Up the ranks

GROUP TREASURER PAUL RILEY TELLS **GRAHAM BUCK** HOW LEEDS BUILDING SOCIETY HAS WEATHERED THE FINANCIAL STORM AND MOVED UP THE SECTOR'S LEAGUE TABLE.

PHOTOGRAPHER: ROGER HARRIS

The financial crisis of the past two years has underlined the attractions of building societies and their framework of mutuality, but the sector has not escaped the impact entirely. Several struggling societies – Barnsley, Chelsea, Cheshire, Derbyshire and Scarborough – have been absorbed by stronger rivals, while Dunfermline, Scotland's biggest building society, had to be rescued from collapse, in part by Nationwide.

In this bleak environment Leeds Building Society (formerly Leeds & Holbeck) has proved resilient. Until quite recently it vied with West Bromwich to be the UK's eighth-largest building society, but after edging ahead of its rival and seeing Britannia absorbed last August by Co-operative Financial Services, and Yorkshire and Chelsea announce plans to merge, it now ranks fifth.

Members concerned about Leeds' ability to survive tougher conditions were reassured at last year's AGM that the society had withdrawn from commercial lending – the area that caused Dunfermline's troubles – by the middle of 2008, although it has retained its existing portfolio of business.

"Dunfermline overstretched itself in the commercial lending field," says Paul Riley, Leeds' general manager and group treasurer. "It's a much smaller proportion of our overall business and we are much better capitalised. Leeds is one of the very strongest building societies. We may be fifth biggest, but we punch above our weight and are stronger than some of our bigger competitors. I share the board's belief that we will remain independent, which means not entering into any mergers that could potentially jeopardise that position."

Leeds has entered into one major union: in 2006 it merged with Mercantile as the dominant partner. Riley says the deal benefitted both parties: "While it has a local focus in our heartland, Leeds is a national player. Mercantile was predominantly based in the North East, so it represented a good geographic fit and all Mercantile branches were retained post-merger for a number of years."

Leeds has also adopted a cautious approach by applying stricter lending criteria to its mortgages. Its maximum loan to value figure has fallen from 95% to 85%, although in the majority of cases the figure is significantly lower.

Riley says that one of his current main concerns is the prospect of resurgent inflation, which will directly affect the market in which Leeds operates by eroding the value of savings.

His treasury team was actively involved in developing and launching the society's Inflation Buster bonds, but the product is currently unavailable due to changed market conditions.

"We look to provide value by offering savers attractive rates, so we regularly review the possibility of reintroducing the Inflation Buster product," he explains. "However, we use a derivative swap contract to hedge the risk and at the moment this just isn't feasible.

"It's also unlikely that we'll resume commercial lending for some time, although we never say never. However, in the near term we will focus on prime residential. We also still offer loans for buy to let and specialise in the shared ownership market, providing a viable mortgage for first-time buyers."

Riley's connections with the society go back to when he joined Leeds & Holbeck (as it was then still known) as a full-time employee in the mortgage department. "Leeds is my home town, so I worked there on a part-time basis in my student days while studying for an economics degree at Coventry University," he explains.

The first four years were spent in mortgage servicing and lending, which subsequently led to work in the finance department as a management information analyst.

In 1996 he moved to the treasury department as a risk analyst and quickly decided that treasury was the route he wanted to pursue. "Leeds at that time was still a relatively small building society, so my work not only included balance sheet risk management, but also money management funding, liquidity investment and hedging. It was also staunchly mutual, at a time when other building societies had converted to banks or were considering conversion."

However, the late Nineties was also a time when "carpetbagging" posed a threat to building societies that opted not to convert. There were fears that individuals would gain membership of societies by making the minimum investment necessary, solely with the aim of forcing through a conversion and pocketing the free shares.

"Possibly we imagined the threat of conversion to be greater than it actually was," admits Riley. "None of these individuals ever made it to board level and so the campaign never gained real impetus."

Nonetheless, his boss at that time was seconded to deal with the carpetbagging threat, and the society changed its rules so that demutualisation needed a 75% yes vote rather than a simple majority.

Riley was promoted to head of group treasury in 2000 when his predecessor left. He decided it was time to embark on the ACT qualifications to cement his new status. "You can't approach the course with a half-hearted attitude or you're bound to fail, which is a message that I also give my staff," he says. "I followed the guidelines suggesting the minimum number of study hours to be applied to each module and kept a record to ensure I put in the required number. I recognised that if I didn't put in the work, then I'd be struggling. The ACT's resources, such as past papers and sample questions, were invaluable but to anyone thinking of undertaking the qualification I can only urge them to practise, practise, practise."

Leeds & Holbeck finally became Leeds Building Society in 2005, having waited for years to claim the title for itself. Its ambition had long been thwarted by local rival Leeds Permanent – today perhaps best remembered for hiring actor George "Minder" Cole in the Eighties to advertise its Liquid Gold account as "a nice little earner" – which had already claimed the epithet "the Leeds".

But Leeds Permanent's days as an independent ended in the mid-Nineties, when it was acquired by Halifax. The deal left the Leeds Building Society name vacant and after a 10-year wait Leeds & Holbeck finally claimed it for its own. It was a break with its history, though, Holbeck being the suburb of Leeds in which the society first began business in 1875.

Leeds' current treasury team is divided into front-office, middle-office and back-office operations, with Riley's responsibilities spread over front-office, where four staff report to him, and middle-office, which employs a further five. "When I took over as head of treasury a decade ago a total of three people reported to me, so I have developed two distinct teams and recruited for each of them," he says. "Currently I'm looking to add a further two people to the middle-office team to tackle the growing burden of regulation."

Two years into the recession, Riley does not anticipate any early improvement in the economic backdrop. He thinks that the low interest rate environment is likely to continue at least until the end of this year and while the housing market has recently shown signs of life, mortgage lending continues to be restricted.

He identifies funding as his current main concern: "Leeds is happy to lend to customers with the right credit quality, but first has to get its hands on funds through the retail marketplace. About 80% of our overall funding comes from savings accounts held with us by the general public and it's a highly competitive market at present.

"As Northern Rock suffered so publicly from its heavy reliance on the wholesale market, everyone is now chasing the retail market as a result. And we've still got some way to go before we emerge fully from recession."

Much time over the past year has been occupied by ensuring that Leeds meets the Financial Services Authority's new standards and requirements on liquidity. "This entails greater investment in gilts, treasury bills and Bank of England reserve, so that the society has more of a liquidity buffer," explains Riley. "We're looking to build up our liquid assets, but it's not easy when the higher the quality, the lower the return that it provides."

Riley added the position of general manager to that of group treasurer in November and observes that, at the senior management level, the external regulatory and political environment has come very much to the fore since the advent of the credit crunch.

"Some elements of the financial services industry are manifestly unfair," he says. "Northern Rock, RBS and HBOS all now rely on government backing and this creates an unlevel playing field on both savings and mortgages. As state-backed institutions, they are compelled to lend and must do so at attractive rates."

In the building society sector, capital has become a major issue. As a member-owned mutual, Leeds is barred from issuing equity as a means of raising capital and instead issues permanent interest-bearing shares. The FSA intends to classify permanent interest-bearing shares as Tier II capital. While there is valuable capital in Tier I through retained earnings (where Leeds is particularly strong), ranking permanent interest-bearing shares as Tier II effectively prevents building societies from being able to raise external capital through Tier I should they wish to do so.

"There has been a lengthy debate between the FSA and building society representatives on whether permanent interest-bearing shares should – and can – be classified in future as Tier I, and the debate is likely to continue for some time to come," says Riley.

While he stresses that Leeds does not currently need external capital, it is an important issue for the sector as a whole.

"A potential change of government this spring is unlikely to make a great difference," he says. "Neither of the two main parties offers a formulated or definitive view of how they regard the role of the building society sector, nor do they offer much support for it either as their focus remains on the banks."

Despite this tough environment, Riley still enjoys his work and his location: "As for many people who work outside the capital, London had an appeal when I was younger and I considered relocating there, but I've now got over that phase. Leeds is my home town. I like living here and I'm committed to working for a mutual organisation rather than a plc, where you're at the behest of shareholders."

There is little pressure from members for a change. At the AGM, Leeds asks members to vote in support of its directors, who put themselves up for re-election every three years and promote the values of remaining an independent mutual.

"We always get good turnout and support is typically well over 90%," says Riley. "We like to think that this support reflects the fact that, despite the demise of the Dunfermline, the financial crisis has demonstrated the benefits of mutuality. We believe the building society movement offers a valuable alternative to banking with a plc."

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