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Societies mull controversial share deals

A number of building societies, including Chelsea and Principality, are considering whether to follow West Bromwich with share deals that critics fear will lead to less competitive rates for savers and borrowers – as well as reducing potential future windfalls.

West Bromwich last week announced a £182m debt-for-equity swap with institutional investors that boosted its capital strength and spared the society – which lost £39m last year – from having to be rescued or broken up. As part of the deal, West Bromwich will pay up to 25 per cent of future profits to holders of a new type of equity called profit participating deferred shares (PPDS).

Other societies have since been talking to the Financial Services Authority about how they might raise capital through PPDS. Some announcements could come within weeks following “stress tests” of societies by the regulator.

The new capital option is expected to slow the rate of takeovers among the 50-plus remaining mutual lenders. But critics argue that paying dividends to outside shareholders means less value for members.

“Worse rates are inevitable – if you’ve got shareholders to satisfy, you’ve got to put them first,” said Steve Huxham, a leading building society campaigner.

Ralph Silva, financial analyst at TowerGroup, a research company, said: “This is not good for building society members. Members may be happy their society has been saved but outside investors will now have a say in the business and may push for greater influence.”

Huxham added that any windfall payments for members from a future takeover or demutualisation would also be diluted by PPDS issues. “A business that is 75 per cent mutual... will mean 75 per cent windfall value,” he suggested.

Having outside shareholders is also seen as controversial within the mutual sector, which has long claimed that not having to pay dividends has enabled societies to offer better interest rates than banks.

Adrian Coles, director-general of the Building Societies Association, said raising capital in this way was a “significant change” and amounted to a “partial, quasi demutualisation”. “It’s controversial because it gives external investors an interest in the profitability of the society,” he

said.

Andy Golding, chief executive of Saffron Building Society, said: “There is a concern about serving two masters rather than one [the members].”

Robert Sharpe, West Bromwich’s chief executive, said that while he “understood the fears”, the society’s deal was “not ‘creeping demutualisation’ because [the investors] have no seat on the board and only one vote [whatever the size of their PPDS holdings].”

Following the debt-for-equity swap, West Bromwich will save £13m a year in interest payments, he added, and profits would have to bounce back to a £52m record before members lost out. “Rest assured, there will be market-leading products [for customers],” he said.

Speculation over which society could be next to do a PPDS deal has centred on a handful of names including Chelsea and Principality. Both are among a range of mutual lenders that have suffered credit downgrades by rating agencies recently.

Chelsea, which posted a £29m loss for last year, said issuing PPDS would be an option if the FSA decided the society’s capital levels were too low.

Peter Griffiths, chief executive of Principality, said that while the Welsh society will consider PPDS at its board meeting this coming week, it was “unlikely we will be rushing in”.