

BUILDING SOCIETIES ACT 1986

DECISION BY THE FINANCIAL SERVICES AUTHORITY ON THE APPLICATIONS OF CATHOLIC BUILDING SOCIETY AND CHELSEA BUILDING SOCIETY FOR CONFIRMATION OF A TRANSFER OF ENGAGEMENTS UNDER SECTION 95 OF THE BUILDING SOCIETIES ACT 1986

The Financial Services Authority appointed Eric Engstrom, a manager in Retail Firms Division, to hear and decide the application on its behalf.

1. INTRODUCTION

- 1.1 The **Catholic Building Society** ("the Catholic") and the **Chelsea Building Society** ("the Chelsea") applied on 14 October 2008 to the Financial Services Authority ("the Authority") for confirmation of the transfer of engagements of the Catholic to the Chelsea.

Procedure

- 1.2 Paragraph 8 of Schedule 16 to the Building Societies Act 1986 ("the Act") requires that, where a building society applies to the Authority for confirmation of a transfer of engagements, a notice shall be published stating that interested parties have the right to make representations to the Authority with respect to the application. The notice must specify the date, determined by the Authority, before which any written representations, or notice of a person's intention to make oral representations, must be received by the Authority, and the date(s) on which the Authority intends to hear any oral representations. In the case of this proposed transfer of engagements ("the merger") notice was given:
- (i) in the Daily Telegraph, the Daily Mail, the London Gazette and the Edinburgh Gazette by the Catholic and the Chelsea on 14 October 2008;
 - (ii) in the Belfast Gazette by the Catholic and the Chelsea on 17 October 2008;

- (iii) in The Tablet by the Catholic and the Chelsea on 18 October 2008;
 - (iv) in The Universe by the Catholic and the Chelsea on 19 October 2008.
- 1.3 The notices specified **31 October 2008** as the closing date for receipt by the Authority of written representations or notice of intention to make oral representations, and **18 November 2008** as the date set aside by the Authority to hear oral representations.
- 1.4 By the close of 31 October 2008 the Authority had received two written representations and no notice of intention to make oral representations. The Authority decided that, in the absence of any notice of intention to make oral representations, there were no matters which it wished to put to either society at an oral hearing, and that no oral hearing was therefore necessary. No representations were received out of time.

The Purpose of Confirmation

- 1.5 Section 95(4) and (5) of the Act sets out what is required of the Authority when an application is made to it for confirmation of a transfer of engagements. Subsection (4) provides that the Authority **shall** confirm a transfer of engagements **unless** it considers that:
- (a) some information material to the members' decision about the transfer of engagements was not made available to all the members eligible to vote; or
 - (b) the vote on any resolution approving the transfer of engagements does not represent the views of the members eligible to vote; or
 - (c) some relevant requirement of the Act or the rules of any of the societies participating in the transfer of engagements was not fulfilled as regards that society.

The criteria set out in (a), (b) and (c) above are referred to subsequently in this Decision as, respectively, the "First Criterion", "Second Criterion" and "Third Criterion".

- 1.6 Subsection (5) provides that the Authority shall not be precluded from confirming a transfer of engagements by virtue only of the non-fulfilment of some relevant

requirement of the Act or the rules of a society if it appears to the Authority that it could not have been material to the members' decision about the transfer of engagements and the Authority gives a direction that the failure is to be disregarded for the purpose of this section. Section 95(11) of the Act states that a "relevant requirement", with reference to the Act or the rules of a society, means a requirement of sections 94 or 95 of the Act or of Schedule 16 to the Act or of any rules prescribing the procedures to be followed by the society in approving or effecting a transfer of engagements.

1.7 In considering the three criteria, referred to in paragraph 1.5 above, the Authority reconsidered the booklet ("the merger booklet") produced by the Catholic for circulation to its members which contained the statutory statement required to be sent to members of that society under paragraph 3 of Schedule 16 to the Act ("the merger statement"). In addition to the merger statement, the merger booklet contained other information including a letter from the chairman of the Catholic and notice of the Special General Meeting ("the SGM") at which the shareholding and borrowing members' resolutions were to be put. The Authority is entitled to look again at the confirmation stage at issues which it considered in connection with the approval of the merger statement. In doing so, it has a duty to consider any information and arguments put to it by representers and by the societies, which of their nature would not have been available earlier, as well as those arising from its own further consideration of the matter. The Authority, accordingly, cannot properly be bound at the confirmation stage to the view that it took at the time of approval of the merger statement that it did not require further factual information, or to the view which it took of the accuracy of the statement's contents. It is under a duty to re-examine the merger statement and connected issues at the time of confirmation in the light of any new information and arguments available to it. That said, the Authority would clearly only change its view if there were good reason to do so.

1.8 It is, however, **not** for the Authority to consider the merits of proposals which the members have approved.

2. **THE CATHOLIC MEETING AND VOTES**

- 2.1 In its application for confirmation, the Catholic declared under seal that the requisite shareholding and borrowing members' resolutions as required by section 94(2) of the Act, were passed at the SGM of the society on 9 October 2008. A certified copy of the minutes of the meeting was furnished to the Authority.
- 2.2 The Catholic did not propose to pay compensation for loss of office to its directors or officers so no special resolution in accordance with section 96(1) of the Act was required.
- 2.3 The scrutineers for the Catholic reported that the resolutions were passed by the required majorities and confirmed that, in their opinion and subject to certain matters (referred to in paragraph 2.7 below), the arrangements for the conduct of the voting were such as to ensure that notices of the meeting and merger statements were sent to all those entitled to receive them, with the requisite periods of notice being given, in accordance with the Act and the society's rules, and that there were satisfactory procedures to ensure the safe custody and proper counting of the votes.
- 2.4 The voting figures were:

Shareholding Members' Resolution	At the Meeting	By Proxy	Total
In favour	35	1,712	1,747
Against	5	105	110
Total	40	1,817	1,857
Percentage of eligible shareholding members who voted:	61.96%	Votes in favour as percentage of valid votes cast:	94.08%

Borrowing Members' Resolution	At the Meeting	By Proxy	Total
In favour	4	106	110
Against	0	6	6
Total	4	112	116
Percentage of eligible borrowing members who voted:	32.49%	Votes in favour as percentage of valid votes cast:	94.83%

- 2.5 By virtue of section 94(2) and (5)(a) of, and paragraph 27A of Schedule 2 to, the Act, a shareholding members' resolution must be passed by no less than three-quarters of the numbers of the shareholding members of the society qualified to vote on the

resolution and voting either in person at the meeting or by proxy on the resolution. This was secured: 94.08% of the shareholding members who voted cast their votes in favour of the shareholding members' resolution.

- 2.6 By virtue of section 94(2) and (5)(a) of, and paragraph 29 of Schedule 2 to, the Act, a borrowing members' resolution must be passed by a simple majority of borrowing members qualified to vote on the resolution and voting either in person at the meeting or by proxy on the resolution. This was secured: 94.83% of the borrowing members who voted cast their votes in favour of the borrowing members' resolution.
- 2.7 The scrutineers reported that a small number, 38 in total, of notices of SGM had been mailed without the requisite periods of notice being given as required by the Act and the Catholic's rules. These require 21 clear days' notice to be given expiring with the date of the SGM or, if earlier, the date specified by the Catholic, under its rules, as a final date for receipt of instruments appointing proxies to vote at the meeting. The rules of the Catholic provided that the final date of receipt of proxies is not less than two clear days before the date of the meeting. The Catholic should therefore have dispatched notices of the SGM in time for them to be received on or before 14 September 2008. The scrutineers identified that 38 eligible shareholding members were wrongly omitted from the initial mailing file, and that their merger booklets containing the notice of the SGM had been dispatched outside the notice period. However, all 38 members were mailed on 16 September 2008. The scrutineers also reported that 26 of these 38 members validly voted by proxy.
- 2.8 The Catholic's scrutineers also provided an analysis of the spoilt or invalid votes (5 in respect of the shareholding members' resolution and 1 in respect of the borrowing members' resolution).

3. **THE CHELSEA'S APPLICATION**

- 3.1 In its application for confirmation the **Chelsea** declared under seal that, pursuant to the consent of the Authority in accordance with section 94(5)(b) of the Act, it had undertaken by a resolution of its Board of Directors to fulfil the engagements of the Catholic.

- 3.2 Section 94(5)(b) of the Act allows a society that proposes to accept a transfer of engagements to resolve to do so by a resolution of the Board of Directors, if the Authority consents to that mode of proceeding, rather than by the passing of a shareholding members' resolution and a borrowing members' resolution at a general meeting. The Authority has indicated, in its guidance on Merger Procedures contained in paragraphs 2.4.41 and 2.4.42 of the Building Societies Regulatory Guide ("BSOG"), the general circumstances in which it may be prepared to give such consent. The two key factors are that (i) the transferee society's assets are substantially – more than 5:1 – larger than those of the transferor society and (ii) the merger will not affect the interests of the members of the transferee society to a significant extent. The Chelsea's assets are nearly 270 times those of the Catholic. In addition, the Chelsea explained to the Authority how the merger would not significantly affect the interests of its members. Having considered this explanation the Authority gave its consent to the Chelsea on 22 July 2008. The Chelsea was not required, therefore, to hold a general meeting so as to secure members' approval of its acceptance of the transfer of the Catholic's engagements.
- 3.3 Section 96(4) of the Act does however require that any distribution of funds by a society in consideration of the transfer must, if it exceeds prescribed limits, be approved by the members' resolutions of the other society as well as by the members' resolutions of the society making the distribution. Under the Building Societies (Mergers) Regulations 1987 (SI 1987/2005) as amended by the Building Societies (Merger) (Amendment) Regulations 1995 (SI 1995/1874), the relevant prescribed limit in a full transfer of engagements is 5% of the total assets of the society to whose members the bonus is paid, or that society's reserves after deducting its fixed assets (i.e. its free reserves), whichever is the less. The estimated gross cost of the bonus to be paid to the Catholic's members is £750,000 which is less than either the Catholic's free reserves (£2.48m) or 5% of its total assets (£2.6m) (all as shown in, or derived from, the Catholic's merger statement). Therefore approval by the Chelsea members of the bonus distribution is not required by section 96(4).
4. **THE REPRESENTATIONS AND THE CATHOLIC'S AND THE CHELSEA'S RESPONSES**

- 4.1 Paragraphs 4.2 to 4.3 of this section summarise the substance of the points made by the two representers together with the Catholic's and the Chelsea's responses. Paragraph 4.4 refers to other issues relevant to confirmation. The points are marshalled according to the criteria in section 95 of the Act to which they appear to relate most closely.

The First Criterion – Material Information

- 4.2 One **representer** made the statement that the merger booklet is too one-sided to enable a balanced decision about the merger to be made. The **Catholic** rejected this, asserting that it had provided all information required to be given by the Act and BSOG. In the Catholic's view there was no evidence to support the representer's assertions about the merger booklet.
- 4.3 One **representer** made a number of specific points concerning alleged deficiencies in the merger booklet which – in the view of the representer - made it a one-sided document that will get rubberstamped by the FSA as providing sufficient information. In response, the **Catholic** listed all the key sections included in the merger booklet in order to demonstrate that the society had provided sufficient information necessary to meet the requirements of the Act and BSOG and to allow members of the Catholic to make an informed and balanced decision in relation to the merger. The specific points made by the representer, and the responses by the Catholic, are set out in (i) to (v) and 4.4 (i) and (ii) below. As some of the points raised by the representer related to the Chelsea, a copy of the representation was sent to the Chelsea, as well as the Catholic, in order for the Chelsea to provide any comments it considered appropriate to make.
- (i) the **representer** stated that the Catholic had operated from its head office in Strutton Ground, Westminster long enough to have realised that its cost was high; he also queried why the Board's belief that the society's position was no longer sustainable had not been shared with members before. The **Catholic** responded that, while the society had taken into account the high cost base associated with the head office building when reaching a decision to recommend the merger, this had only been one factor; other factors which were detailed in the merger booklet had also been considered. The high cost of

its head office alone did not make the society's position unsustainable. The Catholic also said it believed that its members would become members of a more cost effective organisation following the proposed merger;

- (ii) the **representer** said that members appear to be expected to regard Chelsea's 14 branches in Greater London as a benefit with no mention of the high cost base. The **Catholic** rejected the statement, explaining that it did not consider that there was any further information which it should have disclosed in relation to the 14 branches which was material to the members' decision about the transfer of engagements. The society also considered the 14 branches in Greater London would provide significant benefits to members and pointed out that members of the Catholic would become members of a more cost-efficient organisation following the proposed merger;
- (iii) the **representer** stated that a decision could have been made on Mr Gould's (the CEO of the Catholic) position going forward and that members should have been informed. The **Catholic** rejected this statement and explained that, at the time the merger booklet was posted to members, the statement made about Mr Gould's position going forward was accurate and that it set out clearly the implications of possible different outcomes which might apply to Mr Gould, depending on events which were still unfolding. The Catholic believed that this provided sufficient information for members and did not consider that there was any further information which it should have disclosed which was material to members' decision about the merger;
- (iv) the **representer** said that fuller information was needed on the Catholic's land and buildings and when they were valued. The **Catholic** responded that it had taken appropriate professional valuation advice at the appropriate time to enable it to make the statement in the merger booklet regarding the valuation of land and buildings. It did not consider that there was any further information which it should have disclosed in relation to the valuation of land and buildings which was material to the members' decision about the merger;
- (v) the **representer** questioned Chelsea's statement that it remained committed to its mutual status which he said many other societies had said before converting

and was therefore meaningless. In its response, the **Chelsea** reasserted its belief that its customers were best served by it remaining a building society, and that it was therefore fully committed to maintaining its mutual status. The Chelsea also stated that the proposed merger with the Catholic in no way changed this commitment.

Representations on Other Matters

4.4 One of the **representers** also raised two other points, namely;

(i) referring to Chelsea's statement that it treated its customers fairly, the **representer** queried what the FSA was doing about other societies that by implication did not treat their customers fairly. The **Chelsea** said that it believed treating customers fairly to be a core element of its customer service philosophy. It also commented that it thought it was a matter for the FSA to consider the representer's comments if it felt the need to do so;

(ii) the **representer** also stated that the Chelsea had indicated that it would remain at its present size which the representer said could not be believed. The **Chelsea** stated that it did not believe it had made any claims within the merger booklet that it would remain at its present size and therefore felt unable to respond to the representation in more detail.

4.5 In the view of the Authority the representations referred to in paragraph 4.4 are not relevant to the three confirmation criteria.

5. THE AUTHORITY'S CONCLUSION

5.1 The Authority is **required** to confirm a proposed transfer of engagements **unless** it considers that any of the three criteria referred to in paragraph 1.5 above apply. The Authority's own view of the way in which it interprets the three criteria is summed up below, followed by its respective conclusions on the representations made and on other matters relevant to the three criteria.

(i) The First Criterion – Material Information

- 5.2 This criterion is mainly, if not exclusively, directed to the information provided by a society to the generality of its investing and borrowing members. The totality of information provided to members has to be assessed, recognising that the relevance of a particular piece of information to an investor and a borrower might be different, and the extent to which, if at all, it falls short of what might be expected and whether it is within the bounds of reasonable possibility that the members' decision on voting would have been different had any deficiency in information been made good. If it is considered that such a deficiency might have changed the outcome of the vote the Authority should put the decision back to the members. But this requires the Authority to take account both of the size of the vote and of the size of the majority.
- 5.3 In determining whether this criterion applies, the Authority will have regard to the material put to members, the representations made, the societies' responses and, if appropriate, taking points of its own accord. It will consider whether information provided to members is what might reasonably have been expected of a society considering its fiduciary duty and the extent to which, if at all, it falls short, and whether any deficiency identified was sufficient to amount to information that was material to members' decision.
- 5.4 As explained in paragraphs 3.1 and 3.2 above, the Chelsea obtained, and relied on, the Authority's consent to proceeding by way of Board Resolution. It was therefore not required to put a shareholding members' resolution and a borrowing members' resolution to a Special General Meeting, or to circulate a statutory statement to its members, and did not do so. The First Criterion cannot therefore apply to the Chelsea in relation to the merger.
- 5.5 The Authority considered, having regard to the representations summarised in paragraphs 4.2 and 4.3 above, whether the criterion applied in this case to the Catholic. In doing so it reconsidered the merger booklet, and has reached the following conclusions:
- (i) the Authority finds that the merger booklet contained sufficient information in order for a member of the Catholic to make an informed decision on the merger proposal. In particular the Authority notes that the merger booklet, in addition to covering all the matters required to be included in that document

by the Act and by BSOG, also gave a clear explanation as to why the board of the Catholic had concluded that a merger – and specifically a merger with the Chelsea – was in the best interests of its members;

- (ii)(a) the Authority finds that the Catholic had provided a number of reasons in the merger booklet to explain to its members why its Board had concluded that it was no longer sustainable for the society to continue as an independent building society, of which the cost of operating from a London based head office was just one. The Authority, as referred to in (i) above, notes that the merger booklet gave sufficient information about the reasons for the merger. The Authority also notes that the merger booklet explained that the board of the Catholic believed it was “no longer” sustainable for the Catholic to continue as an independent society: this indicates that this was a recent view reached by the board. But in any event any failure to tell the members prior to the issue of the merger booklet that the board had reached this view is not relevant to any of the three criteria;
- (b) the Authority finds that, given the Catholic had only one branch office (located in Central London), it was not unreasonable for the Catholic to suggest that members would benefit from the expanded branch network of the Chelsea which included 14 branches in Greater London. The Authority also concludes that it was not necessary for the Catholic to provide detailed information on the alleged high cost base of Chelsea's Greater London branch network in order for members to make an informed decision on the merger proposal: the merger booklet provided information about the cost ratios of the two societies which set out that the Chelsea's were significantly lower than the Catholic's;
- (c) the Authority finds that the merger booklet contained sufficient information in order for members to understand the position of Mr Gould (the Catholic's CEO) going forward, explaining as it did that consideration would be given to possible employment opportunities for Mr Gould in the merged society and setting out the implications if such opportunities could not be found, including the termination payment he would receive. In addition (and as referred to in paragraph 2.2 above) the Catholic did not propose to pay Mr Gould (or any

other director or officer) compensation for loss of office. The Authority therefore finds that there was no requirement – and indeed no need – for Mr Gould’s position to have been finalised before the merger booklet was signed off by the two societies;

- (d) the Authority finds that the merger booklet contained sufficient information about the valuation of the Catholic’s land and buildings. The merger booklet explained (on page 13) that the Catholic’s land and buildings are carried in its books and on its balance sheet at a value of £725,000, the same figure as the board’s estimated fair value of the land and buildings;
- (e) the Authority finds no evidence to suggest – and none was put forward by the representer – that the Chelsea does not remain committed to its mutual status. And the Authority notes that in its Annual Report & Accounts 2007 the Chelsea stated "We remain committed to our mutual status, believing that our customers are best served by Chelsea remaining a building society".

5.6 Having considered the representations falling under the First Criterion as set out above, the Authority finds no evidence to support the claim that the merger booklet was one-sided and did not give sufficient information to allow members to reach an informed decision on the proposed transfer of engagements. The Authority finds, therefore, that the **First Criterion does not apply**.

(ii) The Second Criterion – The Views of Members

5.6 The main mischief to which this criterion appears to be directed is a resolution carried by a small and unrepresentative number of votes. In the case of the Chelsea no members' resolutions were put (as previously explained) and so the Second Criterion cannot apply to the Chelsea in relation to the merger.

5.7 The Catholic is, as explained in paragraphs 2.5 and 2.6 above, subject to:

- (i) the requirements in section 94(2) and 5(a) and paragraph 27A of Schedule 2 of the Act that a shareholding members' resolution approving the terms of the merger must be passed by not less than three-quarters of the number of

shareholding members of the society qualified to vote on the resolution and voting either in person at the meeting or by proxy on the resolution; and

- (ii) the requirements in section 94(2) and 5(a) and paragraph 29 of Schedule 2 to the Act that a borrowing members' resolution approving the terms of the merger must be passed by a simple majority of borrowing members qualified to vote on the resolution and voting either in person at the meeting or by proxy on the resolution.

5.8 The scrutineers' report confirms that both these requirements have been satisfied. Having regard to the voting figures reported by the scrutineers (set out in paragraph 2.4 above) and to the absence of any representations alleging that the result of the vote did not represent the views of the members, the Authority finds that **the Second Criterion does not** apply.

(iii) The Third Criterion - Requirements of the Act and the Rules

5.9 As explained in paragraph 1.6 above, the relevant requirements of the Act are those set out in sections 94 and 95 of the Act and in Schedule 16 to the Act and the relevant requirements of the Rules are those prescribing the procedures to be followed by the society in approving or effecting a transfer of engagements. The rules of the Catholic of particular relevance are Rules 31 (Special Meetings), 32 (Notice of Meetings), 36 (Entitlements of Members to Vote on Resolutions) and 40 (Counting of Votes).

5.10 In proceeding by way of board resolution the Chelsea is relying on the Authority's consent under section 94(5)(b) of the Act and on the Catholic's distribution to its members falling within the prescribed limits. These matters are covered in paragraphs 3.1 to 3.3 above.

5.11 As explained in paragraph 2.7 above, the scrutineers reported that some members received notice of the meeting outside the notice period. Under the Catholic's rules, and in conformity with the Act, the society must give at least 21 clear days' notice of the meeting. As explained in paragraph 2.7, the Catholic should have dispatched notices of the SGM and voting papers in time for them to be received by 14 September 2008. But 38 members – as also referred to in paragraph 2.7 – were not sent notice of the meeting until 16 September. However, the Authority notes that (i)

the number of members who received late notice of the SGM was a very small proportion of the total membership, (ii) the members voted for the merger by a significant majority, and (iii) the majority of those members who were sent notice of the SGM late did, in fact, cast valid votes.

5.12 The Authority finds that there was a failure on the part of the Catholic to give sufficient notice of the SGM to all members eligible to vote, as required by the Act and the society's Rules. 38 members eligible to vote were not sent notices of the SGM until less than 21 days before the closing date for receipt of proxies. However the Authority is satisfied that this would not have had a significant effect on the outcome of the vote. **The Authority has, therefore, concluded that the failure could not have been material to the members' decision about the transfer and that it should give a direction under section 95(5) of the Act that the failure is to be disregarded.**

5.13 **The Authority finds that the Third Criterion applies in respect of one failure to fulfil relevant requirements of the Rules of the Catholic. This failure relates to the requirement to give at least 21 days' notice of a meeting, to every member eligible to vote, expiring with the last day for receipt of proxies. The Authority considers it appropriate to give a direction under section 95(5) of the Act that the failure should be disregarded.**

6. **DIRECTION**

The Authority, having considered the applications by the Catholic Building Society and the Chelsea Building Society for confirmation of the transfer of engagements of the Catholic Building Society to the Chelsea Building Society has concluded, having regard to the information available to it, that there was one failure to fulfil relevant requirements of the Rules of the Catholic Building Society in that 38 members eligible to vote and entitled to receive notice of the SGM, did not receive 21 days' notice of the meeting.

The Authority is satisfied that this failure could not have been material to the members' decision about the transfer. The Authority accordingly directs under section 95(5) of the Building Societies Act 1986 that this failure is to be disregarded for the purposes of section 95.

7. DECISION

The Authority has considered the applications of the Catholic Building Society and the Chelsea Building Society for confirmation of the transfer of engagements of the Catholic Building Society to the Chelsea Building Society. Having had regard to the information available to it, and to the direction under section 95(5) of the Act contained in section 6 above, the Authority confirmed the transfer of engagements on 15 December 2008.

For and on behalf of the
Financial Services Authority

ERIC ENGSTROM

15 December 2008

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