

Bank of England

Prudential Regulation Authority

BUILDING SOCIETIES ACT 1986

DECISION BY THE PRUDENTIAL REGULATION AUTHORITY ON THE APPLICATIONS OF MANCHESTER BUILDING SOCIETY AND NEWCASTLE BUILDING SOCIETY FOR CONFIRMATION OF A TRANSFER OF ENGAGEMENTS UNDER SECTION 95 OF THE BUILDING SOCIETIES ACT 1986

The Prudential Regulation Authority appointed Dele Adeleye, the Head of UK Deposit Takers Supervision, to hear and decide the application on its behalf.

1. INTRODUCTION

1.1 **Manchester Building Society** ("the Manchester") and **Newcastle Building Society** ("the Newcastle") applied on 14 April 2023 to the Prudential Regulation Authority ("the Authority") for confirmation of the transfer of engagements of the Manchester to the Newcastle.

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 Manchester) 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 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 3.149 to 3.152 of Supervisory Statement 19/15 ("Exercising certain functions under the Building Societies Act 1986") ("Supervisory Statement 1915") the criteria it will use in exercising its discretion to give such consent. These include 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. Having considered the relevant factors, the Authority gave its consent to the Newcastle on 20 February 2023. Therefore, the Newcastle was not required to hold a general meeting to secure members' approval of its acceptance of the transfer of the Manchester'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).
- 1.7 The Authority must consult the Financial Conduct Authority (the "FCA") before confirming a transfer of engagements or giving a direction under section 95 of the Act.

2. THE APPLICATIONS

- 2.1 On 20 February 2023 the Authority gave a direction under section 42B(3) of the Act (as referred to in paragraph 1.2 above) enabling the Manchester to resolve to transfer its engagements to the Newcastle by board resolution. In this case, the direction was given under section 42B(3)(b) because the Manchester was already seeking a merger with the Newcastle. On 20 February 2023 the Authority gave its consent to the Newcastle resolving to proceed with the merger with the Manchester by means of a board resolution under section 94(5)(b) of the Act rather than by a general meeting and vote. On 23 March 2023, the Authority approved the MNS which the Manchester was required to send to its members. The MNS was sent to the Manchester's members. The Newcastle was not required to send a statement to its members.
- 2.2 On 14 April 2023, both societies applied to the Authority for confirmation of the merger. The Manchester provided the opinion of its independent auditors that "the Society's arrangements for the mailing were such as to ensure that the MNSs 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 Edinburgh Gazette and in the London Gazette on 18 April 2023 and in the Belfast Gazette on 21 April 2023; and
- (ii) in the Times, Daily Telegraph, The Journal and in the Manchester Evening News on 18 April 2023.

These notices confirmed the information given in the Manchester's MNS, that the closing date for interested parties to make written representations, or to give notice of intention to make oral representations, was 12 May 2023 and that the Authority intended to hear any oral representations on 23 May 2023.

3. REPRESENTATION 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 Two written representations were received by the Authority by the closing date of 12 May 2023. The Authority did not receive any notices of intention to make oral representations and therefore an oral confirmation hearing was not required to be held.
- 3.3 Paragraphs 3.4 to 3.17 of this section **summarise** the substance of the main points made by the representers together with the Manchester's and the Newcastle'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 4.24. Other points made by representers are summarised in paragraph 3.16.

Unreasonable prejudice

- 3.4 **One representer** has stated that he holds, and also represents a number of members who are holders of, the Manchester's Permanent Interest-Bearing Shares (PIBS). The representer contends that, while the proposed Merger is in the best interest of most members, he and other PIBS holders would be disadvantaged as a result of Newcastle becoming the issuer of the PIBS and, by doing so, provide an inferior covenant to such PIBS holders when compared to the current covenant provided by the Manchester.
- 3.5 **The Manchester responded** by noting that the merged society offers a superior

covenant for PIBS holders compared to the Manchester as a standalone entity. It is acknowledged that Manchester had a common equity tier 1 (CET1) ratio of 24.4% as at 31 December 2022, whereas Newcastle had a CET1 ratio of 12.5% as at that same date. Both societies have a strong enough CET1 ratio to provide comfort to PIBS holders that they currently have an appropriate covenant. The Manchester and Newcastle also made the following points:

- (i) The Manchester's CET1 capital is diminishing as the business is now loss making, with no prospect of becoming profitable under its current model. It is also subject to material risks. For example, subsequent to the figures quoted above, the transition from IFRS4 to IFRS17, when accounting for the Spanish Lifetime portfolio, resulted in a reduction of over £4m in CET1 on 1 January 2023 and will see much higher levels of volatility in coming periods. This reduction was fully disclosed within the most recently published and audited consolidated financial statements of the Manchester Group as at 31 December 2022 and reference was made in section 6 of the MNS.
- (ii) The PIBS generate an income stream for holders through the coupons that are paid every six months. The ongoing losses and additional risks that the Manchester faces lead to the possibility that these coupons will not be capable of being paid by a stand-alone Manchester; circumstances that are much less likely to affect the combined entity.
- (iii) The risks facing the Manchester are such that it remains necessary to retain both CET1 and Tier 2 capital at the present time. In the absence of a merger, or an alternative strategy for the Manchester, it is unlikely that the Board would determine that it would be appropriate to redeem the PIBS and, even if it was minded to, it would require regulatory approval to do so. A redemption of the PIBS would lead to a reduction in total regulatory capital, and if redeemed at a premium, this would also result in a reduction to CET1 capital.
- (iv) The representer states that absent the merger, "the call option on the 6.75% series will be invoked in 2030". This is far from certain. The forecast losses to 2030 may mean that the Manchester will not have enough excess capital to make the call at that time. Assuming the Merger is completed it will be for Newcastle to determine whether it redeems the PIBS at the call date, or earlier, and that will be a commercial decision for it to take. It does not seem correct,

however, to assume that a redemption would be more likely if the Manchester remained a stand-alone society.

- (v) The representer acknowledges in his representation that he “can see the merits of a merger between the [Manchester] and [Newcastle] – and it is not [his] intention to stop that from happening”.
- (vi) In considering whether the Unreasonable Prejudice Criterion applies, the Manchester noted that the issue is not whether the members or a proportion of them would be worse off under the proposed Merger than they would have been under some hypothetical merger negotiated on more favourable terms (in this case a merger which involves an off market offer to repurchase the PIBS from their holders), but whether they would be significantly worse off under the proposed Merger than they would be if the Manchester were to remain independent. Having regard to the ongoing losses and additional risks that the Manchester faces, the covenant the Newcastle will provide is currently stronger. When looking at the ability of the combined entity to pay the coupons under the PIBS, on a comparative basis there is a greater likelihood that a stand-alone Manchester will not be able to do so.

The Act and the Rules

3.6 **One representer** objected to the fact that the terms of the merger do not include any provision for the payment of a bonus to the Manchester’s members.

3.7 **The Manchester responded** that the absence of any such provision for payment of a bonus involves no unreasonable prejudice to the Manchester’s members. A merger between building societies does not involve the reserves of the transferor society being taken solely for the benefit of the transferee society. The members of the transferor society become members of the transferee and have membership rights in the transferee and an interest in the combined reserves of the transferee. In considering whether the Unreasonable Prejudice Criterion applies, the issue is not whether the members or a proportion of them would be worse off under the proposed Merger than they would have been under some hypothetical merger negotiated on more favourable terms (i.e., in this context, the terms including provision for payment of a bonus), but whether they would be significantly worse off under the proposed Merger than they would be if the Manchester were to remain independent. Having regard to the risks to the Manchester's future if it were to remain independent, the Manchester submits that,

notwithstanding no bonuses will be paid, the balance of advantage comes down clearly in favour of the proposed Merger. **The Manchester** also noted that there was no statutory requirement to pay a bonus to members on a merger and that no such requirement arose from the rules of the Manchester. The absence of any provision for payment of a bonus to members in connection with the Merger does not involve any failure to fulfil a relevant requirement of the Act or of the Manchester's Rules.

3.8 One representer argued that the members of the Manchester should have been consulted and given the opportunity to vote on the proposed merger. The representer contended that an EGM should be held to enable members to express their views.

3.9 The Manchester responded that Parliament has expressly provided in section 42B of the Act that, where the conditions in section 42B(3) are satisfied, the Authority is empowered to direct that a building society may resolve to merge with another society by a resolution of its board of directors rather than by resolutions of its shareholding and borrowing members under section 94(2). The Authority gave a direction under section 42B(3) to the Manchester and the board acted within the authority conferred by the Authority. Where such a direction is given, the fact that the Manchester has not convened a meeting of its members is a necessary consequence of its adopting the course authorised by the Authority and involves no failure to fulfil a relevant requirement of the Act or of the Manchester's Rules.

3.10 One representer raised a concern over whether there was an issue with the Manchester's Spanish lifetime mortgage book and if this should have been included in the MNS.

3.11 The Manchester responded that the MNS contains all the information required to comply with the Act and the Regulations as well as containing other information requested by the Authority in this particular case. The Manchester believes, therefore, that the MNS fully meets the disclosure requirements arising under the Act.

3.12 One representer said that the Manchester board could realise a financial benefit from the merger in what they described as the board members being paid off with no obvious benefit to its members.

3.13 The Manchester responded by summarising the position relating to payments to the members of the Board as outlined in section 5 of the MNS:

- (i) Except as stated below, no director of the Manchester will be paid any compensation or other consideration in connection with the Merger.

- (ii) Upon the termination of Paul Lynch's and Mark Winterbottom's employment they will receive termination payments for payment in lieu of notice, employer pension contributions in respect of their 12 month notice period and contractual and statutory redundancy payments. It was stated that the payment of employer pension contributions for their 12 month notice periods to each of Paul Lynch and Mark Winterbottom is considered by the Manchester and Newcastle to be appropriate in the circumstances for the following reasons:
- In the event that Paul Lynch and Mark Winterbottom were to work their notice period instead of receiving payment in lieu of notice, these employer pension contributions would have been paid into their pension schemes over the 12 month notice period.
 - The Manchester and Newcastle consider the payment of the employer pension contributions to be fair and reasonable in the circumstances; and the Manchester and Newcastle do not believe that the payment of employer pension contributions as set out above for Paul Lynch and Mark Winterbottom will pose any detriment to either Manchester or Newcastle members.
 - In the case of the payment of employer pension contributions in respect of Paul Lynch and Mark Winterbottom as described above, the Authority provided its consent to such payment on 16 March 2023 in accordance with paragraph 2(1) of Schedule 8A. A special resolution of members under section 96(1)(a) is not required in these circumstances as such requirement is displaced by paragraph 2(1) of Schedule 8A in cases where the Authority has given a direction under section 42B(3).
 - The MNS contains all the particulars required by paragraphs 16 to 19 of the Schedule to the Regulations.
- (iii) The Chair of the Manchester is contractually entitled to six months' non-executive director fees on ceasing to hold office on a merger and three non-executive directors of the Manchester will receive a flat fee to act on the cessation accounts committee of the Manchester for three months following the Effective Date.
- (iv) Other than in the case of Paul Lynch and Mark Winterbottom with respect to their employer pension contributions, no director of the Manchester whose

employment is terminated by reason of redundancy will receive any compensation for loss of office or diminution of emoluments that would require the consent of the Authority under paragraph 2(1) of Schedule 8A of the Act.

(v) No director has an interest in the Merger or in the Manchester or Newcastle other than any interests as members of the Manchester or Newcastle or as directors or officers of the Manchester and/or its connected undertaking.

(vi) Accordingly, the Manchester submits that the provisions for the proposed termination payments to be made to members of the Board discloses no failure to fulfil a relevant requirement of the Act or of the Manchester's Rules, nor do the proposed payments create any prejudice to the members of the Manchester.

3.14 **One representer** argued that members of the Newcastle should have been allowed to vote on the proposed merger.

3.15 **The Newcastle** responded that it 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 Manchester by a resolution of its Board. The Newcastle board is convinced of the strategic merit of the Merger, following a process of investigation and due diligence. However, due to the relative size of Newcastle, the Merger will not affect the interests of members of Newcastle to a significant extent. The Newcastle board therefore determined that there would be no prejudice to Newcastle members in seeking consent from the Authority to proceed with the Merger by way of board resolution, rather than approval by member resolution.

Representations on Other Matters

3.16 One representer has questioned whether the Board have considered alternatives to the Merger, such as a merger with a different society or a transfer to a non-mutual organisation.

3.17 **The Manchester** responded that its Board has in previous annual reports and accounts stated that the Manchester was open to a merger with a building society or a transfer to a non-mutual organisation. The Board has entered early-stage discussions with a number of third parties to consider whether a transaction could be undertaken, however none of the options discussed were considered to be in the best interests of

the Manchester's members. In concluding that a merger with another building society was the best option for the Manchester, the Board was strongly influenced by their belief that a mutual building society is best placed to deliver good value to shareholding and borrowing members over the longer term. In selecting Newcastle as the Manchester's preferred merger partner in the building society sector, the Board had regard in particular to the fact that, as a much larger building society, Newcastle could provide greater stability and certainty for the Manchester's members and (in the light of the paragraph 3.149 to 3.152 of SS 19/15) that Newcastle could be expected to obtain the Authority's consent under section 94(5)(b) of the Act to its undertaking to fulfil the Manchester's engagements by board resolution, so enabling the Merger to be completed quickly. The Board believes that it is in the best interests of the Manchester's members that a merger with Newcastle be completed as quickly as possible.

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 the members of the Manchester, 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 sufficient unless the prejudice was significant. In determining whether any such prejudice arises, the Authority must consider all circumstances relevant to the merger.
- 4.5 The circumstances in which this merger is taking place were described by the Manchester in section 1 of the MNS. The Manchester has been winding down its balance sheet since 2013, following losses in 2013 relating to a change in auditor guidance over hedge effectiveness for their lifetime mortgage book. The Manchester has not written any new mortgage business during this time and the current level of deposits serve to fund existing mortgages as the book winds down organically. It is quite reasonable, in the view of the Authority, to anticipate that the Manchester would have recurring losses that would deplete capital reserves each year in the absence of a merger arrangement. 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 that the board of directors of the Manchester acted properly for the purpose of protecting the investments of the Manchester's shareholders and depositors by resolving, by board resolution, to transfer the Manchester's engagements to the Newcastle. The Authority also finds that the Manchester's members were given sufficient information about the difficulties facing the Manchester to enable them to understand the reasons for the merger.
- 4.7 The Authority has also considered whether the implications of the merger would result in any unreasonable prejudice for the members of the Manchester (or a proportion or them) more broadly. This includes having regard to all matters covered by the MNS. In particular, the Authority notes that:

- (a) In terms of membership rights, all Shareholding Members and Borrowing Members of the Manchester will be deemed to have become Shareholding Members or Borrowing Members of Newcastle (as applicable) from the date that they became a member of the Manchester (if this date is any earlier than any existing membership of Newcastle) and provided that their membership of the Manchester has been continuous. Holders of the Manchester's PIBS will become holders of PIBS in Newcastle. The holder of the Manchester's profit participating deferred shares ("PPDS") has agreed that, before the effective date of the merger, the PPDS will be repurchased and cancelled.
- (b) The provisions refer to potential changes to the terms and conditions of the Manchester's savings accounts and mortgage accounts. This includes provisions for Newcastle to make changes to the terms and conditions within three years of the effective date. The Authority understands FCA has asked Newcastle to inform it of any proposed changes to the legacy terms it intends to implement in line with the Instrument of Transfer, so that it has an opportunity to consider them before any proposed change takes place (see paragraph 4.12 below). This continuing oversight by the FCA in the area will help mitigate the risk of any prejudice arising, as result of future anticipated changes to the terms and conditions.

4.8 The Authority has also considered whether the merger would result in any unreasonable prejudice to the members of Newcastle (or a proportion of them). As explained at paragraph 1.3 above, Newcastle applied to the Authority for consent to proceed by Board resolution to accept the transfer of engagements of the Manchester under section 94(5)(b) of the Act. The Authority was satisfied at this point that - taking into account the factors in paragraphs 3.149 to 3.152 of Supervisory Statement 19/15 - the merger would not affect the interests of members of Newcastle to any significant extent. The Authority has updated its assessment and continues to be satisfied that the merger will not affect the members of Newcastle to a significant extent, given relative asset sizes of the societies in particular.

The PRA's views on the representations received as they relate to the First Criterion

- 4.9 As noted above, representations were received in relation to the First Criterion.
- 4.10 One representer argued that he would be unreasonably prejudiced as a holder of the

Manchester's PIBS contending that Newcastle would provide an inferior covenant to PIBS holders when compared to the Manchester's covenant. The Authority agrees with the Manchester's assessment in broad terms and notes that:

- (i) The Manchester's capital position is likely to continue to decline as the Manchester is in a state of run-off where it is loss-making and its lifetime mortgage book continues to grow as a proportion of total assets. The change in lifetime mortgage book accounting treatment from IFRS4 to IFRS17 has a material day one impact of c. £4m and exposes the Manchester to several fair value accounting risks that can impact its future capital position.
- (ii) The Authority agrees with the Manchester's assessment that while the Manchester's CET1 ratio is currently higher than Newcastle's, the quantum of capital held by the Newcastle is significantly higher and Newcastle remains a profitable building society.
- (iii) The Manchester did not make any PIBS coupon payments between April 2016 to October 2021 given challenges with its profitability and capital position. The Authority also agrees with the Manchester that, when looking at the ability of the combined entity to pay the coupons under the PIBS, on a comparative basis there is a greater likelihood that a stand-alone Manchester will not be able to do so.
- (iv) In light of the circumstances above the Authority does not consider that any unreasonable prejudice will arise for the PIBS holders for the reasons given by the representer.

4.11 The Authority has also considered whether the other representations received – and which are discussed in more detail in paragraphs 4.14 to 4.21 below - indicate that any unreasonable prejudice will arise to the members or a proportion of them. The Authority is satisfied that this is not the case.

The FCA's views

4.12 The FCA were consulted in accordance with the Act and stated that they are not aware of any conduct issues in respect of the Manchester or the Newcastle that would preclude the merger. Given the ongoing viability concerns that the Manchester has faced over recent years, its current trading position, and the absence of any viable

longer-term strategy, the FCA considers the merger as providing the best outcomes for the Manchester's members. The merger also offers the Manchester's members better options in terms of access to branches and the range of products available at the Newcastle. Given the relative size of the Manchester, the merger does not increase the membership or assets of the Newcastle significantly. The FCA have confirmed with the Newcastle that its intention is that the level of service provided to Manchester customers will remain the same. It is not anticipated that customers will suffer any reduction in service level. As the integration process is completed, the services offered to Manchester customers will improve as access to branches and other services become available. The proposed changes to the terms and conditions will be limited to those which are reasonably necessary to enable the transferred products to be assimilated into the systems, procedures, and product lines of Newcastle. The Newcastle also indicated that it will abide by any applicable law in relation to changes to shareholding, deposit and borrowing members, and the FCA would therefore expect it to comply with any consumer contract legislation. If the clauses specified were to be used, the FCA assume that the original contracts include a term that allows variations to be made and the term would be considered fair and sufficiently transparent under the Consumer Rights Act 2015. Consequently, the FCA raised no objections.

- 4.13 The Authority, having considered the representations and responses and having regard to the circumstances of the proposed merger, the other matters referred to above and to its interpretation of "unreasonably prejudiced", finds that the proposed transfer of engagements will not result in the members or a proportion of them being unreasonably prejudiced by the transfer.**

The Act and the Rules

- 4.14 The Second Criterion is 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 (taking into account the relevant modifications made by Schedule 8A of the Act). The relevant requirements of the rules are any rules of the Manchester or the Newcastle 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. However, the Authority is mindful that the Human Rights Act 1998 requires the Authority to avoid acting in a way which is incompatible with rights under the European Convention on Human Rights ("the ECHR"). Furthermore, so far as it is possible to do so, primary legislation must be read and given effect in a way which is compatible with the ECHR.

- 4.15 One representer argued that members of the Manchester should have been given the opportunity to vote on the proposed merger.
- 4.16 The Authority considered whether the representations 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, section 42B(3)(b) of the Act provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct that a building society may resolve transfer its engagements to one or more other building societies via a board resolution (instead of via the usual resolutions required by section 94(2) of the Act). The Authority gave careful consideration to the current facts of this particular case and having considered the application of the statutory tests in the relevant circumstances, and having consulted the FCA, concluded that it was expedient to protect the investments and depositors of the Manchester to allow it to proceed with the transfer by way of board resolution. Accordingly, a vote of the members of the Manchester was not required.
- 4.17 On the question of there being no bonus paid to members, 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. The Authority agrees with the Manchester's assessment that the absence of any provision for payment of a bonus to members in connection with the merger does not involve any failure to fulfil a relevant requirement of the Act or the Manchester's rules.
- 4.18 In the case of an expedited merger – such as this proposed merger (paragraph 1.2 above refers) - the Act provides that the information specified in the Regulations (paragraph 1.2 above refers) is to be provided to the society's members. The Authority is satisfied that all members entitled to receive a copy of the MNS received one (paragraph 2.1 above refers). The Authority is also satisfied that the MNS contained all the information required by the Regulations, including around the Manchester's lifetime mortgage book. The MNS included information around the interest rate on

lifetime mortgages and concerning Newcastle's application of fair value adjustments to the Manchester's assets and liabilities (including its loan portfolio) noting that these adjustments were yet to be finalised and externally audited at the time the MNS was published. The MNS also confirmed that there had been no material adverse changes in the financial position of the Manchester, other than the impact of the transition to IFRS9 for the Spanish lifetime mortgage portfolio as fully disclosed in financial statements of the Manchester as at 31 December 2022. Finally, the Authority is satisfied that members of the Manchester were given sufficient information about the difficulties facing the Manchester to enable them to understand the reasons for the merger.

- 4.19 On the question of payments to be made to directors of the Manchester, the MNS explained that all of the directors of the Manchester will resign from their positions without any compensation for loss of office or diminution of emoluments attributable to the Merger, save for termination payments that would be made to the executive directors (as set out in paragraph 3.13). On termination of their employment, Paul Lynch and Mark Winterbottom will not receive any bonus payment but will receive termination payments including payment in lieu of notice, employment pension contributions equal to their notice period and contractual/statutory redundancy payments. In each case the Manchester made clear that these payments would be limited to the directors' contractual and statutory entitlements, with the exception of the employment pension contributions. Section 96 and Schedule 8A of the Act make provision about the payment of "compensation" to directors and officers for loss of office or diminution of emoluments attributable to the merger and how such payments are to be authorised. However, (i) in the view of the Authority (and as explained in paragraph 3.44 of Supervisory Statement 19/15), "compensation" does not include statutory redundancy payments, damages for breach of contract or other payments, for example, falling due under the terms of any pre-existing contracts of employment or a pre-existing arrangement giving rise to a reasonable expectation, and (ii) in any event section 96 is not a relevant requirement of the Act. Moreover, the Authority has no power to prohibit the making of statutory or contractual payments to one or more of its directors by a building society. The Authority provided its consent under section 96(1)(a) of the Act (as modified by paragraph 2(1) of Schedule 8A to the Act) to allow the employer pension contribution payments. This was on the basis that the Authority considered them to be appropriate and reasonable in the circumstances of

the Merger (and cause no unreasonable prejudice for members).

- 4.20 On the question of the Newcastle members voting on the proposed merger, the position is as explained in paragraph 1.3 and 4.8: i.e., the Newcastle received the consent of the Authority to resolve to undertake to fulfil the engagements of the Manchester by resolution of its board of directors.
- 4.21 In the view of the Authority, the representations in paragraph 3.16 do not indicate that any relevant requirements were not fulfilled.
- 4.22 The Authority is aware of one relevant requirement which has not been met. Paragraph 3(3) of Schedule 8A to the Act requires that the MNS is sent out within 14 days of the board resolution approving the transfer. The Authority understands that due to the correction of some errors identified in the MNS, and the printers being closed on two bank holidays, the sending of the MNS was delayed. **The Authority considers that this could not have been considered material to the members' decision on the transfer and that they had sufficient time to consider the information in the MNS. Accordingly, the Authority directs that failure to meet this relevant requirement can be disregarded in accordance with section 95(5) of the Act.**
- 4.23 The Authority has not identified any relevant requirements (in addition to those referred to above) which were not fulfilled.
- 4.24 The FCA has not raised any concerns in respect of the relevant requirements ground in its response to the PRA's consultation.
- 4.25 Having considered the representations and the societies' responses to them, and having regard to the matters discussed above, the Authority has not identified any failure on the part of the Manchester or the Newcastle to fulfil any relevant requirement of the Act or of the societies' rules (except the failure which has been disregarded referred to in paragraph 4.22).**
- 4.26 The Authority then considered whether the merger process, as provided by statute, involving the Manchester proceeding by board resolution following a direction from the Authority under section 42B(3) of the Act, is incompatible with any rights under the ECHR.
- 4.27 As regards to the "Protection of property" in article 1 of the First Protocol to the ECHR, in the Authority's opinion, even if membership rights in the society can be characterised as "possessions" for the purposes of that article, the members of the Manchester will not be "deprived" of them within the meaning of the article. In

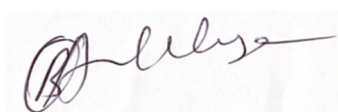
particular, it is relevant that membership rights in the Manchester will be substituted by membership rights in the Newcastle. Moreover, the Authority considers that any control of the use of members' property is proportionate and can be justified in the general interest, namely, the protection of the investments of shareholders and depositors.

- 4.28 Another Convention Right which is potentially relevant here, in the context of the members not being given an opportunity to vote on the proposed merger, is the right of freedom of expression recognised by article 10 of the ECHR. The Authority notes, however, that members retain the right to make their views known through their ability to make representations at the confirmation stage. Furthermore, any interference with the freedom of expression is proportionate and can be justified in the public interest, as noted above.

5. THE AUTHORITY'S DECISION

The Authority has considered the applications by Manchester Building Society and Newcastle Building Society for confirmation of the transfer of the engagements of the Manchester to the Newcastle. The FCA were consulted and raised no objections. 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.

Dele Adeleye

A handwritten signature in black ink, appearing to read 'Dele Adeleye', enclosed in a thin blue rectangular border.

For and on behalf of the Prudential Regulation Authority

5 June 2023