Financial Services Authority

FSA.

BUILDING SOCIETIES ACT 1986

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

The Financial Services Authority appointed Sheila Nicoll, the director of Retail Firms' Division, to hear and decide the application on its behalf.

1. INTRODUCTION

1.1 **Scarborough Building Society** ("the Scarborough") and **Skipton Building Society** ("the Skipton") applied on 10 January 2009 to the Financial Services Authority ("the Authority") for confirmation of the transfer of engagements of the Scarborough to the Skipton.

Procedure

1.2 Section 42B(1)(a) of the Building Societies Act 1986 ("the Act") provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct a building society to transfer its engagements to one or more other building societies. Where the Authority gives such a direction, or the sole reason that it does not give a direction is that the society is already seeking a merger, the Authority may give a direction under Section 42B(3) of the Act. Such a direction enables the society, if it chooses to do so, to proceed with the merger by board resolution rather than by resolutions of the society's shareholding and borrowing members which would otherwise be required. In such a case, the transferor society (in this case the Scarborough) is required to send a Merger Notification Statement ("MNS") to all its members who would be entitled to notice of a meeting had one been held. This MNS must have been approved by the Authority, before being sent,

as containing the information required by the provisions of Schedule 8A, paragraph 3(1) to the Act, so far as its contents concern the matters specified in the Schedule to the Building Societies (Merger Notification Statement) Regulations 1999 (Statutory Instrument 1999/1215) ("the MNS Regulations"). That information includes an explanation of the reasons for the merger, the financial positions of each of the societies, the consequences for the members, and any interests of the directors and other officers in the merger.

1.3 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 set out in paragraphs 2.4.41 and 2.4.42 of the Building Societies Regulatory Guide ("BSOG") guidance as to the criteria it will use in exercising its discretion to give such consent. The two key factors are that: (i) the transferee society's total assets are substantially larger than those of the transferor society, with a ratio of 5:1 being used as a broad first measure, and (ii) the merger will not affect the interests of the members of the transferee society to any significant extent. At the time the Authority made its decision on Skipton's application for consent under section 94(5)(b) of the Act, the Skipton's assets were 4.8 times larger than those of the Scarborough, marginally below the 5:1 ratio referred to in the guidance in BSOG. But importantly, the Skipton explained to the Authority how the merger would not significantly affect the interests of its members. Having considered this explanation, as well as the asset size ratio, the Authority gave its consent to the Skipton on 31 October 2008. Therefore, the Skipton was not required to hold a general meeting so as to secure members' approval of its acceptance of the transfer of the Scarborough's engagements.

1.4 Having resolved to merge, and the MNS having been sent to the eligible members of the transferor society, the societies may apply to the Authority for confirmation (see paragraph 1.5 below) and must publish notices of their applications in the Official Gazettes and in newspapers. The merger cannot proceed without confirmation from the Authority.

The purpose of Confirmation

1.5 Section 95 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. Subsections (3) and (4) (as modified by paragraph 5 of Schedule 8A) provide that the Authority **shall** confirm a transfer of engagements **unless** it considers that:

(a) the members or a proportion of them would be unreasonably prejudiced by the transfer; or

(b) some relevant requirement of the Act or the rules of any of the societies was not fulfilled.

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

1.6 The confirmation process provides an opportunity for interested parties, in either society, to make representations to the Authority with regard to the two confirmation criteria, and for the Authority to review the proposed merger against those criteria and in the light of the representations. If the Authority finds that either of the criteria apply, it may direct either society to remedy the defects. If it is then satisfied that the defects have been substantially remedied, the Authority must confirm the merger; if not, it must refuse confirmation (Section 95(6), as modified by paragraph 5 of Schedule 8A to the Act).

2. THE APPLICATIONS

2.1 On 31 October 2008 the Authority gave a direction under Section 42B(3) of the Act (as referred to in paragraph 1.2 above) enabling the Scarborough to resolve to transfer its engagements to the Skipton by board resolution. In this case, the direction was given under Section 42B(3)(b) because the Scarborough was already seeking a merger with the Skipton. On the same day, the Authority gave its consent to the Skipton resolving to proceed with the merger with the Scarborough by means of a board resolution under Section 94(5)(b) of the Act rather than by a general meeting and vote. On 30 December 2008, the Authority approved the MNS which the Scarborough was required to send to its members. The MNS was sent to the Scarborough's members. The Skipton was not required to send a statement to its members.

2.2 On 10 January 2009, both societies applied to the Authority for confirmation of the merger. The Scarborough provided the opinion of its auditors that "the society's arrangements for the mailing were such as to ensure that the Merger Notification Statements were sent to all those entitled to receive them, in accordance with the requirements of the Act and the Rules of the society". The Societies published notices of their applications:

(i) in the London Gazette on 14 January 2009 and in both the Edinburgh Gazette and the Belfast Gazette on 16 January 2009; and

(ii) in The Times, The Independent, the Daily Mail, the Scarborough Evening News and the Yorkshire Post on 14 January 2009.

These notices confirmed the information given in the Scarborough's MNS, that the closing date for interested parties to make written representations, or to give notice of intention to make oral representations, was 28 January 2009 and that the Authority intended to hear any oral representations on 11 February 2009.

3. REPRESENTATIONS AND RESPONSES

3.1 Schedule 16 to the Act provides that the Authority must send copies of written representations to the participating societies and allow them to comment on the representations.

3.2 Seventeen written representations, including two notices of intention to make oral representations, were received by the Authority by the closing date of 28 January 2009. However, prior to the date set for the confirmation hearing (i.e. 11 February 2009), the two representers referred to above, withdrew their intentions to make oral representations. Consequently, as there were no longer any interested parties who had given intention to make oral representations by the closing date stated in the MNS, an oral hearing was not required to be held.

3.3 Paragraphs 3.4 to 3.23 of this section **summarise** the substance of the main points made by the representers together with the Scarborough's and Skipton's responses. They do not include every detail of every point made, although every point has been considered by the Authority. The points are marshalled according to the confirmation criterion to which they appear to relate most closely. The Authority's conclusions on these points are set out in paragraphs 4.2 to 4.20. Other points made by representers are summarised in paragraph 3.24.

Unreasonable prejudice

3.4 **Three representers** raised concerns about the arrangements proposed as a consequence of the merger, regarding the payments due from borrowing members. They said that, for most borrowing members of the Scarborough, the merger will mean that:

(i) the day on which their monthly payment is collected will move forward from 28th to the 1st of the month;

(ii) the payment that would otherwise have been payable on 28 March 2009 will not be collected; and

(iii) the payment will be added to the mortgage balance and will bear interest unless and until the borrower chooses to pay it.

The representers argued that they would be unreasonably prejudiced by these arrangements and that additional interest that affected members would be required to pay if they do not make the March payment amounts to a penalty and is also unreasonable.

3.5 **The Scarborough** explained that the consequences of this change for borrowers are summarised within section 10 (b)(iii) on page 14 of the MNS which states:

"The Scarborough's payment date for payments due from borrowing members under the terms of mortgages is, in most cases, the 28th day of the month. If the Effective Date is 30 March 2009 (as currently envisaged), then the March payment, due from borrowing members on 28 March 2009, will not be taken on that date. A payment will be due on 1 April 2009 and borrowing members will be required to make that payment. Borrowing members will be given the option of making the March payment which was due on 28 March 2009. If they do not, then they will have to pay interest on that outstanding payment." Both the **Scarborough** and the **Skipton** in response to the representations on this matter explained:

(i) the requirement that affected members pay additional interest if they choose not to make the March payment is nothing more than a particular instance of a general requirement that members pay interest due on the outstanding balance of their mortgage if and so long as it remains outstanding. In addition, the societies state that such a requirement does not involve any sort of penalty and is not unreasonable. In their view it does not cause affected members unreasonable prejudice;

(ii) the difference in payment dates between the Scarborough and Skipton reflects the different ways the two societies charge and compound interest. It is considered necessary for the payment dates to be aligned in order for the mortgages of the Scarborough to be integrated with and operated on Skipton's systems, and assimilated with Skipton's existing mortgages.

(iii) in consequence of the need to align the payment dates of mortgages of the Scarborough with the payment dates of Skipton's mortgages, the merger faces the practical problem of how best to achieve that alignment. The societies argued that the solution which has been identified and adopted by the Scarborough and Skipton, embodied in the arrangements proposed, is a reasonable one. These arrangements allow affected members not to make the March payment, thereby preventing the merger from causing affected members cash flow problems arising from the different payment dates of the Scarborough and Skipton. It was further explained that affected members will have the option of being able to make 11 payments instead of the 12 payments that they would have otherwise been required to make during 2009 if the merger did not take place: affected members also have the option of (in addition to making the March payment in full at any time between 28 February 2009 and 27 March 2009) making the March payment in full at any other time over the remaining term of the mortgage; increasing their monthly direct debit for a period to pay off the March payment or making additional payments at times and in amounts of their choosing to pay off the March payment. Affected members will not have this choice if the merger does not proceed. If the merger proceeds and affected members choose not to make the payment before 27 March 2009, they will be required to pay interest due on the part of the outstanding balance of their mortgage which would not be outstanding if they had made the March payment. The payment of such interest does not put members in a worse position compared to if they were to defer a mortgage payment with the Scarborough. If affected members do not wish to pay such interest, then it is open to them to make the March payment. The various options open to members were to be set out in a letter to all affected members. Furthermore the societies explained that, as regards affected members, the missing March payment (if affected members chose not to make it) would not be treated as being in arrears.

(iv) in determining whether the affected members will suffer unreasonable prejudice in consequence to the arrangements proposed, regard should be had to the fact that Skipton's residential standard variable rate and its buy-to-let standard variable rate were lower than the Scarborough's standard variable rates (and all Scarborough members paying interest at either of its variable rates – or with reference to such rates – would, following the merger, pay interest with reference to the Skipton's variable standard rates). The Skipton explained that this benefit would affect 35% of the mortgage accounts held by Scarborough's borrowing members;

(v) in determining whether affected members would suffer unreasonable prejudice the Authority is entitled, in their view, to have regard to the fact that the merger would be beneficial to the Scarborough members as a whole (for the reasons set out in the MNS). If the merger did not proceed and the Scarborough failed, this could result in less favourable treatment for borrowers.

3.6 **Three representers** expressed concern regarding the proposed changes to the terms and conditions of mortgage and investment products held with the Scarborough, and about the fact that members will not be given details of some of these changes until nearer the Effective Date of the merger. One of these representers suggested that the MNS imposes revised terms and conditions in relation to mortgage accounts currently held with the Scarborough which they consider unfair under the Unfair Terms in Consumer Contracts Regulations 1999 ("the UTCC Regulations"). In addition, another of these representers expressed concern that the Skipton is introducing a redemption charge where none previously existed and that interest will be calculated annually instead of daily.

3.7 **The Scarborough** responded that it understands that it has long been a feature of transfers of engagements between building societies that the Instrument of Transfer of Engagements may include provision for the terms and conditions which apply to investment and mortgage products supplied by the transferor society to be varied so as to enable those products to be assimilated with the investment and mortgage products supplied by the transferee society. The Scarborough further explained that in the case of a transfer of engagements taking place following a direction given under Section 42B(3) of the Act, paragraph 14 of the MNS Regulations, issued in accordance with the Act, requires the MNS to provide details of:

(a) “Any changes in the terms on which the investments of the members of the transferring society will be operated by the accepting society, and

(b) a description of the arrangements to assimilate the range of investment accounts operated for shareholding members of the transferring society into the range of accounts operated for shareholding members of the accepting society.”

Schedule 15 of the MNS Regulations also requires the MNS to detail: “Any changes in the terms on which loans by the transferring society to its borrowing members secured on land will be operated by the accepting society.”

The **Scarborough** stated that there was power for the transferor and transferee societies to agree in the instrument of transfer on changes to the terms of investment and mortgage products which the transferee society has supplied to its members and other customers, being changes which are necessary to enable the transferred products to be properly assimilated into the range of products which the transferee society supplies to its members and customers. The Scarborough state that the Instrument of Transfer of Engagements (“Instrument”) entered into in the present case makes provision for changes to be made to the terms and conditions of investment and mortgage products supplied by the Scarborough, and particulars of these changes are given in the MNS. More specifically:

(i) Section 9(a) of the MNS states that the limited changes to the terms and conditions of the Scarborough’s investment products may be made before the Effective Date:

“to the extent that such changes are reasonably required by Skipton for the purpose only of ensuring that, from the Effective Date, the terms and conditions of the Scarborough’s share and/or deposit accounts are consistent with the account administration, payment systems and processing requirements (including IT requirements) and/or notification requirements of Skipton, and Skipton’s Rules, and not further or otherwise”.

Given that any such changes will be made before the Effective Date, the Scarborough stated their intention is that these will be made in exercise of powers of variation already contained in the relevant investment account documentation.

(ii) Section 9(b) of the MNS deals with changes to the terms and conditions of the Scarborough’s share and deposit accounts that will take effect on the Effective

Date. The changes are then detailed in Schedule 3 to the MNS (Part 1 of that Schedule being a summary of the changes, and Part 2 being a full statement of the changed terms). These changes are intended to deal with cases in which it had become apparent at the date of the Instrument that a term which currently applies to the Scarborough's investment accounts would require those accounts to be operated in a way that was not compatible with the systems which Skipton uses to operate its own share and deposit accounts. The purpose of the changes set out in Schedule 3 is to vary each such term so far as necessary to enable the accounts to be operated consistently with Skipton's systems and, for operational and administrative reasons, with Skipton's terms and conditions as from the Effective Date. This approach, the Scarborough further argued, is also relevant to the changes to the terms and conditions of the Scarborough's mortgage products as described within section 10(a) of the MNS.

(iii) Given that the requirement for the merger to be completed quickly, it was not possible for the two societies to be certain that, by the date of the Instrument, they had identified all the terms currently applicable to the Scarborough's share and deposit accounts which would, if left unchanged after the Effective Date, require those accounts to be operated in a way that is incompatible with Skipton's operational, procedural and system processes. The Instrument accordingly makes provision for Skipton to make further changes, at any time between the Effective Date and 1 January 2010, to the terms and conditions of investment accounts formerly held with the Scarborough. As is stated in section 9(c) of the MNS, the period from the Effective Date to 1 January 2010 is the period which Skipton believes will be required to make an adequate assessment of the integration requirements for migrating the Scarborough's share and deposit accounts onto Skipton's IT systems. Scarborough also submit that this argument also applies to Skipton's power to make changes to the terms and conditions of the Scarborough's mortgage products during the period from the Effective Date to 1 January 2010, as detailed within section 10(b) of the MNS.

In relation to the suggestion that the MNS imposes unfair terms under the UTCC Regulations, the Scarborough submits that they do not consider any of the revised

terms and conditions resulting from the merger to be unfair, and state that the changes have been required:

(a) to ensure that varied terms will override any of the existing mortgage terms which are in conflict; and/or

(b) if justified by one of the integration-related reasons specified in the MNS.

The Scarborough also explained that the representer who expressed concern that Skipton will be introducing a new redemption charge and calculating interest annually instead of daily had misunderstood the position. The Scarborough added:

(a) both Skipton and the Scarborough currently make a charge for the redemption and discharge of a mortgage and it is not the case that a new charge is being introduced where none previously existed;

(b) as is apparent from condition 3(a) of the new mortgage terms and conditions set out in Part 2 of Schedule 4 to the MNS, Skipton will be charging interest on a daily basis. It is the Scarborough rather than Skipton which currently charges interest (in most cases) on an annual or monthly basis.

3.8 **One representer** said that the Scarborough Chairman and one of its non-executive directors should not be allowed to damage the merged society by being appointed to Skipton's board when they have brought the Scarborough "to the point of ruin".

3.9 **The Scarborough** responded that it does not accept that the Chairman or any other of its directors, have brought the Scarborough to the point of ruin. Nor does it accept that the appointment of two of the Scarborough's non-executive directors as non-executive directors of Skipton (as explained within section 5 of the MNS), will be damaging to the merged society. It is also believed that there was no basis for suggesting that the appointment of these two directors would be unreasonably prejudicial to those members of the Scarborough who will become members of the Skipton given that:

(i) the individuals in question have both been approved by the Authority as fit and proper persons in accordance with the Authority's Handbook to perform the non-executive director function in their capacity as directors of the Scarborough;

(ii) they are required to be approved by the Authority as fit and proper persons in accordance with the Authority's Handbook prior to their appointment to the Skipton board;

(iii) their appointment to the Skipton board requires the prior approval of the Skipton board itself; and

(iv) they will make up only two of the eleven members of the enlarged Skipton board (which will include seven other non-executive directors).

3.10 **One representer** argued that in the case of investors who have savings with both the Scarborough and Skipton, the merger will reduce compensation cover from the Financial Services Compensation Scheme ("FSCS") with effect from 1 October 2009, when the £50,000 limit on compensation will cease to apply separately to savings held in Scarborough-branded accounts and savings held in Skipton-branded accounts.

3.11 **The Scarborough** explained that as stated in section 9 of the MNS, Skipton has notified the Authority that it intends to use the name 'Scarborough' in relation to all share and deposit accounts formerly held with the Scarborough, and the Authority has confirmed that the £50,000 limit on compensation payable under the FSCS will continue to apply separately to any such accounts held by an individual immediately before the Effective Date. It is subsequently argued that as a result, members of the Scarborough who have savings not exceeding £50,000 with each of the Scarborough and Skipton ("Relevant Members") will continue to be fully covered by the FSCS in the period following the Effective Date. The Scarborough acknowledged that the rule (i.e. 10.2.10 of the Compensation Sourcebook in the Authority's Handbook) which will enable the £50,000 limit to apply separately to Scarborough-branded accounts following the Effective Date is a temporary measure implemented by the Authority, which will apply only until 30 September 2009. The Scarborough stated that the period for which this temporary measure will apply is determined by the Authority (who are currently consulting on future changes to the FSCS) and, as such, is outside the control of the Scarborough and Skipton. The Scarborough accepts that a degree of prejudice may be suffered as a result of the merger by those "locked in Relevant Members" (assuming there is no extension in the period for which the current rule applies), whose combined savings with the Scarborough and the Skipton will exceed £50,000 but who will be prevented by the terms on which their accounts are held from reducing their combined savings to below £50,000 by making penalty free withdrawals before 30 September 2009. In addition, it drew attention to the

Authority's Confirmation Decisions in two other recent building society mergers (i.e. the Nationwide Building Society's merger with the Derbyshire Building Society and its subsequent merger with the Cheshire Building Society - published on 21 November 2008 and 4 December 2008 respectively), to support its contention that locked in Relevant Members of the Scarborough will not be unreasonably prejudiced by this proposed merger.

The Act and the Rules

3.12 **Eight representers** argued that the members of the Scarborough should have been consulted and given the opportunity to vote on the proposed merger, with one representer describing the merger process as a "rejection of mutuality".

3.13 **The Scarborough** responded that Parliament has expressly provided in Section 42B of the Act that where the conditions of that section are satisfied, the Authority is empowered to direct that a building society may resolve to merge by a board resolution, rather than by a vote of its members. The Authority gave a direction under Section 42B to the Scarborough and the board acted within the authority conferred by the Authority.

3.14 **Four representers** objected to the fact that the terms of the merger do not include any provision for the payment of a bonus to the Scarborough's members.

3.15 **The Scarborough** responded that there was no statutory requirement to pay a bonus to members on a merger and also that no such requirement arose from the rules of the Scarborough. In addition, the **Skipton** confirmed that no bonus payment will be made to either Scarborough or Skipton members as a result of the merger, in order to preserve capital.

3.16 **Six representers** questioned the entitlements of the directors of the Scarborough citing one or both of the following concerns:

(i) that, having regard to the circumstances which have led to the merger, the Scarborough's directors should not have been offered positions with Skipton or be eligible for bonuses or termination payments; and

(ii) that more detailed information should have been given about the benefits payable to the Scarborough's directors and the variations in the terms of employment of the Scarborough's executive directors following the merger Effective Date.

3.17 **The Scarborough** responded that the MNS contained all the information required by the Act. It also said that no compensation was to be made to any director of the Scarborough for loss of office or diminution of emoluments attributable to the merger. There was therefore no requirement for the Scarborough to obtain the consent of the Authority under the provisions of the Act for the making of such payment. In relation to the directors of the Scarborough who have been offered positions with Skipton, the **Skipton** confirm that they are satisfied that the individuals in question are fit to be appointed to the positions that have been offered to them.

3.18 **Six representers** suggested that the Scarborough had not provided its members with sufficient information about the need for the merger, with **one representer** specifically questioning the need to proceed quickly without a vote of the members.

3.19 **The Scarborough** stated that information provided within section 1 of the MNS that led the directors to conclude that the merger is in the best interests of the society and its members is sufficient and that, once determined, such a merger should be completed as quickly as possible. In addition, and as stated in 3.17 above, the Scarborough believe that the MNS contains all the particulars required by the Act.

3.20 **Two representers** argued that insufficient time was allowed for members to communicate their concerns regarding the proposed merger to the Authority, with one of the representers concluding that adverse representations were being actively discouraged.

3.21 **The Scarborough** confirmed that the Authority's approval of the MNS was received on 30 December 2008. Since that date fell just before the New Year break, printing did not start until the week beginning 5 January 2009 and, given the size of the mailing, was not ready for collection by the Royal Mail until 10 January 2009. Scarborough submit that paragraph 3(3)(b) of Schedule 8A to the Act required the MNS to be sent to members within 14 day's of the Scarborough's board of directors passing a resolution to proceed with the merger, and that this board resolution was passed on 29 December 2008. The Scarborough therefore conclude that they consider the mailing of the MNS on 10 January 2009 accordingly complied with the requirements of paragraph 3(3)(b). In addition, Scarborough stated that the majority of members would thus have had from 12 to 28 January 2009 in which to consider the documentation and, if they so wished, to make representations to the Authority. Scarborough believe that this timetable, which they state was agreed with the

Authority, gave ample time for any members who wished to make representations to the Authority to do so.

3.22 **One representer** argued that the Skipton members have been disenfranchised on the proposed merger.

3.23 **The Scarborough** responded that the Skipton had been given consent by the Authority – acting in accordance with the powers conferred on it by the Act – to agree to the merger with the Scarborough by a resolution of its Board.

Representations on Other Matters

3.24 Representers put forward points in relation to a number of other issues, including: failure of the Scarborough to disclose its financial position (and conversely making optimistic statements) at the time of its AGM in August 2008; making alleged misleading comments about the financial position of the Scarborough in correspondence with an individual member; making various allegations about the conduct of the directors of the Scarborough, in relation to the alleged mismanagement of the society; suggesting that the Authority will not give serious consideration to representations from members; referring to suggested inadequate supervision of the Scarborough by the Authority in the past; suggesting that the Authority's conclusions are "again a foregone conclusion", and raising a general concern about competition issues arising from the merger, including a suggestion that smaller societies should be encouraged to merge with each other to combat the dominance of the larger societies such as the Skipton.

3.25 In the view of the Authority the representations referred to in paragraph 3.24 above are not relevant to the two confirmation criteria.

4. THE AUTHORITY'S CONCLUSIONS

4.1 This part of the Decision sets out the Authority's conclusions, with its reasons, having regard to the information available to it, including the written representations and the societies' responses to them and to the Authority's enquiries.

Unreasonable Prejudice

4.2 Paragraph 5 of Schedule 8A to the Act replaces the two confirmation criteria in paragraphs (a) and (b) of Section 95(4) of the Act by a single criterion which reads:

"The members or a proportion of them would be unreasonably prejudiced by the transfer;"

4.3 It is important to note that this criterion does not refer simply to "prejudice". For the Authority to be precluded from confirming the merger, the prejudice must be "unreasonable". In the Authority's view, in determining what is unreasonable prejudice for these purposes, it should have regard to the circumstances in which the transfer of engagements is taking place. In particular, that for a direction to have been given under Section 42B(3) allowing the transferring society to resolve to transfer its engagements by board resolution, the Authority must have considered it expedient in order to protect the investments of shareholders or depositors:

(a) that the society should transfer its engagements to one or more other building societies, and has either given a direction to that effect, or the only reason it has not done so is that the society is already seeking to transfer its engagements, and

(b) that the society should be given a direction allowing it to resolve to transfer its engagements by board resolution instead of by the usual members' resolutions.

4.4 The Authority therefore considers that for it to refuse confirmation on the ground of unreasonable prejudice to members, or a proportion of them, the nature of any prejudice must be such that, having regard to the circumstances of the merger as described above, it is sufficient to justify the Authority preventing the merger from proceeding on the terms proposed. The Authority's view is that it is unlikely that any prejudice would be of such a nature unless the prejudice was significant.

4.5 The circumstances in which this merger is taking place were described by the Scarborough in Section 1 of the MNS. It is quite reasonable, in the view of the Authority, to anticipate that a building society which published accounts disclosing a pre-tax loss – with the trading background and continued uncertainty in outlook for the markets in which it operates creating the risk of a continuing weakening of its capital position - could be the subject of a loss in confidence. That might in turn trigger a run on shares and deposits. It is clearly in the interests of members for the risk of such a situation to be avoided if at all possible.

4.6 The Authority finds, having regard to the circumstances in paragraph 4.5 above, that the board of directors of the Scarborough acted properly for the purpose of protecting the investments of the society's shareholders and depositors by resolving, by board

resolution, to transfer the society's engagements to the Skipton. The Authority also finds that the Scarborough's members were given sufficient information about the difficulties facing the society to enable them to understand the reasons for the merger.

4.7 On the question of the March payment and the position of affected members who, if they do not make this payment in full between 28 February 2009 and 27 March 2009, will be charged interest on that outstanding payment, the Authority notes that affected members (i) will not be treated as being in arrears as regards the missing March payment, (ii) have been given a number of different options for making the March payment from which affected members can choose depending on their individual circumstances, and (iii) the change in mortgage payment date is necessary for the mortgages of the Scarborough to be integrated with, and operated on, Skipton's systems: it is therefore a necessary part of the merger assimilation and integration process (paragraph 4.8 below also refers as regards this latter point). The Authority accepts that affected members (in particular those who will not benefit from paying a reduced standard variable rate of interest) will be prejudiced by the merger. However taking account of these points set out in (i) to (iii) above, and having regard to the circumstances in which the merger is taking place (paragraph 4.5 above refers), as well as to the points made in paragraphs 4.3 to 4.4 above, the Authority does not consider the prejudice in respect of affected members to be unreasonable and therefore the Authority may not decline to confirm the merger on these grounds.

4.8 As regards the proposed changes to the terms and conditions of mortgage and investment accounts, the Authority acknowledges the Scarborough's statement at paragraph 3.7 as to the power for such terms and conditions to be amended to enable systems and the administration of the transferor society (in this case the Scarborough) to be integrated with, and operated on, the systems and the administration of the transferee society (in this case the Skipton). The Authority notes that the proposed changes to the terms and conditions of mortgage and investment accounts in this case are necessary to allow accounts to be migrated from the computer systems operated by the Scarborough to the computer systems operated by the Skipton or to allow Scarborough accounts to be operated in a way which is consistent with Skipton's administration, payments systems and processing requirements (including IT requirements). Having regard to the above, to how any changes will be applied (as described in the MNS) and to the circumstances in which this merger is taking place, the Authority does not consider that the merger will result in members or a proportion

of them being unreasonably prejudiced by the merger. As regards the assertion that the MNS imposes unfair terms under the UTCC Regulations, the Authority is not required to come to a view in this Decision as to whether the MNS imposes unfair terms under these Regulations. The protection available to consumers under the UTCC Regulations is not affected by the Authority confirming this proposed merger.

4.9 On the question of the appointment to the board of the Skipton of the Scarborough's Chairman and one other non executive director of the Scarborough, the Authority notes that (i) these two individuals will be required to be approved formally by the Authority as fit and proper persons (to be non executive directors of the Skipton) prior to their appointment to the board of the Skipton: and the fact that they have been previously approved as non executive directors of another building society does not automatically qualify them as fit and proper to be non executive directors of the Skipton, and (ii) they will make up only two of the eleven members of the board of the Skipton.

4.10 As regards the position of investors who have savings with both societies and the cover they receive under the FSCS, the position was explained in the MNS. In summary, following amendments made by the Authority to the rules in its Compensation Sourcebook ("COMP"), in certain circumstances where one building society merges with another society, and subject to meeting certain conditions (and the Authority is satisfied that these conditions will be met following this proposed merger), a separate £50,000 FSCS depositor protection limit can be retained for pre merger account holders. This means that a Scarborough shareholding member immediately prior to the Effective Date who is also a shareholding member with the Skipton immediately prior to the Effective Date will be entitled to a separate FSCS limit of £50,000 (the maximum amount covered by the FSCS in respect of deposits with one building society) for each of his/her accounts giving such persons a maximum protection limit under the FSCS of £100,000. However, and as noted by the representer, the changes to the COMP rules are only a temporary measure until 30 September 2009 pending a consultation by the Authority on wider reforms to the FSCS. The Authority has therefore considered the position for members of the Scarborough – and who are also investors with the Skipton – should the changes to the rules in COMP be withdrawn on 30 September 2009 and not be replaced by similar provisions. First, the Authority notes that for depositors who are able to withdraw their monies from either society without the payment of a penalty the

solution would be in their own hands. While they would need to withdraw some of their monies to bring the total amount invested to below the FSCS limit – as well as place the money elsewhere – it cannot, in the view of the Authority, be argued that this amounts to a prejudice which is unreasonable in the particular circumstances of the merger. As regards those depositors who will be prevented by the terms on which their accounts are held from reducing their combined savings in the two societies to below £50,000 by making penalty free withdrawals by 30 September 2009, the Scarborough accepts that a degree of prejudice will be suffered: the Authority shares this view. However, in the view of the Authority, in considering whether there has been a breach of the criterion it is necessary (as referred to in paragraphs 4.3 and 4.4 above) to have regard to the circumstances of the merger, referred to in paragraph 4.5 above. The board of the Scarborough concluded, reasonably in the view of the Authority, that in these circumstances it would carry an unacceptable degree of risk to continue as an independent society. In the event the Scarborough was unable to meet demands from retail depositors for withdrawals, then the society may be determined in default for the purposes of the FSCS, leaving investors to look to the FSCS for compensation. This would leave investors unable to access their accounts with all the concerns and difficulties that would bring. And while their investments would be covered by the FSCS they might also be faced with a further period of being denied access to their deposits until the FSCS paid out monies to them in compensation. However these potential difficulties would be avoided by the execution of a merger with the Skipton. The Authority notes that those members with combined deposits in excess of the FSCS limit will, as soon as the fixed term expires – which in many cases will be less than one year from the date of the merger – be able, if they wish, to withdraw all or some of their deposits without penalty. In summary, the Authority having regard to the circumstances of the merger and the potential impact on the members of the Scarborough of its not going ahead, does not regard the prejudice in respect of these members with fixed term accounts with both societies (and with a combined balance in excess of the FSCS maximum) to be significant and therefore certainly not sufficient to justify the Authority from withholding confirmation of the merger.

4.11 **The Authority, having considered the representations and responses and having regard to the circumstances of the proposed merger and to its interpretation of "unreasonably prejudiced", finds that the proposed transfer of engagements will**

not result in the members of the Scarborough, or a proportion of them, being unreasonably prejudiced by the transfer.

The Act and the Rules

4.12 Section 95 subsections (3) and (4) of the Act provide that the Authority shall confirm a merger unless it finds that "some relevant requirement of this Act or the rules of any of the societies participating in the [merger] was not fulfilled …". The relevant requirements of the Act are Sections 94 and 95 and Schedule 16. The relevant requirements of the rules are any rules of the Scarborough or the Skipton prescribing the procedure to be followed by the societies in approving or affecting a merger. The Authority may not refuse confirmation on the grounds that some other requirement of the Act, or of some other statute or of the general law, was not fulfilled.

4.13 A number of representers argued that members of the Scarborough should have been given the opportunity to vote on the proposed merger. The Authority considered whether the representation drew attention to any failures to fulfil any relevant requirements of the Act or of the societies' rules. On the contention that members were wrongly denied a vote on the merger the Act specifically provides for a merger to proceed by board resolution in specified circumstances (see paragraph 1.2 above).

4.14 In the case of an expedited merger – such as this proposed merger (paragraphs 1.2 and 4.13 above refer) – the Act provides that the information specified in the MNS Regulations (paragraph 1.2 above refers) is to be provided to the society's members. The Authority is satisfied that this took place (paragraph 2.2 above refers). The Authority is also satisfied that the MNS contained all the information required by the MNS Regulations. Finally, and as noted in paragraph 4.6 above, the Authority is satisfied that members of the Scarborough were given sufficient information about the difficulties facing the society to enable them to understand the reasons for the merger.

4.15 On the question of there being no bonus or distribution of reserves, the Act makes permissive provision, in Section 96, for distribution of funds (by way of bonuses or special interest rates) to be made to members in connection with a merger, subject to certain conditions, but does not require distributions to be made. Neither does the Act place a duty on directors to maximise the value of the society for its members.

4.16 On the question of payments to be made to directors of the Scarborough, the MNS explained that the Chief Executive of the Scarborough, Mr Litten, will continue to be employed by the Skipton after the Effective Date in accordance with his existing

service contract, subject to the variation to his position (Mr Litten will become Group Commercial Director of the Skipton: this is an officer role but a non board position). It is also explained that prior to the Effective Date he may become entitled to a bonus under the terms of his contract with the Scarborough (for the period 1 May 2008 to the Effective Date) and what the maximum amount payable by way of bonus under that contract could be, but noted that the actual amount of the bonus would be determined by Scarborough's board. The MNS also explained that the three other executive directors of the Scarborough would also continue to be employed by the Skipton after the Effective Date in jobs that will not be an officer role or board position. The position in respect of their bonus entitlements was also explained: in each case the position was similar to that of Mr Litten. In addition, the MNS explained that two non executive directors of the Scarborough would become non executive directors of the Skipton and that one (the Chairman of the Scarborough) would receive lower fees than he currently receives and one would receive higher fees. Finally, the MNS made it clear that no benefits or any compensation for loss of office or diminution of emoluments or other consideration that would require approval in accordance with the Act will be paid to any director or officer of the Scarborough. Having regard to the position set out above, the Authority finds that the MNS provided the information in respect of directors that it was required to by the Act and that no payments are to be made to directors and officers that require approval in accordance with the Act.

4.17 The Authority is satisfied, as explained in paragraph 4.14 above, that the MNS contained all the information required by the Act (paragraph 1.2 above refers) and also that it provided sufficient information about the need for the merger.

4.18 As regards the time allowed for members to make representations to the Authority, the Authority notes that (i) the Act does not set out a minimum time between the mailing of the MNS and the closing date for receipt of representations, and (ii) the MNS clearly explained the time by which representations to the Authority had to be made. Notwithstanding point (i), the Authority considers that, having regard to the circumstances in which this merger is taking place, members had sufficient time – at least 14 days – in which to consider the position and then make representations.

4.19 On the question of the Skipton members voting on the proposed merger, the position is as explained in paragraph 1.3 above: i.e. the Skipton received the consent of the

Authority to resolve to undertake to fulfil the engagements of the Scarborough by resolution of its board of directors.

4.20 **Having considered the representations and the societies' responses to them, and having regard to the matters discussed in paragraphs 4.12 to 4.19 above, the Authority finds that there was no failure on the part of the Scarborough or the Skipton to fulfill any relevant requirement of the Act or of the societies' rules.**

5. THE AUTHORITY'S DECISION

The Financial Services Authority has considered the applications by Scarborough Building Society and Skipton Building Society for confirmation of the transfer of the engagements of the Scarborough to the Skipton. Having had regard to the information available to it, including the representations made to it and the Societies' responses to those representations and the Authority's enquiries, the Authority confirms the transfer of engagements.

Sheila Nicoll
For and on behalf of the
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20 March 2009

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