself a very nice retirement package, if I was the chief exec. What do you think?

Martin Shaw: There has obviously been a culmination of issues.

Q46 **Dame Angela Eagle:** It is a strategy. It is a pretty rubbish one, except for personal aggrandisement, is it not?

Martin Shaw: It is a three-act tragedy, in terms of finding a solution by investing in the general insurance business, knowing that the life and pensions business was shrinking, but then realising, probably too late in the day, that that was not the panacea they were hoping for. They then sold the general insurance business for a good price, but recognised that that did not stem the initial problem. In LV's case, it comes back to having growth in the membership that it has not been able to achieve.

Some other mutuals, faced with a similar issue, have resolved that. They have created new forms of member, which have been able to give them a greater, more permanent sense on a viable minimum number of members for the future.

Q47 **Dame Angela Eagle:** One other thing I wanted to ask about was whether the monoculture and the lack of diversity in the UK market means that the regulators simply do not understand or spend very much time thinking about mutuals. Therefore, you are being regulated by people who do not understand the values or the culture of your sector.

Martin Shaw: We have regular meetings with the FCA and the PRA. Unfortunately, they are not always with the same people, so we start the education process.

Dame Angela Eagle: You do that over and over again, I bet.

Martin Shaw: Institutionally, the regulators should have a broad understanding of mutuality. As I mentioned, their expectation that ownership structure is not one of the issues they take into consideration sufficiently is one of the major drawbacks. If they were more open minded to that, it would be easier to take them to account for the lack of consideration of different business structures.

Mike Regnier: That certainly is not what I have seen. I think the regulators really understand the difference in ownership structure. Through all the conversations I have ever had, they are keen to make sure that there is a broad diversity of ownership models and other different structures in the long term for the UK financial services sector. That is important and that is what I have seen in evidence.

What could change a little bit maybe is around perhaps parity of esteem. It seems that, while the differences are well understood and valued, and that broad tapestry of ownership structure is valued, the go-to approach generally is to say, "Let us come up with new rules that work for the banks and then let us work out what it means for the building societies or the mutuals". If some of those solutions were designed with that broader tapestry in mind, in terms of parity of esteem, we would probably be in a slightly better place. Certainly, I do not see what you mentioned, fortunately.

Q48 **Dame Angela Eagle:** Lucky, with respect to credit unions, do you see that you are properly understood? It is difficult for you to say publicly whether you think the regulators are any good, because if you get on the wrong side of them it is not very nice. What do you think in terms of that understanding?

Lucky Chandrasekera: We are quite fortunate, especially on the Bank of England and PRA side, that our regulators have been there for a long time with the credit union movements. Also, they attend a lot of events with us—our AGMs and our different events. They are talking to us constantly, so they understand their remits and all that, yes.

Q49 **Dame Angela Eagle:** Finally, Martin and Mike, if there was one thing you think that could be changed that would make it much harder to demutualise the existing mutual sector, what would it be?

Mike Regnier: It would be to do what the building societies did, which is put their own internal protections in place to stop people coming in and trying to demutualise from within. That has worked for us.

Martin Shaw: For me, I would like to have that conversation with Treasury where we look at the idea of disinterested capital and separate out membership from who owns the money in the business.

Q50 **Anthony Browne:** I have some follow-up questions about credit unions primarily. You mentioned earlier, Lucky, in your response, that the number of members of credit unions has gone up, and I think business is doing fairly well, but the actual number of credit unions has gone down. Also, there have been some failures of credit unions. Is that the reason why they have gone down, or why have they declined?

Lucky Chandrasekera: It is the combination of both. Sometimes the credit unions find that the maintenance of the business is difficult, the original founder members leave and there is no continuity there. Some of them are small organisations that started in the church halls and they cannot scale up the business. The technology and the premises are not there. These ones tend to either close down or merge with the local credit union.

Q51 **Anthony Browne:** I used to be chief executive of the British Bankers' Association and we did a lot of work supporting credit unions. I worked with the DWP, which had a programme for that. The Archbishop of Canterbury had a taskforce on supporting credit unions, which I was on, trying to compete the payday lenders out of business. What do you see as the main challenges for credit unions now? You mentioned the lack of institutional and technological capability for some of the smaller ones. Are there particular barriers to growth further?

Lucky Chandrasekera: There are a couple of things. There are a few things that we can do to bring the legislation into the 21st century, if you like. The one big thing is the technology. We are competing with a lot of other organisations, the challenger banks, that are coming in. There are all kinds of fintechs. Most of the credit unions find that they do not have capital or expertise to implement those systems. That is the big barrier. Some credit unions are working on those things to implement them right now.

Q52 **Anthony Browne:** How can you get the expertise?

Lucky Chandrasekera: It is just that we need the additional capital to employ the right people, develop the systems and bring it to the next level.

Q53 **Anthony Browne:** Is that a bit of a Catch-22? Obviously you cannot raise capital except from savings from members.

Lucky Chandrasekera: The only way that we can do it is by saving or leaving some money from our profit, on top of giving the dividends and everything, then leave some money for the additional developments and all that. Yes, it is a Catch-22. Some credit unions can get subordinated loans and implement the technology if they want, but then they have to pay the loan over the years to come.

What most of the credit unions do is set aside some money from their profits, so that will take years and years to build. Then they use that money to develop technology. By then, we are a bit too late, and we have a catch-up game that time. Technology changes very fast and it takes some time for us to get that new technology developed.

Q54 **Anthony Browne:** I think in your opening comments you mentioned credit unions in the US. The UK has a small credit union sector compared to many countries—Germany, France and so on. Why is it so much smaller here than other countries?

Lucky Chandrasekera: It is mainly because of the mutual sector in the UK, especially the building societies and the co-operative banks. During the 1980s, they were massive, with about 35% to 40% of the penetration at that time. Then the demutualisation came in and all the members who were in the banks now, like Abbey National, did not go back to other building societies and open accounts, so the penetration went down.

Q55 **Anthony Browne:** How does that affect credit unions?

Lucky Chandrasekera: I was talking about the mutual sector.

Q56 **Anthony Browne:** Yes, we heard about that, demutualisation. Why are the credit unions in the UK so much smaller?

Lucky Chandrasekera: We are competing with the co-operative banks. Other mutuals are bigger, so the building societies and all that. The USA and most other countries do not have building societies. It is only Australia and New Zealand that have building societies. The USA does not have building societies, so its mutual sector is the credit unions.

Q57 **Anthony Browne:** So it is Yorkshire Building Society's fault—*[Laughter.]* The Government have been quite open in supporting credit unions and have certainly had programmes to try to support them, as I mentioned earlier. Is there anything in particular that you want from Government, or indeed the financial services industry more widely, to support the credit union sector?

Lucky Chandrasekera: The change in legislation is the key thing that we are looking at, so including some things in the Credit Unions Act, the general-purpose objective, if you like, and allowing the credit unions to provide financial services. Which financial services depends on the risk appetite of individual credit unions. Some might want to provide mortgages, current accounts, credit cards, insurance, insurance brokerage or whatever. We need those provisions included in the Credit Unions Act, so the credit unions that are capable of providing those services apply for the permission from the regulators to do so.

There are then a couple of other small things that we need to change in the legislation. Some of them are not fit for the current environment, for example the register of members. Right now, any member can ask to see the list of names and addresses of the credit union members. We need to make it available for everyone to see. That is contradicting the GDPR regulations, privacy policies and all that. That needs to change.

There are some other things, like family members. Family members can join but, if the family member moves away from their house, they cannot join. As a result, some of our colleagues cannot lend money because the family members are living apart and they are not in the same house. They cannot give mortgages and other products for those family members. Those things need to change in the legislation to enable us to grow the credit union sector.

Q58 **Anthony Browne:** I think I am right in saying that one difference between the credit unions in the UK and other countries is that the ones in the UK tend to be geographically based, like your London Mutual Credit

Union. They are based on towns. In other countries, they tend to be based on employment groups or other affinity groups, like the police officers credit union or the firefighters credit union. In America, I think they are almost all based on different professions and so on. There is a theory that actually that makes it more difficult for you to market, because people do not feel a union of affinity because they live in the same town as much as they do if they work in the same profession or for the same employer. Do you think that is a barrier?

Lucky Chandrasekera: In the UK, we also have that ability to offer services for police forces. For example, we provide services to the Ministry of Defence right now. It is there, but the geographical part is the restriction. Right now, it says 3 million potential members and we know for sure no credit union will get 3 million members. It needs to change to 3 million members, rather than potential members. That really restricts us. That restriction is there for us for various reasons, but it is not allowing us to grow, if you like.

Q59 **Anthony Browne:** I have a couple of questions about pay, but I was actually going to ask Mike Regnier. You got the headlines recently for your pay. It was reported as saying that you earned £926,000 and a bonus of £226,000 last year, so £1.15 million. Is that right?

Mike Regnier: That is right, yes.

Q60 **Anthony Browne:** I was just looking at the pay for the chair of Barclays bank, Nigel Higgins. He got £541,000, so less than half what you earned, and Barclays Bank is 30 times bigger than Yorkshire Building Society in terms of assets. It is a global, systemically important bank, one of the world's largest financial institutions. Do you think deserve twice as much as the chairman of Barclays Bank?

Mike Regnier: Pay is not set by me. It is set by the remuneration committee. They look at a number of factors in assessing what they think the right level of pay should be.

Q61 **Anthony Browne:** Do you think there is proper governance over pay of mutuals, and of building societies in particular? You do not have the shareholders asking questions about it.

Mike Regnier: You have independent directors, who represent the interests of the membership as a whole. That is what they are there to do. The structures are set up in a way that allows them to do that.

Q62 **Anthony Browne:** Do you think I am right in saying that your pay, compared to your assets, is far higher than most banks?

Mike Regnier: That is an interesting way to look at pay.

Q63 **Anthony Browne:** You could compare it to turnover.

Mike Regnier: It is the same thing. It is an interesting way to look at pay. You have to look at the skills and experience you need.

Q64 **Anthony Browne:** Why do you think the pay of a building society chief executive should be higher than the equivalent pay of—

Mike Regnier: The pay of building society chief executives is considerably less than the equivalent pay of bank chief executives.

Q65 **Anthony Browne:** Is that for the same-sized institutions?

Mike Regnier: For the same-sized institutions, yes, it is. It is less for the same size institutions.

Q66 **Anthony Browne:** What do you think your members think about you earning over £1 million a year?

Mike Regnier: We respond to members' questions in our AGMs every year. From time to time, not every year, sometimes we get questions about pay; sometimes we do not.

Q67 **Anthony Browne:** Martin, is Bupa one of your members?

Martin Shaw: No, it is not. It is not a mutual.

Anthony Browne: It is not a mutual anymore. Okay, I will not ask that question then.

Q68 **Emma Hardy:** Good afternoon, everybody. I want to talk a little bit about the impact of Covid-19 and what effects it has had. My first question is for all of you. How effective has the mutual sector been at adapting to the impact of the Covid-19 pandemic, so just some general comments to start us off?

Lucky Chandrasekera: During the pandemic, our deposits grew. It is understandable. People do not have anything to do with the money; they cannot go on holidays. We found that our deposits increased quite a lot. At the same time, lending decreased. People did not want to borrow money. Members did not want money. As a result, it affected the balance sheets of us and a lot of other credit unions as well.

Two things that affect our profitability and the capital are higher liquidity, which affects them negatively, and less borrowing affecting our income and everything, so we cannot increase our capital. Yes, most of the credit unions managed to weather that issue.

Right now, we are beginning to see most of the credit unions' lending books increase. Deposits are going down, so you have started to see that now. It is mainly because the credit unions, over the years, built up enough capital, so we had a good resilience at that time to cope with the pandemics like that.

Q69 **Emma Hardy:** That sounds quite positive, if more people were able to save and fewer people were having to borrow. That is quite positive. What about you, Mike, and the building societies? How has Covid been for you?

Mike Regnier: During the pandemic, the unprecedented support that was provided by the Government, the Treasury and the Bank of England has been extraordinary. It really has. In the markets that we operate in, so mainly mortgages and savings, as Lucky said, we have also seen an increase in the overall level of deposits that we have been holding, which has been useful.

We have also seen quite a buoyant mortgage market. House prices have gone up by another 10% year on year and there has been quite strong demand because of the stimulus that was put in around stamp duty to try to encourage and support the housing market during the crisis.

At the other end, we have also been supporting borrowers who have been struggling. As a sector, we granted almost half a million payment holidays for those people who needed them during the early stages of the pandemic in particular, where their income might have been under strain for various reasons before the furlough scheme was introduced, etc.

There is also a lot that societies have done for their colleagues. For example, for Yorkshire one of the decisions that we made very early on was that we would commit to not making any redundancies as a result of Covid, not reducing anybody's hours as a result of Covid, not putting anybody on furlough and calling on, effectively, Government support to pay our colleagues' wages. Our business was robust and strong enough to be able to do that throughout, so we made that decision very early on.

We also did things like allowing colleagues unlimited sick leave and unlimited dependants and carers' leave if they needed to look after schoolchildren that were home schooling or whatever. We said, "We will change our policies so that, with a sensible conversation with your line manager, you do what you need to do, and we will find a way of coping", which our colleagues responded to brilliantly. They have been fantastic throughout.

Q70 **Emma Hardy:** I know it is probably not for our Committee to talk about dependant leave, but it is an issue that I have had raised with me so many times, so I am really pleased you have done that. Parents need to take time off when their children are self-isolating with Covid, but I will not go into that now. Martin, how has Covid-19 been for you?

Martin Shaw: The immediate reaction from our members to Covid, at the point where everyone was starting to work from home, was to prioritise customer service. In other words, they moved the sales team into support to customers. If you tried to contact a big business in the early stages of Covid, you would find you would have to complete various online forms and wait a while for them to respond. Our members managed to keep the phonelines open and to keep a strong and direct contact point with consumers.

We found that the volumes of claims were falling, but consumers still needed help, support and guidance about their products and more generally. I mentioned before as well that we introduced things like GP 24-hour services to support consumers. We also saw some of our members introduce things like mental health support, because of course there were concerns about that during Covid. We saw specific and individual actions by organisations intended to best support the needs of their customers.

We saw very low levels of lapse, because, actually, most consumers recognised how important their insurance product was. If, for example, you have a health policy that is costing you only £10 a month and you are seeing a health pandemic affecting the world, the one thing you are going to want to do is make sure you can keep on paying that £10 a month. We saw, if anything, an increasingly positive relationship between our members and their customers.

Of course, as 2020 went on, some of the falls that we saw in the investment market started to recover, which meant that the capital positions of our members were never affected. That meant that they were also able to explore ways to share some of the unintended profits that we saw from Covid as well. In other words, if fewer people were cancelling policies and fewer people were claiming, the business P&L looked quite strong, so we saw decisions by organisations to try to share more of that with their customers in meaningful ways.

Q71 **Emma Hardy:** That is really interesting. I would love to talk about house price increases and how much of that is happening in Yorkshire, because I am hearing that, for obvious reasons, people wish to leave the capital city and move to our beautiful part of the country, but I will not go into that right now. I wondered generally what impact mortgage and loan deferrals have had on building societies and credit unions in the past two years, or have you not had mortgage or loan deferrals?

Mike Regnier: Do you mean in terms of defaults on mortgages? Is that what you are talking about?

Emma Hardy: Yes, so the people having to defer payments or people defaulting on them. You mentioned payment holidays, but I am just wondering, particularly in mortgages and loans, what impact that has had on you in the past two years, during Covid and now.

Mike Regnier: It is a very good question. Surprisingly for a global pandemic, you would have thought that we would be seeing levels of arrears that were ticking up, but, certainly for us, our current levels of arears, so customers who are struggling to pay us back, are the lowest they have ever been.

Emma Hardy: That sounds positive.

Lucky Chandrasekera: We found the same. We had a number of payment holiday requests from our members. We worked with them and approved their requests. After the pandemic, now they are getting back to work and they start to pay those loans, which is really good. We did our job, looking after our members and reacting to their responses, needs and demands. As a result now, the delinquencies are going down. Payment holiday delinquency is going down because people are beginning to start to work and find money to pay the loans and other things.

Q72 **Emma Hardy:** That is really interesting. Both of you mentioned before about savings, that people have been able to save more and that you are having fewer defaults. I do not know how you analyse—if that is the right word—your customers, but is that the same across all customers? Is that the same for the self-employed and the employed, or is it a different picture for different types of customer, in terms of who is able to save, who is not, who might be wanting payment holidays and who is not? How is the pandemic affecting that?

Mike Regnier: You will be unsurprised to hear that it is not an equal picture. In the main, our data shows us that pensioners have ended up with higher savings balances, as have higher-income professionals. There are certain segments of the population that have struggled more. Particularly younger people, many of whom want to save, are finding it hard to do so. For them, there is a cost-of-living challenge as well, which I suspect might become more challenging as we look into an inflationary environment over the next couple of years, which seems increasingly likely.

Emma Hardy: It has been uneven.

Mike Regnier: In the same way that house prices do not rise equally everywhere, that savings benefit that we have seen has not been felt by all segments of the population in the same way at all.

Q73 **Emma Hardy:** If we are thinking about those people who have struggled, I wonder how building societies, credit unions and mutuals are supporting that group in society who have not had as easy—if that is the right word—a pandemic.

Lucky Chandrasekera: We have some members from the service sector. They were the ones who struggled and requested payment holidays, and all that. Now that things are getting better, they are beginning to get their income coming in. The good thing about that is that those who wanted the payment holidays are coming back to us. We sometimes experience that people take money and just go away. That did not happen, which is really good. That shows that the mutuality is working. Understanding about the people's needs and things, and reacting to them, is important.

The service sector is the one that was affected, but we worked quite a lot with the hospitals, because we do payroll deductions for a number of hospitals and the hospital staff. That worked really well, and we came up with a number of special products for them to borrow money during the pandemic. It is just reacting to their needs.

Q74 **Emma Hardy:** I am conscious I am going to be told I am out of time, so

I am going to quickly ask you, Martin, whether you have seen any difference in the reaction within insurance industries between mutuals and non-mutuals in terms of the speed and likelihood of paying out claims during the pandemic. I am thinking about insurance because I know, as a constituency MP, I am hearing a very mixed picture when it comes to insurance. I wondered if you had picked up on any difference between mutuals and non-mutuals.

Martin Shaw: Talking to our members, we have seen many of them use the time when their claims departments have seen lower demand to reinvest into improving services and processes. They are coming out of the pandemic with a new investment in improved technology and new commitment to continue to speed up. If anything, we are experiencing positive trends in that respect.

When we look at, for instance, things like claims on income protection policies in 2020, we saw virtually no change in the proportion of claims that were paid within our sector. That is a significantly better position than it is for a non-mutual, because our members are predisposed to paying claims wherever they can. There is no sense of saying, "This is the insurance company's money". It is the members' money, so why would we not pay that? We have seen that continued commitment to pay claims quickly, fairly and at undiminished rates from what we saw prior to the pandemic.

Emma Hardy: Thanks to all of you and thanks to Mike for the report on young people, saving and money resilience, which I recommend to the rest of the Committee.

Q75 **Gareth Davies:** Before I begin, I want to declare that, in 2011, I was employed by Columbia Threadneedle Investments, which acquired Liverpool Victoria's asset management business. During my time there, we were also an investor in several building societies, including Yorkshire Building Society's debt issuance.

I want to ask about access to capital and, Martin, pick up on a few things that you have mentioned. Obviously mutuals do not have the ability, or have very limited ability, to raise equity capital. Building societies have CCDSs, but my understanding is that mutuals do not. What other options are there for mutuals to raise capital?

Martin Shaw: Typically, if you are a mutual running short of capital, you have a number of options. The first one is to seek a merger with a mutual with deeper pockets. We have seen a lot of that over the years. It is one way of making sure that the overall sector remains strong. That has supported many small organisations in a quiet way of making sure that the sector looks after itself.

If that option is not available, larger mutuals have in the past been able to raise subordinated debt. Both Royal London and Liverpool Victoria have done so in the past. That is probably available only to large organisations, because you are looking for institutional investors to carry up that debt. We have seen successful tranches of that. It does not count towards your core capital, so actually it is a limitation in as much as it is a blessing, because you are restricted by what you can do with that money.

The third option that might be available is to seek reinsurance support to your business. Again, medium to larger sizes of organisation have relied on reinsurance to offset some of the premiums or, indeed, to invest in the business to help them grow as well.

I guess the final option that is open to a mutual with insufficient capital is to consider winding up. There are options, not all of them good ones, but there is that primary failure in the ability to gain access to external capital.

Q76 **Gareth Davies:** You have alluded in a previous answer to, I think, the Australian corporations legislation of 2019, which built on the 2015 Act, which you also referred to, in this country. If we were to get into a position in the UK where mutuals were able to issue equity while protecting the integrity of members' interests, what kind of impact and change would you say that would have on the sector?

Martin Shaw: The interesting question would be to ask Liverpool Victoria, if that Act had proceeded through, whether that would have been a viable option for it. The answer is probably yes, in as far as it would help to resolve its capital problem. It would not resolve its membership issue, but that is another matter entirely.

The Mutuals' Deferred Shares Act allowed for institutional investment but also the possibility of smaller individuals investing in mutual deferred shares. You would need that secondary aspect to make mutual deferred shares more effective for small organisations. The costs of setting up a large tranche would be restrictive for small businesses, but you could imagine the two or three largest mutual insurers gaining from that and then smaller ones looking for other solutions that sprang from it.

Q77 **Gareth Davies:** You talked about the Mutuals' Deferred Shares Act and I think you said there were two issues or reasons why the Government did not proceed with it: first, issues around the tier 1 capital and, secondly, HMRC and the taxation. Have you had any recent engagement with the Government on either of those two issues, or both?

Martin Shaw: We have cross-referenced it on regular occasions where we have talked to Treasury or responded to consultations. We recognise that the primary legislation would need to change. Across mutual insurers, building societies and co-operatives, we have had good engagement with Treasury over the last three or four years in particular, in terms of taking a more strategic approach. We have also recognised that there is a limitation on the time for primary legislation. There are relatively easy fixes, but they need legislative fixes to be able to sort out the concerns that HMRC has.

Q78 **Gareth Davies:** This is the last question on this area. We are seeing a lot of the banks digitise to a significant degree. To what extent are the funding model and the restrictions that you have described here today resulting in building societies and mutuals not being able to invest in innovation and to digitise to the extent perhaps that they need to do?

Martin Shaw: Digitisation is becoming more and more important for all businesses. It is becoming more of the way that many consumers are comfortable in dealing with financial services, but not all. Many of our members serve people who are not well served by the financial services industry as a whole. They may still have problems with access to banking. They may feel like they are underserved on their insurance needs.

It is really important for us to make sure that we are open to customers through a variety of channels. I stressed how important it was to have telephone lines where customers could talk directly to a member of staff during the pandemic. That remains really important for many of our members. For younger people coming in, it becomes more important to offer a range of channels. Across AFM members, we hold over 2 million child trust funds from people who are still in their teens and, therefore, have a different expectation on how they engage with a financial services provider in the future.

The challenge for small organisations, such as the ones I represent, is to make sure that you can make those digital investments in a cost-effective way. We are starting to see many examples of options for automation and artificial intelligence coming into financial services now at a price range that is achievable for a small organisation. Historically, scale was a challenge for small organisations that wanted to compete in IT terms. It is becoming a lot less so now.

We launched a report last week across our members, looking at these issues and at the capacity and interest in the sector for collaboration around digital issues as well. There are certainly some lessons we could learn from the building society sector, which has done that in the past. As small cottage industries, we can see a range of ways of achieving the same result.

Mike Regnier: For us to answer that same question, if you would like me to, it is less about capital for building societies. All the building societies are extremely well capitalised. It is a question of scale and it is a constant gripe, actually. No matter how big you are in our industry, you always feel that you need to be bigger. Whether you have a balance sheet of £300 million, a balance sheet, in our case, of close to £50 million, or a balance sheet of £500 million, you always think you need to be a bit bigger, but yet all those organisations of very different scales continue to compete and do what they do.

You are right: the big challenge for all of us is digital, IT, IT security and cyber security. There is a lot of pressure on all of us to continue to invest in those areas, either to drive efficiencies through automation or just to protect our members' assets in the case of cyber security. It is easier to do that the bigger you are, but the cost of doing it goes up the bigger you are as well. It is a challenge we all face.

Q79 **Alison Thewliss:** I have some questions around the current legislation and regulatory regime, some of which you have all touched on. If I could start with you, Martin, you mentioned the letter that you had written to the Treasury. Have you had a reply to that letter, and do you have any other things that you wanted to say about the letter, in terms of requests to the Government, that you have not covered already?

Martin Shaw: We have started the engagement process. As I mentioned, we have written the letter. We have had acknowledgement from Treasury that it is looking at it and agreement to set up a meeting in the near future to explore the issues there. When we entered into that process, it was with the knowledge of the Economic Secretary, who has made the point that there is no open door for new legislation, but who also recognises that, after 30 years of living with legislation that, if I am honest, was probably out of date the day it was written, there is definitely scope there to find ways to redress some of the shortcomings that we have now.

Q80 **Alison Thewliss:** Given the different types of business models that exist, do you think that there is an adequate distinction between how mutuals and non-mutuals are regulated? Should there be that distinction?

Martin Shaw: We definitely would not want to go back to the days before the regulatory structure that we have today, which saw a separate friendly societies registrar. We recognise the value of having a co-ordinated regulatory structure. Insurance Solvency II is the key basis by which regulation is delivered.

We see that there is opportunity for greater proportionality and greater recognition of the need to achieve key outcomes, but with a capacity to do them in different ways. We have responded into the recent Treasury call for evidence on the review of Solvency II with suggestions for how that can be made more proportionate. If that is the starting point for how all regulation follows on, if that is set out in the right way, that will help tremendously.

From a conduct perspective, our members are naturally predisposed to be compliant. For instance, there has been an awful lot of activity from the FCA recently on things like a customer duty, issues around vulnerable customers and diversity. Our members have been very active proponents in taking up those requirements and looking to stretch themselves to meet those needs. The regulators would acknowledge that our members are generally seeking to be compliant.

We need to continue the dialogue with them around making sure that the context is always right and that rules written to support the needs of consumers are not written in a way that causes unintended consequences. We constantly work with the regulators to work those out of the system.

Mike Regnier: I will probably just say two things. One thing I have already mentioned is parity of esteem. That is around thinking, when regulation is being dreamt up, about all the different ownership models at the same time, rather than mutuality being a bit of an adjunct on the end of it. I would say that that is one thing.

Secondly, the biggest one is proportionate regulation that effectively recognises that there are organisations of very different scale and complexity operating in our sector. One of the benefits of a post-Brexit world is that we are in charge of our own regulation for financial services, which is wonderful. I am delighted that the Treasury's future regulatory framework reflects that.

I am also delighted that the PRA has been talking about strong and simple in terms of its approach to regulating smaller firms that are perhaps less complicated than some of the larger firms. It is great to see that happening. Obviously we would welcome much more of that and particularly from the other regulators that are yet to respond, just to reflect that, for very simple businesses that are quite small and pretty straightforward, the regulatory burden is immense.

Q81 **Alison Thewliss:** What kind of bits of regulation would you like stripped out of that?

Mike Regnier: The PRA's strong and simple one is a great example of what good could look like for our sector. Obviously, as Lucky will come on to, I am sure, in a minute, the PRA started with the credit union space actually, in terms of defining those rules and making it very straightforward for credit unions. Now it is starting to think about what that might look like for smaller building societies as well. The conduct framework is a conduct framework. It is the same for everybody and it is extremely complicated.

Q82 **Alison Thewliss:** Would that include the regulatory capital requirements as well?

Mike Regnier: That is what the PRA's consultation at the moment is looking at.

Q83 **Alison Thewliss:** Have you a view on where that should sit?

Mike Regnier: The proposal at the moment is basically, for smaller firms, to have probably slightly higher requirements, but to really simplify the work that firms need to do to work out how much capital they need. That is welcome, because it reduces that burden of having to comply. You know it is a very simple way of complying and, as long as you follow a simple set of rules, you know exactly where you stand. That is what a lot of smaller firms would like. For organisations of our scale, we can cope with a bit more complexity.

Q84 **Alison Thewliss:** Martin, you mentioned earlier the FCA and the PRA not having done enough to oversee the demutualisation process. I wondered if you thought that there was more that they should do, in terms of considering those wider factors when approving those transactions. There is lots of talk about the importance of competition and competitiveness, but not really so much on diversity. Is that something that you think should be in there?

Martin Shaw: Yes. There are a number of levels of work they can do. First is to take a view on the benefits of diversity in financial services. We have not really seen much of an articulate view of that from the PRA or the FCA. They obviously have a competition objective, but it is not always clear how they perceive that to operate, from the perspective of generating diversity of business line.

The perspective of whether you prevent demutualisation is one we have touched on. I could see much more scope for the regulators to take a more active view there on the long-term interests of the customers. If the evidence is that every past demutualisation apart from one has resulted in a loss of independence for that new organisation and coincided with a fall in investment returns, a reduction in the number of claims paid and inferior customer service, those are legitimate customer service issues to consider. The regulators are not prepared to take an active view on those at the point where the demutualisation is first considered.

Q85 **Alison Thewliss:** You talked about LV= inheriting from 180 years of previous members. Should there be a specific protection for that legacy capital?

Martin Shaw: That is held in perpetuity by the business, not just for today's policyholders, but for future generations. In effect, that is the fund that would help to grow the business. With leadership that sees future viability for the business, that is where you would expect them to employ that.

Q86 **Alison Thewliss:** In terms of starting up new organisations, it seems to me that there are an awful lot of historic organisations out there. You will be aware of the Medical and Dental Defence Union of Scotland, which is based in my constituency. It was set up in 1902. Are there any other specific barriers that prevent mutuals offering specialist cover in areas perhaps that are underserved by traditional businesses?

Martin Shaw: If you take an example, I was doing some work recently with the Local Government Association, which recognises that councils across the country are faced with ever increasing costs for insurance and for policies that hardly ever pay out. Its view was that the best solution to that was to create its own mutual organisation, but, after many years, it is finding it difficult to get to a viable structure. It is finding active engagement from incumbents within the sector that is looking to undermine its efforts. It is very easy to get discouraged by that. That lack of a kind of start-up process within the regulators—the fact that the incentives are weighed towards incumbents in the sector—makes it very difficult to start up a new mutual business.

Alison Thewliss: I saw you nodding, Mike. Did you have something you wanted to add?

Mike Regnier: I was nodding because I was talking about this earlier with Ecology and the fact that we have not had any building society for 40 years now, unfortunately.

Q87 **Alison Thewliss:** I will move on to Lucky with some questions about credit unions. What kind of impact have the 2019 changes had so far? Have you seen the benefit of those? Has the benefit come too late for some organisations? I am aware of some credit unions in Glasgow that have had to close their doors because they basically could not manage with the regulation burden that they were being put under.

Lucky Chandrasekera: No, we did not find this difficult, on the new legislation and the capital requirements. That is what you are talking about, right? Yes. No, we did not find it difficult, but we always believe that we are managing members' money, so we need to have a well-capitalised organisation, just in case we have higher delinquency or something unexpected. The pandemic is a good example. Having enough capital would help us to face those kinds of challenges.

Most of the credit unions did not find it challenging when the 2019 changes came through, but some struggled. Some of them are, as a result, merging with some other credit unions now.

Q88 **Alison Thewliss:** One of the requests from credit unions that I know in Glasgow, the BCD Credit Union in particular, is that they feel as though, as a result of the pandemic and the things you talked about, about people not wanting to borrow but wanting to save, they are now sitting on money that they cannot get back out the door in any useful way. Would you see a benefit in being able to lend to other organisations, like perhaps locally-based housing associations, local businesses or organisations, which would have a community benefit but might not necessarily be available to you under the rules as they stand?

Lucky Chandrasekera: Right now, I do not think the legislation allows us to do that. Similarly, we cannot borrow money from other organisations either. The only way that we can borrow money is as a subordinated loan from housing associations, if they are allowed to do that. It is another barrier as well. Traditionally, most of the credit unions do not hold a lot of money. Our business model is very simple: we collect members' money and we lend it to each other. If we run out of money, we can increase the dividends or the ISA rates to get some money deposited in, but most of the time we do not sit on a lot of deposits.

Q89 **Alison Thewliss:** Has there been an increase in those deposits over the course of the pandemic, though, to any significant extent?

Lucky Chandrasekera: There was a huge increase in the deposits, yes. Most of the credit unions were experiencing the same thing. Luckily, now members are beginning to borrow money and most of the liquidity has reduced.

Chair: That brings us to the end of this session. Can I thank our three witnesses very much indeed for appearing before us? It has been a very fruitful and interesting session. Mutuals are a very important part of the financial services landscape. Discussing building societies, mutual insurers, credit unions and other structures has been helpful, the challenges and particularly the regulatory environment within which you operate. It has been interesting to hear your views on that and helpful to touch on London Victoria as well. That concludes this session.