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Co-operative & Community Benefit Societies and Credit Unions Bill [HL]

Bill No 50

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This Bill was introduced in the 2008-9 session as a Private Members Bill by Malcolm Wicks. Progress on that Bill was delayed in the House of Lords and the original Bill fell at the end of the session. The new Bill is a private member's bill introduced into the House of Lords and incorporates changes to reflect points made during the Lords stages of the previous Bill. It has been introduced with government support and is introduced in the Commons again by Mr Wicks.

The Bill is the latest in a series of measures which have reformed and modernised the regulatory position and commercial organisation of what is often described as the 'third sector' in financial services: the loose grouping of organisations with mutual status and whose classifications reflect their industrial origins such as the industrial and provident societies and credit unions.

Timothy Edmonds

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Summary

This Bill was introduced in the previous session as a Private Members Bill by Malcolm Wicks. It has government support. It was reintroduced, with amendments, this session in the House of Lords. It seeks to liberalise aspects of the regulatory framework that applies to bodies in the 'third sector' which includes everything from the Co-operative movement to small credit unions. The main reforms proposed in the Bill are:

- to require new industrial and provident societies (other than credit unions) to be registered as co-operative or community benefit societies;
- to re-name the Industrial and Provident Societies Acts;
- to apply the *Company Directors Disqualification Act 1986* to industrial and provident societies;
- to give the Treasury powers to apply to industrial and provident societies, with appropriate modifications, company law on investigation of companies, company names and dissolution and restoration to the register; and
- to give the Treasury powers to make provisions for credit unions corresponding to any provisions applying to building societies.

In parallel with the Bill the Government has proposed a Legislative Reform Order which will make further major changes to the regulatory structure governing industrial and provident societies and credit unions. The reform order will, amongst other things provide for:

Industrial & Provident societies (IPS)

- Abolition of the minimum age for membership and reduce the minimum age for becoming an officer of a society to 16.
- Facilitate the easier dissolution of societies
- Give IPSs the flexibility of choosing their own year-ends
- Remove the requirement on IPSs to have interim accounts audited.

Credit unions

- Broaden the potential membership of a credit union
- Allow credit unions to admit bodies corporate to membership
- Allow credit unions to offer interest on deposits
- Abolish the 8% per annum limit on dividends
- Allow credit unions to charge for providing ancillary services to their members.

1 Introduction

Interest in what is collectively called the “third sector” has heightened recently because of the problems of the mainstream financial service providers. Building societies have openly advertised themselves as safe and ‘boring’ institutions compared with ‘riskier’ banks which have become tainted with high levels of bad debts and their involvement in perceived reckless lending.

At a different scale of activity, credit unions – often tiny organisations, run with volunteers and locally based – are being promoted as an alternative to all sorts of ills in the world of credit finance, from unsympathetic banks to very unsympathetic ‘loan sharks’. Mutuality, in all its guises, has never had such a high perceived standing as now. A guide to the various types of organisation comprising the third sector and some history of legislative attempts to reform it up to this Bill can be found in Section 4 of this Paper.

This Bill, the third in a series of legislative measures, introduces a series of reforms that modernise the governance structure of parts of this varied and sometime fractured sector. Accompanying the Bill is a legislative reform order which will affect both credit unions and provident and industrial societies. An explanation of this order may be found in section 3 of this Paper.

2 The Co-operative And Community Benefit Societies and Credit Unions Bill

The organisation and regulation of the ‘third sector’ is far from simple. Legislation specific to one form of organisation is supplemented by legislation that applies to broader groups. Within the groups, e.g. mutuals, there exists a wide range of dissimilar businesses.

The general history of legislation has been one of incremental deregulation, while maintaining some protection of their assets and purposes. Much of the legislation has been by government supported Private Members’ Bills of which this Bill is the latest.

The Bill was introduced as a Private Member’s Bill in the House of Lords by Lord Tomlinson. Drafting has been assisted by the Treasury and incorporates amendments to the previous Bill lost at prorogation of the previous session. It will be sponsored in the Commons by Mr Malcolm Wicks.

1.1 The Bill

The main objects of the Bill are

- to require new industrial and provident societies (other than credit unions) to be registered as co-operative or community benefit societies;
- to re-name the Industrial and Provident Societies Acts;
- to apply the Company Directors Disqualification Act 1986 to industrial and provident societies;
- to give the Treasury powers to apply to industrial and provident societies, with appropriate modifications, company law on investigation of companies, company names and dissolution and restoration to the register; and
- to give the Treasury powers to make provisions for credit unions corresponding to any provisions applying to building societies.

Explanatory Notes on the Bill (produced by the Treasury) are available on the internet[1] as is the Bill[2] itself.

The legislation has been broadly welcomed by the groups most affected by it. For example,

The Co-operative Party:[3]

> The outcome of this Bill could be of tremendous significance for the mutual sector and the wider economy- putting co-operatives on an equal footing with proprietary companies in a number of respects and so allowing a renaissance of mutual enterprise.

The Association of British Credit Unions (ABCUL) declared its 'great support' for the original Bill:.[4]

> "We're delighted to welcome new legislation for co-operatives and credit unions," says Helen Barber, Head of Legal Services at Co-operativesUK. "We have been working with the Treasury for some time to modernise the laws that cover our sector and this Bill is a valuable step forward on the road to reform."

Other issues put forward by the industry in the consultation on the legislative reform order (LRO) (see section 3 of this Paper) are included in the Bill but not in the LRO.

The Bill has a significant impact on the governance of Industrial and Provident societies:

- The term 'Industrial and Provident is seen as being old fashioned hence, under Clause 1 societies will be renamed as either co-operative societies or as community benefit societies. Under Clause 2 legislation referring to industrial and provident societies will be similarly renamed.

- Clause 3 will apply the *Company Directors Disqualification Act 1986*, which enables directors guilty of a variety of offences to do with the mismanagement of a company to be barred from holding office, to societies – it already does to other mutuals. Similarly, the provisions for striking off a company are applied to societies. In this case the society will have its registration cancelled. New societies will have to register – not be regulated – with the FSA

- Clause 4 concerns the application of aspects of company law, such as the investigation of companies and their affairs and share dealings and the regulation of company names to societies Order of the Treasury. The Bill gives the Treasury great flexibility in applying relevant parts of company law to societies. The Explanatory notes state:

  > Subsection (1) gives to the Treasury the flexibility to decide whether to apply existing provisions or to make new, equivalent provisions and, in either case, to make appropriate modifications. These powers will enable the Treasury to choose the most appropriate legislative technique to apply relevant provisions of company law to industrial and provident societies and to make modifications so as to adapt company law to the potentially different requirements of industrial and provident societies. For example, it is possible that the FSA, which is the registrar for industrial and provident societies, will take for industrial and provident societies some of the responsibilities that

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[1] http://www.publications.parliament.uk/pa/cm200809/cmbills/014/en/09014x--.htm
[2] http://www.publications.parliament.uk/pa/cm200809/cmbills/014/09014.i-i.html
[3] Co-operative Party website
[4] ABCUL press release 27 January 2009

> the Secretary of State has for companies in respect of investigations and ordering a change of name.

The Bill also has implications for credit unions:

Clause 5 in the Bill gives the Treasury the power to apply to credit unions any enactment applying to building societies. This would allow changes to be made to bring credit union law in line with building society law on specific issues. A number of provisions of the *Building Societies Act 1986* deal with issues specific to institutions which accept deposits and could be relevant to credit unions. These include requirements to provide a summary financial statement to members and depositors, audit and accounts requirements, rules on electronic voting, issues relating to directors and governance matters and duty to disclose interests, ownership of subsidiaries and prohibition on floating charges and restrictions on dealing in derivatives and certain other financial instruments. Some key aspects of credit union legislation cannot be changed, such as the use of the name credit union and regulations regarding deposit taking.

Clause 7 of the Bill deals with general matters relating to the power of the Treasury to make Orders under previous Clauses in the Bill. By virtue of this Clause, all subsequent Orders will be determined by the affirmative procedure.

Lords second reading

The Bill had its second reading in the Lords on 11 December 2009. As the Bill's sponsor, Lord Tomlinson, pointed out, the Bill is only one part of the reform package many features will be made via a later legislative reform order to be published by the Treasury. He said:[5]

> I do not propose to go over all the background to the Bill or to sing the virtues of its subjects. Suffice it to say that, as far as I am concerned, it is axiomatic that co-operatives, community benefit societies and credit unions are good things. They are good of themselves, but they have been working in a very out-of-date legislative framework. The Bill, taken together with the legislative reform order which the Treasury will be introducing, makes the legal framework fit for the 21st century.
>
> I mention the legislative reform order because the Bill arises from a wide public consultation on co-operatives, community benefit societies and credit unions. Everything that can be done by way of a legislative reform order will be introduced by the Treasury in that form, but essential parts of the outcome of the public consultation depend on primary legislation, and the Bill addresses that. As I said, the Bill forms part of a package to reform legislation affecting industrial and provident societies and credit unions.

Lord Tomlinson outlined how the current Bill differed from its predecessor.[6]

> The Bill contains the same substantive changes to legislation that were set out in its predecessor, but the concerns that were raised about it form the basis of the amendments. The Delegated Powers Committee supports the amendments to the Bill and the Constitution Committee, in its first report for the Session 2009-10, which was published yesterday, also supported the changes. In essence, the concerns were in connection with powers granted to the Treasury to import measures from the Companies Act in relation to industrial and provident societies under Clause 4 and to apply building society law to credit unions under Clause 5. Specific concerns were

[5] HL Deb 11 December 2009 c1241
[6] Ibid c1243

> expressed in respect of the powers granted to the Treasury to create criminal offences and of the fact that there was no express duty in the Bill to consult before making regulations under Clause 4. In addressing these concerns, I draw your Lordships' attention to Clauses 4(7)b and 5(1), which ensure that the Government can create offences only in circumstances corresponding to the offence in the legislation being applied and subject to a maximum penalty no greater than is provided in the corresponding offence. Additionally, I refer your Lordships to Clause 4(8), which makes explicit the requirement to consult before assimilating company law measures into industrial and provident society legislation. Such a requirement to consult in relation to building society law and credit unions existed in the previous draft of the Bill and is contained in Clause 5(6).

There was a short second reading debate and because no amendments were proposed for committee or expressions of interest to speak at committee there was no Lords committee proceeding.

3 Legislative Reform Order

Of considerable importance to the mutual sector, arguably of greater impact than the current Bill, are the Government's proposals, following consultation, contained in a legislative reform order for both credit unions and Industrial and Provident societies (IPS).[7]

The key proposals contained in the legislative reform order were outlined in a Treasury explanatory document published in November 2009.[8] They were:

> Amendments to the Industrial & Provident societies Acts of 1965 and 1968.
>
> A1 Abolish the minimum age for membership and reduce the minimum age for becoming an officer of a society to 16.
>
> A2 Remove the restriction on the maximum holding of non-withdrawable shares in an IPS
>
> A3 Amend the provision on charging a fee for a copy of a society's rules
>
> A4 Facilitate the easier dissolution of societies
>
> A5 Give IPSs the flexibility of choosing their own year-ends
>
> A6 Remove the requirement on IPSs to have interim accounts audited.
>
> Amendments to the Credit Unions 1979 Act
>
> B1/2 Amend the requirements for membership of a credit union
>
> B3 Reform restrictions on non-qualifying members of credit unions
>
> B4 Allow credit unions to admit bodies corporate to membership
>
> B5 Allow credit unions to offer interest on deposits
>
> B6 Abolish the 8% per annum limit on dividends

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[7] LRO laid in accordance with S14 of the *Legislative Reform Act 2006*. Further details may be found in a Library Paper on the Bill at http://hcl1.hclibrary.parliament.uk/rp2006/rp06-006.pdf

[8] HM Treasury, Legislative Reform Order, November 2009

B7 Amend the "attachment of shares" provisions

B8 Allow credit unions to charge the market rate for providing ancillary services to their members.

A summary of some of these measures, together with comments from respondents, edited from the Treasury document, are shown below:

3.1 Industrial & Provident societies

Proposal A1: Membership age

4.3 Section 20 of the 1965 Act enables minors between the age of 16 and 18 to join a society unless its rules provide otherwise, but not to become an officer of a society. 4.5 Article 8 of the draft Order amends the 1965 Act to provide for persons under the age of 16 to become members and to reduce the age limit for becoming an officer to 16. Societies retain the ability to make contrary provision in their rules. Consultation respondents welcomed the proposal to amend section 20, commenting that it would not only allow for creative engagement with the younger generation but would engender a sustainable membership amongst the next generation.

Proposal A2: Remove the restriction on the maximum holding of non-withdrawable shares

4.7 At present, subject to limited exceptions, the maximum shareholding which any one member may have in an IPS is limited to £20,000. This constitutes an unnecessary obstacle to productivity, as it prevents members from investing more than £20,000 in the society and so allowing the society to expand and invest. The limit is particularly onerous for agricultural cooperatives which use their share capital for capital investment in plant and machinery as it restricts the total amount of investment such societies may make. It also constitutes an obstacle to profitability, as increased investment from their members could increase societies' opportunities to diversify or expand their business and in turn improve their profitability.

4.8 IPSs may issue shares which are transferable i.e. which can be transferred to another person who also qualifies for membership of the society and / or withdrawable i.e. which the member can withdraw and receive the value of the shares from the society. The proposal to remove the limit on shareholding was limited to non-withdrawable shares as doing this for withdrawable shares could have unintended consequences in terms of the application of European banking rules and money laundering regulations to IPSs.

4.10 Article 3 of the draft Order amends s6 of the 1965 Act so that the £20,000 limit will not apply to shares which are not withdrawable.

4.11 The Treasury has power to raise the £20,000 limit in S6 of the 1965 Act but in doing so would not be able to distinguish between withdrawable and non-withdrawable shares. Use of this power would therefore be an inadequate means for securing the policy objective.

Proposal A3: Amend the provision on charging a fee for a copy of a society's rules

4.13 Section 15 of the 1965 Act prevents a society charging more than 10 pence for a copy of its rules. This limit does not reflect the actual cost of such provision and therefore constitutes a financial burden.

4.15 Article 7 of the draft Order amends the 1965 Act to enable societies to specify a fee not exceeding £5 for the provision of rules to non-members. Thus societies will no longer be able to charge members for provision of the rules but will be able to cover the cost of providing copies

Proposal A4 Facilitate the easier dissolution of societies

4.18 Under the 1965 Act a solvent society wishing to dissolve must prepare an instrument of dissolution, which must be signed by not less than three-quarters of the members of the society. This requirement makes it difficult for societies to dissolve, particularly if they have lost touch with a significant number of their members. Without being dissolved a society remains encumbered with having to confirm to statutory requirements such as filing annual returns. In addition the FSA is still required to perform its statutory requirement as registrar for dormant societies.

4.19 Consultation respondents were supportive [...] but wished some safeguards to be put in place to prevent an extant society from being dissolved and allowing demutualisation by the back door.

4.20 Article 9 of the draft Order provides for an easier route for dissolution based on the model of transfer of engagements to another society. Under this procedure (a) only two-thirds rather than three-quarters of those who vote must agree; and (b) there is no requirement for at least half of the qualifying members of the society to have voted. The additional safeguards are that, in the case of IPSs, the society must be dormant to be able to use this procedure; and in the case of credit unions, the dissolution must be confirmed by the FSA.

Proposal A6: Remove the requirement on IPSs to have interim accounts audited

4.28 Under the 1968 Act those IPSs which choose to publish interim accounts are required to have them audited. This is in contrast to the position for companies, which are not required to have their interim accounts audited.

4.29 Article 10 of the draft Order reduces this burden by providing that a society can publish interim accounts provided that they are published alongside the last published year-end accounts and are clearly identified as unaudited interim accounts.

4.30 Consultation respondents were supportive of this proposal.

3.2 Credit unions.

Proposal B1/2: Amend the requirements for membership of a credit union

4.32 Under the 1979 Act membership of a credit union is based on the concept of a "common bond" between its members. S1 of that Act provides that a society may be registered as a credit union if it is shown, to the satisfaction of the FSA that, among other things, admission to membership is restricted to certain specified membership criteria "and that in consequence a common bond exists between members of the society".

4.33 The Treasury proposed to remove the additional "common bond' requirement and allow credit unions to provide for more combinations of membership qualifications than is possible under the current legislation. The membership qualifications would be renamed "common bonds".

4.34 To prevent credit unions becoming too big, a new "potential field of membership" test would be created with a maximum of 1 million potential members.

4.35 Consultation respondents agreed that current membership requirement is overly restrictive and strongly supported allowing credit unions to provide for any combination of common bonds. They suggested that a 2 million limit of potential members would be more appropriate and that the numerical limit should only apply to common bonds relating to locality (e.g. residing or being employed in a particular locality) as other common bonds (e.g. being employed by a particular employer) would be naturally limited.

4.36 Article 13 of the draft Order removes the requirement on a credit union to show that a common bond exists between members of the society. It renames the existing membership qualifications "common bonds" and allows for credit unions to provide for membership under any combination of those common bonds. It imposes a new "potential field of membership" test which a credit union must meet if one or more of its common bonds relate to locality. The requirements of that test are: (a) that the number of potential members of the society do not exceed two million; and (b) that it is reasonably practicable for every potential member to participate in votes of the society, serve on the society's committee and have access to all the services offered by the society.

Proposal B3: Reform restrictions on non-qualifying members of credit unions

4.38 The 1979 Act restricts the number of non-qualifying members a credit union may have to a maximum of 10 per cent. Non-qualifying members are members who cease to fulfil the qualifications for admission to membership: for example, they are no longer resident in the locality or employed by the relevant employer.

4.39 The Treasury considers this artificial restriction to be an unnecessary burden on credit unions. In today's mobile society it is increasingly likely that individuals will change employers, move to different parts of the country or alter their lifestyle in other ways which mean they no longer qualify for membership of a particular credit union.

4.40 Consultation respondents were supportive of the Treasury's proposal to repeal the 10% limit, taking the view that members should not have to change their financial services provider purely because they had moved house or job. Respondents preferred the concept of permanent membership based on the tenet that once a member, always a member.

4.41 Article 16 of the draft Order repeals the 10% legislative limit on non-qualifying members, leaving credit unions free to set their own limits via their rules.

Proposal B4: Allow credit unions to admit bodies corporate to membership

4.43 At present the 1979 Act explicitly prevents credit unions from admitting bodies corporate to membership. In addition the membership requirements are not designed for individuals becoming members on behalf of unincorporated associations or partnerships.

4.44 The Treasury considers this to be an unnecessary burden on credit unions, constituting an obstacle to productivity. [...]

4.45 The Treasury therefore proposed repealing the restriction on corporate bodies becoming members, subject to safeguards setting a limit on the percentage of such bodies and the number of shares to be held by them. The Treasury also proposed creating a new class of shares, called deferred shares, to be offered to corporate bodies. The purpose of deferred shares is to provide a mechanism for bodies corporate to invest in a society, to give it support and strengthen its finances, without allowing them excessive influence over the society by being able to withdraw their shares.

4.46 Consultation respondents were divided on this proposal. The majority welcomed the potential for corporate membership while others took the view that membership should be based on individuals and the inclusion of corporate members would create a burden on societies and detract from the core principles of one member one vote.

4.47 A number of respondents were concerned that allowing credit unions to offer only deferred shares to bodies corporate would limit their ability to offer services to corporate members. They argued that many local community groups and charities were incorporated and so would be unable to use the credit union for day-to-day banking and other services. They pointed out that a significant number of credit unions would like to be able to provide services to small, incorporated businesses and social enterprises. In response to this the Treasury has accepted the case for allowing flexibility for credit unions to be able to offer either ordinary shares or deferred shares to corporate members.

4.48 Respondents were generally supportive of proposals to limit the proportion of corporate members in a credit union compared to individual members, and to limit the proportion of shares and loans held by these members. They saw this as an important safeguard to prevent corporate members from wielding undue influence over the operations of the credit union.

4.49 Article 15 of the draft Order provides for credit unions to admit corporate bodies and individuals acting on behalf of unincorporated associations or partnerships to membership, if its rules so provide. However the number of corporate members is limited to 10% and the number of shares, other than deferred shares, held by corporate members cannot exceed 25%.

4.50 Article 13 of the draft Order makes specific provision for membership criteria in relation to corporate bodies. It also requires credit union rules to make provision for terminating the membership of corporate members or the repayment of shares in order to comply with the limits set out above.

4.51 Article 17 of the draft Order creates a new class of shares called deferred shares which can be offered to any member of a credit union. The key feature of deferred shares is that the principal can only be repaid to the shareholder if (a) the credit union is wound up or dissolved and creditors have been paid in full; or (b) the FSA consents to repayment.

Proposal B5: Allow credit unions to offer interest on deposits

4.53 Under the 1979 Act credit unions cannot offer interest on members' deposits. They can only offer a discretionary dividend. The Treasury takes the view that this puts credit unions at a disadvantage in comparison with banks and building societies which do not have this restriction.

4.54 Consultation respondents agreed that credit unions should be able to offer interest on members' deposits subject to the safeguards set out in the consultation document, which have been carried over into the draft Order.

4.55 Article 19 of the daft Order will allow credit unions to offer interest-bearing shares, provided that certain conditions are met. These conditions are:

• the credit union's rules provide for interest-bearing shares to be offered;

• its most recent year end balance sheet has been submitted to the FSA;

• that balance sheet shows that it holds reserves of at least £50,000 or 5% of its total assets, whichever is greater; and

• its auditors state that the systems of control of the credit union are adequate to manage the payment of interest on shares.

Proposal B6: Abolish the 8 per cent per annum limit on dividends

4.58 The 1979 Act prevents credit unions from paying a dividend in excess of 8 per cent per annum. This restricts productivity as it limits credit unions' ability to innovate by offering a range of savings products which could include products which would attract a higher rate of dividend.[...]

4.59 Consultation respondents agreed with the Treasury's proposal to abolish this limit, some taking the view that there were already safeguards in place to allow members at an AGM to vote on a dividend proposed by directors. The FSA suggested maintaining the limit on dividends where a credit union dissolves to prevent any surplus going to members rather than charity (as specified in the current legislation).

4.60 Article 21 of the draft Order restricts the application of the 8% limit so that it only applies on dissolution of a credit union.

Proposal B7: Amend the "attachment of shares" provisions

4.62 Under the 1979 Act a credit union member has to obtain the permission of the credit union Board to make a withdrawal of shares, where this would reduce the member's shareholding to less than his total liability to the credit union. This is in contrast with the position of a bank or building society customer who does not face such restrictions and can in general withdraw savings or use a current account without the permission of the bank or building society.

4.63 The Treasury originally proposed amending the 1979 Act so that the credit union's permission is not required for such withdrawals unless the rules of the credit union specifically require it.

4.64 A number of respondents, particularly those representing credit union boards were opposed to this proposal on the basis that the decision on allowing withdrawals below the level of liability should remain a discretionary decision of the Board of Directors. Some respondents were concerned that members would not wish to vote for a provision in the rules allowing the credit union to prevent withdrawals in such circumstances as they may have outstanding loans. This could impact on the liquidity of the credit union and increase the risk of the loan portfolio.

4.65 Taking account of these views, the Treasury modified its proposal so that the decision, while remaining with the Board of Directors, is taken at the time a person takes out a loan rather than at the time a person, to whom a loan has been made, tries to make a withdrawal that would decrease his shareholding below the amount of the loan. This ensures that the position is made clear to the borrower at the time he takes out the loan rather than relying on the discretion of the Board when trying to make a withdrawal at a later date.

4.66 Article 18 of the draft Order therefore repeals section 7(5)(b) and inserts a provision into section 11 (loans) requiring the terms of a loan (other than a secured loan) to include provision as to whether for the duration of the loan the borrower or guarantor is to be permitted to withdraw shares which would reduce his shareholding to less than his total

liability. Article 27 provides that the repeal of s7(5)(b) will not apply in relation to loans made before the draft Order comes into force.

Proposal B8: Allow credit unions to charge the market rate for providing ancillary services to their members

4.68 Under the 1979 Act credit unions may only charge on a cost-recovery basis for services which are ancillary to accepting a deposit or making a loan, such as making or receiving payments, issuing and administering chequebooks and money transactions.[...]

4.69 Consultation respondents were in favour of allowing credit unions to charge market rate for such services. Respondents explained that in the past credit unions have been put off from developing new services to meet the needs of their members because of the difficulties in calculating the exact cost of providing the service. They were therefore of the view that this proposal would assist credit unions in developing new services in response to the changing needs of an expanding membership.

4.70 Article 20 of the draft Order replaces the current provision in s9A(1) of the 1979 Act with a provision allowing a credit union to charge such fee as it considers appropriate for ancillary services.

4 The Third Sector in financial services

The Government produced its *Third Sector Review*, following a consultation with the sector, in July 2007.[9] At this point one can struggle with the definitions. The Third Sector includes mutuals, co-operatives, credit unions, social enterprises, community interest companies and charities. Several of these groups break down into different constituencies, for example mutuals includes Industrial and Provident Societies and Friendly Societies but each has separate lines of reporting and regulation – something the current Bill aims to end. The following sections will try to outline the key features and development of some of these sectors.

1.2 Social enterprise

This is the broadest definition of third sector operations. Social enterprises (SE) come in a variety of forms and cover a wide range of activities. Common understanding of what an SE is what it can do and where enterprises end and charities and companies begin is often 'fuzzy'. It might be worth, therefore starting with some definitions.

The SE sector is well established in the UK and is represented by the Social Enterprise Coalition (SEC) which has a considerable amount of material about the sector on its website at: http://www.socialenterprise.org.uk. SEC defines social enterprises as:

> Social enterprises are businesses that trade in the market with a social purpose. They use business tools and techniques to achieve social aims and include an incredibly wide range of organisations, for example co-operatives, development trusts, community enterprises, housing associations, social firms, and leisure trusts.[10]

[9] *The future role of the third sector in social and economic regeneration*; HM Treasury Cm 7189, July 2007
[10] See website

The more easily remembered definition is 'businesses trading for a social purpose'. The BERR Small Business Service (SBS) has its own variants on this theme. The Global Entrepreneurship Monitor (GEM) offers:

> Social entrepreneurship is any attempt at new social enterprise activity or new enterprise creation…by an individual, teams of individuals or established social enterprise, with social or community goals as its base and where the profit is invested in the activity or venture itself rather than returned to investors.[11]

Examples of well known social enterprises include Welsh Water, Café Direct, The Big Issue, the Co-Operative Group and Loch Fyne Oysters.

The Government published its *Social Enterprise Action Plan: scaling new heights* in November 2006.[12] This document set out how subsequent government support for the sector will be carried forward, and, on the second anniversary of the plan a progress report was published which includes a list of case studies which may be of interest.[13] A considerable amount of detailed information about the sector can be found on the following BERR website: www.businesslink.gov.uk/socialenterprise.

Community Interest Companies

Community Interest Companies (CICs) have received considerable attention. It is hoped that they provide an operationally beneficial, alternative form of corporate identity for SEs. Information specifically on CICs can be had from the following website: http://www.cicregulator.gov.uk/ It summarises CICs as being:

> Community Interest Companies (CICS) are limited companies with special additional features created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. This is achieved by a "community interest test" and "asset lock", which ensures that the CIC is established for community purposes and the assets and profits are dedicated to these purposes. Registration of a company as a CIC has to be approved by the Regulator who also has a continuing monitoring and enforcement role.
>
> CICs were established by the *Companies (Audit Investigations and Community Enterprise) Act 2004.* Although a comparatively new form of company organisation (since 2005), so there is not yet much of a track record to determine whether they have been a success or not, according to the website there are now nearly 2,500 CICs so there would appear to be considerable interest in this type of corporate form.

1.3 Mutual societies

The first point one might make about the mutual sector is that although it is financially dominated by building societies it remains a diverse sector.

A Treasury paper – on changes to building society law – note "mutual societies are, broadly speaking, societies registered under the Building Societies, Friendly Societies and Industrial & Provident Societies Acts."

> They are:

[11] London Business School, *Social Entrepreneurship Monitor UK 2006, p 5*

[12] *Social Enterprise Action Plan:*

Owned/controlled by their members;

Run democratically on the basis of one member one vote;

Set up to meet the mutual needs of their members;

Not set up to make profits for external shareholders or primarily provide a return on capital;

Share any surplus or profits (the dividend) with their members.[14]

In addition, the sector is of a considerable size, as "together [it has] over 30 million members and combined total assets in excess of £400 billion. The sector is increasingly important in delivering on Government objectives in relation to financial inclusion and social cohesion."[15] Detailed estimates of the whole sector have been published recently by the group Mutuo:[16]

Sector	Number	Members	Employees	Revenue	Assets
		000's		£millions	
Building Societies	55	23,038	51,578	4,700	360,000
Friendly Societies	200	6,000	4,600	2,271	17,500
Mutual insurers	33	10,564	20,102	3,458	77,000
Co-operatives	2,753	9,008	159,434	20,124	6,519
Credit unions	480	733	1,079	31	558
Housing Associations	1,879	5,328	143,654	10,800	52
Leisure trusts	120	na	26,000	620	na
Football supporter trusts	155	116	11	5	5
GP Co-ops and Mutuals	40	na	8,000	150	na
Co-operative trust schools	1	na	140	6	na
Clubs & societies	10,000	9,000	25,000	463	220
Employee owned businesses	200	na	110,000	25,000	na
NHS Foundation Trusts	89	1,120	294,610	16,162	14,562
Total	16,005	64,907	844,208	83,791	476,416
Source: Mutuo					

The diversity of the sector would lead one to think one could not generalise about governance issues facing all mutuals, though the then Economic Secretary Ed Balls, in a speech in November 2006, addressed this directly, when he asked "what are the characteristics of building societies and mutuals that make them such a valued addition to our financial services market and society more widely?":

Firstly, as mutual institutions, building societies are owned collectively by their members - investors and borrowers - without external shareholders in the conventional sense. The benefits of efficiency and innovation are passed directly to members. And many operate with lower cost ratios than PLCs.

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[13] *Social Enterprise Action Plan: Two years on.*

[14] HM Treasury, *The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007: a consultation*, September 2008 para 1.3

[15] HM Treasury, *Explanatory memorandum to the Mutual Societies (Transfers) Order 2009 no. [draft]*, January 2009 para 7.3

[16] Mutuo.co.uk, *Mutuals Yearbook 2008* p3

> Secondly, some mutuals serve markets that are often ignored by PLCs. Many specialist markets are served solely by mutuals, with little or no interest from their proprietary competitors … Thirdly, mutuals are well placed to build local loyalty by making a special contribution to local community life and the delivery of public services. They are committed to supporting the communities in which they operate and are often based in the regions, bringing them closer to their customers …
>
> The fourth element, and the crucial ingredient for me [is] the unique combination of trust and reputation that mutuals often develop. Members know that across the vast range of mutual societies that exist they can expect public service and local commitment. And with the increasing transparency of operation they can be confident that there is a relationship of trust and real mutual benefit.
>
> In our modern financial services world, where many financial products are inherently complex, and where competition, technological advances and product innovation is bringing greater complexity still, this trust is an increasingly valuable commodity. There are around 7,000 different mortgages on the market, for example, and over 2,000 different retail investment funds. At a time when we are asking people to do more, to take on more responsibility with inherently difficult products, financial mutuals from building societies to credit unions are playing, and will continue to play, a valuable role as trusted product providers. As more financial responsibility is expected of individuals, I believe that the mutuals sector can continue to grow in size and capability.[17]

Co-Operatives

It is impossible to talk about co-operatives without saying a little about the Co-Operative Group. The group is the biggest element in SE in the UK, (almost a third of total turnover – see below) and reflects some of the ambivalence of these definitions. Few people would feel that, for example, the Smile Internet Bank was anything other than another bank (albeit one with a strong ethical stance). Furthermore, the Group has made much play of its decision to re-introduce the 'divi' card as a way of returning profits to its members. Although the website[18] stresses the amount that has been paid to charities and community groups and gives ordinary members the chance to do the same, there is an obvious source of confusion between shareholders and members. If all members just pocketed their profit share the group would be significantly less distributive than it has been in the past. Also the announcement that the Co-Op had bought Somerfield and was now closing down that HQ makes it seem very much like any other profit driven organisation.

More recently the Co-Op has taken advantage of new legislation (*The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007* another Private Member's Bill) and has merged with the Britannia Building Society.

Building societies

The history of changes to building society law over the last 20 years is not dissimilar to that of credit unions – deregulation and encouragement to develop away from their traditional model.

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[17] HM Treasury press notice, Speech by Economic Secretary to The Treasury, Ed Balls MP, to the Building Societies Association's annual lunch, London, 9 November 2006

[18] http://web.archive.org/web/20070102164309/http://www.co-operative.co.uk/en/beingamember/shareintheprofits/

This began with the *Building Societies Act* 1986. Arguably, the funding/ business relaxations were less important in the long term than the other parts of the Act, namely that which allowed them to convert to public limited companies. With respect to their business, the Act allowed the societies to diversify into what were called class 3 assets. These assets could include unsecured personal loans up to £5,000, overdrafts and investments in shares and land. Class 3 assets could not exceed 5% of total assets.

The next major Act was the *Building Societies Act* 1997. This had a number of innovations. The 'principal purpose' of a society was widened to include the making loans secured on residential property'. The Act also provided for a building society to have those powers which are conferred on it by the society's memorandum, subject to legislation. So, for example, the society could be far more self determining than it could have been in the past. Previously the Act was the main source of a society's powers, and the change reflects the shift towards a permissive regulatory regime where a society was broadly free to engage in any type of business.

The Act also allowed for loans secured on residential property to form only 75 per cent of a society's total or group assets (the 'lending limit') – down from 95% under the 1986 Act. The Treasury is given the power to reduce the lending limit by order to a minimum of 60 per cent, whilst the Building Societies Commission could modify the calculation of assets in relation to subsidiaries.

Section 7 of the 1997 Act established a funding limit: at least half a society's funds must be raised from its members in the form of shares (that is, funds placed in investment accounts by members of the society). Previously virtually all a societies' funding had come from retail deposits. This, and the limit on the proportion of loans to be used for residential purposes, was referred to as 'nature limit' limits that would ensure that societies maintained their traditional business focus.

The next significant change that affected the societies was the *Building Societies Act 1986 modification of the Lending Limit and Funding Limit Calculations) Order 2004*.[19]

The key part of the Explanatory Memorandum accompanying the SI is shown below:

> One of the requirements of the standards adopted under the IAS Regulation is that securitised assets will be shown on the balance sheet at gross value. This creates an unintentional complication for building societies owing to the statutory restrictions on funding and lending activities that building societies are subject to. These restrictions are referred to as the "nature limits" (so called because the aim of these restrictions is to ensure that the mutual 'nature' and characteristics of building societies are preserved). The funding limit requires building societies to receive 50% of their funding in the form of member deposits and the lending limit requires that 75% of a society's business assets must consist of loans secured on residential property.
>
> 4.3 Currently, calculations made to determine compliance with these nature limits are made using figures for assets and liabilities shown on the balance sheet. Thus, when securitised assets are shown on the balance sheet at their gross value, they will also be included in the nature limits calculations at their gross value. At present, securitised assets are shown net on the balance sheet and are thus included in the nature limits calculations at their net value. Therefore, the effect of this for some building societies will be serious. For example, in the funding limit calculation, some societies will see the proportion of their assets which consist of non-member deposits increase overnight,

[19] SI 2004/3200

> thus exposing building societies to the risk of being in breach of their statutory nature limit requirements.
>
> 4.4 This Statutory Instrument therefore modifies the amount taken into account in respect of securitised assets for the nature limits calculations, so that such assets and their related liabilities are included at net value, as now, regardless of how they are included in the accounts of the society. Therefore societies which use IAS to prepare their accounts will not be put at risk in terms of measuring compliance with the nature limits.[20]

A summary of this might be; prudent accounting standards recommended a treatment of securitised assets which threatened to limit the ability of societies to use more innovative forms of funding without breaking their traditional values. The conclusion: change the law.

Credit Unions

The Association of British Credit Union Lenders (ABCUL) gives a brief introduction to the origins of the movement:

> The ideas and values which are central to how credit unions work were developed in the 19th century; in Britain by pioneer co-operators such as Robert Owen; in Germany by innovators such as Herman Schulze-Delitzsch; and in North America, where Alphonse Desjardin was mapping his vision of co-operative credit. The credit union movement grew quickly throughout America and Canada and quickly became an influence for the rest of the world. [21]

A credit union taskforce established by the Treasury in July 1998 described the then regulatory structure and range of activities allowed to credit unions.

> CUs are registered and regulated by the Registry of Friendly Societies under the Industrial and Provident Societies Acts 1965 to 1968 and the Credit Unions Act 1979. Members save by subscribing for non-transferable shares deposited with the credit union; and may take out loans, at a maximum rate of interest of 1% per month.
>
> 3. The objects of credit unions, as defined by the 1979 Act, are:
>
> the promotion of thrift among the members by the accumulation of savings;
>
> the creation of sources of credit for the benefit of the members at a fair and reasonable rate of interest;
>
> the use and control of the members' savings for their mutual benefit; and
>
> the training and education of the members in the wise use of money and in the management of their financial affairs.
>
> 4. Membership is restricted to those who meet the qualification - the common bond - for a particular credit union. This may be one of four main types: residence in a locality; being a member of, or having an association with, an organisation; working for a common employer or in a locality; and following a particular occupation. The common bond is unique to CUs and is based on the simple idea that members will know each other and will be able to exert moral pressure to ensure that loans are repaid. Its effectiveness is demonstrated by bad debts being, on average, less than 1% of loans.

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20 http://www.opsi.gov.uk/si/em2004/uksiem_20043200_en.pdf

21 ABCUL website

Most credit unions are largely run by unpaid volunteers, providing services to people who may have no dealings with the commercial banking sector.

5. Each share in a credit union is fixed by statute at £1. The maximum saving permitted is £5,000 or 1½% of the total shareholding of a credit union, whichever is the greater. A credit union may accept deposits only as subscription for its shares. It may pay a dividend on shares, not exceeding 8%, after all expenses and taxes have been accounted for. The normal range of dividend payments among employment-based CUs is between 3 and 5%. Community CUs typically pay dividends in the range 1-3%, once established; many pay no dividend at all for the first three years, or indeed ever.

6. In most credit unions loans may be made to members up to a maximum of £5,000 in excess of their share capital. So a member with the maximum of 5,000 shares may borrow up to £10,000. Loans are repayable over two years if unsecured, and over five if secured. Most loans are under £1000. Interest charged on loans may not exceed 1% per month on the reducing balance (12.68% APR maximum). Credit unions may borrow short term from other credit unions and from authorised banks, and may hold their surplus on deposit subject to restrictions. (Broadly they are restricted to current and deposit accounts with building societies and banks). Credit unions may apply to the Registrar for a certificate under Section 11C of the 1979 Act which allows them to lend greater amounts to individual members over a longer period. The Registrar needs to be satisfied that there are appropriate policy manuals documenting the systems, and committees in place to manage the functions - in particular loans and internal audit/supervisory committees.[22]

A table showing the physical assets of the movement is shown below.

Credit Union Statistics			
£ thousand			
Period ending	31/12/2006	31/12/2007	30/08/2008
Number of members at end of	576,545	624,482	652,163
Share capital	436,187	464,774	478,499
Total loans to members	379,921	420,193	455,159
Bad debts written off	920	1,429	4,800
Total assets	520,950	561,496	592,531
Source: ABCUL FSA returns			

By international standards credit union penetration in Great Britain, despite some recent growth, is fairly low. Ireland Australia and the US have far higher levels of participation. The percentage of the population which is a member of a credit union is about half in the Republic of Ireland, 30 per cent in North America and 20 per cent in Australia.[23] Northern Ireland has a separate registry and is more closely linked to credit unions in the Republic than the rest of the United Kingdom. It has more members of credit unions in than in the rest of Great Britain: 267,000.[24]

For a sector of such relative small scale there has been an immense effort to reform it. Over the last fifteen years there have been a series of reports and reviews and legislative consultations and proposals all working broadly towards the same end of liberalising the

[22] *Credit Unions of the Future*, chapter 1, November 1999

[23] *Credit unions of the future: Taskforce report, Para 20*

[24] Ibid., Para 18

sector and encouraging its growth and thus allowing credit unions to become bigger and more 'mainstream'.

In 1994 the Joseph Rowntree Foundation and the National Consumer Council both published reports recommending future reforms. A 1996 deregulation order made some of these changes, including expanding the maximum shareholding and modifying the common bond requirement. Following further calls for reform and expansion from the Commission on Social Justice, initiated by the late John Smith MP[25] and, later, the National Consumer Council, in July 1998, the Treasury taskforce quoted above was established. The taskforce case for expanding credit unions was that they could assist in combating financial exclusion, which it saw as both a cause and a result of social exclusion.[26] It has been the financial exclusion policy imperative that has largely driven forward regulatory changes for credit unions.

This important period in the development of credit unions coincided with the new financial regulatory system ushered in by the *Financial Services & Markets Act 2000* (FSMA). This was a ready made opportunity to change the legislative regime under which the unions had to operate. The then Economic Secretary to the Treasury, Melanie Johnson, announced a series of reforms in November 1999, on the same day that both the taskforce and Policy Action Team 14's (PAT14 the social exclusion team) reports were published.[27] The deregulation initiative was started by a consultation paper issued in November 1998 by the Treasury.[28] The changes removed some of the legislative restrictions which credit unions faced. They included:

- increases in the maximum repayment periods for loans
- greater flexibility in the common bond requirements
- aligning the maximum amount that can be held in youth accounts with that for adults
- removal of the maximum membership limit
- allowing credit unions to charge for ancillary services
- greater flexibility on disposing of re-possessed collateral
- further consultation on increasing the sources from which credit unions can obtain credit, and
- greater flexibility on dividend accounts [29]

Some of these changes were made by the FSMA. Extensions to the maximum loan repayment periods and an increase in the maximum sum permitted in loan accounts came into force through secondary legislation on 1 April 2001.[30]

Credit unions were at this time also brought within the mainstream regulatory scheme of FSMA. Following consultation the FSA maintained the model of a two tier approach, under

25 See *Social Justice* (1994) pp.10-11; 335-340

26 Ibid

27 HM Treasury, 'Enhanced role for credit unions', HM Treasury press release 191/99, 16 November 1999

28 HM Treasury, *Proposed amendments to the Credit Unions Act 1979: A consultation document by HM Treasury*, November 1998

29 HM Treasury, 'Enhanced role for credit unions', HM Treasury press release 191/99, 16 November 1999

30 *Credit Unions (Increase in limits on deposits by persons too young to be members and of periods for the repayment of loans) Order* SI 2001 No 811. See 'Credit unions get improved powers to tackle financial exclusion', HM Treasury press release 31/01, 12 March 2001

which smaller and simpler 'Version 1' type credit unions would be subject to less onerous requirements than 'Version 2' type credit unions.

The current FSA rules are contained in the Credit Union Specialist Sourcebook, part of its regulatory Handbook.[31] Printed out, the rules run to about two hundred pages, and are subject to frequent modification by the FSA. Key requirements under the rules are:

1. Unions can only invest surplus funds in UK and EU banks, or government securities of less than a year's maturity. A union may only hold land or property as a place from which to transact business.
2. Restrictions exist on the source of borrowing by a credit union and on the amount. A version 1 credit union may only borrow up to 20% of its share capital. A version 2 union up to 50% of its capital.
3. Membership. Only individuals may be members, each member must have at least one share. Juvenile (under 16) members may deposit funds (but not buy shares) with a credit union.
4. Common bond. A common bond is "fundamental to the regulatory regime for credit unions".[32] It cannot be extended indefinitely; beyond 1 million members, the assumption is that there can be no bond. The handbook states that:

   It is apparent from the Parliamentary debates on the Credit Unions Act 1979 that persons who had a common bond were envisaged as having some degree of shared identity, a sense of belonging or a collective interest. The *FSA* considers that the bond should be sufficient to encourage members to do some or all of the following:

   - play an active role in the credit union (for example, by volunteering);
   - save regularly;
   - repay loans promptly.

   The sense of obligation to save and repay among the members of credit unions would be greater than among persons dealing with an ordinary commercial provider.

   The determination of a common bond has loosened; however, it remains a complicated matter for the FSA to determine. The Handbook continues:

   "Since the Regulatory Reform (Credit Unions) Order 2003, it is possible for a credit union to adopt a membership qualification combining association and one of the other qualifications set out in section 1(4)(a), (b), (c), (d) or (f) of the Credit Unions Act 1979, as amended (without the need for the *FSA* to approve an additional qualification for each combination, under the power in the tailpiece to that subsection - see CRED 13 Annex 1B). For example, a credit union may now adopt a membership qualification under which some members reside in the locality (but do not belong to a bona fide organisation there) and other members belong to a bona fide organisation in the locality (but do not reside there)."

5. Credit unions are subject to the determinations of the Financial Ombudsman and must co-operate with him.

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[31] FSA Handbook http://fsahandbook.info/FSA/html/handbook/CRED
[32] Ibid Cred 13 Annex 1A 1

6. Loans. Version 1 unions may only lend for less than five years unsecured and ten years secured. No member of a Version 1 union may borrow £15,000 more than their shareholding. The equivalent figures for Version 2 are ten years and 25 years and £15,000, or 1.5% of its total share capital in excess of the borrowing member's shareholding, whichever is the greater.

Several outstanding areas of possible deregulation remained and these were addressed in a further consultation exercise that began with a consultation document issued on 16 October 2001*: Proposed amendments to The Credit Unions Act 1979: A consultation Document by H M Treasury.* The reforms that emerged were included in the *Regulatory Reform (credit Unions) Order 2003 SI 2003/256.* The explanatory note to the SI sets out the main changes made by it:

> Article 3 amends section 1 of the Act so as to permit credit unions to combine the qualification for admission to membership specified in section 1(4)(e) (the associational common bond) with any one of the other qualifications specified in section 1(4), so long as in consequence there exists common bond between members of the society.
>
> Article 4 amends section 3 of the Act. The effect of the amendment is that a body corporate (or an officer or employee of such a body) which has its head office outside England, Scotland or Wales and which is either authorised under the Financial Services and Markets Act 2000 to accept deposits, exempt from section 19 of that Act (the general prohibition) in relation to that activity or subject to legislation that is similar to the relevant legislation that relates to credit unions, may use the title “credit union”. In addition, the Financial Services Authority may give approval to any person or unincorporated association to use the name “credit union”.
>
> Article 5 inserts a new section 9A in the Act. This permits credit unions to charge their members a fee to recover the cost of providing services that are ancillary to the activity of accepting a deposit or making a loan.

A significant loosening of the operational freedom of credit unions was made by the decision to increase the maximum rate of interest that credit unions could charge from 1% to 2% a month. This was affected by order from 1 June 2006.[33] Further change has been announced, but not yet put into effect, by the publication of a draft Legislative Reform Order (see below).

A number of Reports have analysed the current state of credit unions and possibilities for further change and the problems that may arise. The essential difficulty is how does a small local, movement, expand to become major agents of lending and social cohesion given their resource base and skill levels. One such report, by the John Moores University, *Promoting financial inclusion - an analysis of the role of British credit unions in tackling poverty and over-indebtedness in low income communities*, outlines the growth of what it calls the ‘new model’ credit union development. This was based on a view that to survive and grow, unions had to be more professional, business based organisations which serve the needs of the whole community and not just the poor and disadvantaged within them – in a sense a different approach from the government policy which is ‘poor-focussed’.

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[33] *The Credit Unions (Maximum Interest Rate on Loans) Order SI 2006/1276*

The Joseph Rowntree Organisation revisited the sector in 2006 in their Report: *Building Better Credit Unions*.[34] It too highlighted the importance of the development of the new model unions. The recommendations in the Report were:

> 1. Credit union development that concentrates solely on serving the needs of the financially excluded is inherently weak. Development based on a cross section of the population, including affluent sections of society, offers a more viable long-term model. Greater emphasis should be given to this by credit unions, trade associations and the government.
>
> 2. The current trend towards widening of common bonds should be actively encouraged, especially where this facilitates a diversification of membership mix by credit unions.
>
> 3. The widening of common bonds should be accompanied by greater use of credit scoring for loan purposes, given that direct knowledge of members will be diluted and bad debt might otherwise increase without credit scoring.
>
> 4. It is not in the interests of the credit union movement to expect strong credit unions to merge with weaker ones if the result is a weakening in the position of the former.
>
> 5. Given the critical role of volunteer credit union boards, more investment must be made in the training and development of the volunteers who serve on them.
>
> 6. The role of volunteers and their use by credit unions should be further investigated in a dedicated study that takes account of the changing demand for volunteers as affected, for instance, by the growth of professionalism in credit unions, and also the supply of volunteers and the continuing evolution of volunteering policy and practice in different parts of the UK.
>
> 7. Relying on grants to fund the core business of credit unions leads to a dependency culture that ultimately is not conducive to sustainable development. Subvention provided to credit unions should be 'targeted' to particular areas of need (for example, financial exclusion) but not used to fund core business activities or as a substitute for self-reliance on sufficient revenue generated by credit unions themselves.
>
> 8. Greater attention needs to be given to the potential for 'shared services provision' by UK credit unions, particularly in relation to IT. A scoping study supported by all the trade associations would be beneficial.

The perception that credit unions face a difficult future is shared abroad. Even in that bastion of credit unions, Ireland, one commentator examined the movement's challenges:

> Financial products are growing far more complex, as are regulations governing them. As Irish incomes rise, so too have the expectations of financial service providers. Credit unions are finding themselves confronting increasing membership and decreasing voluntary participation. This is combined with increasing resources and increasing pressure to homogenize, regulate and modernize their systems, particularly given the financial integration from the European Union. A key question arises from this tension: can credit unions remain locally driven, locally responsive and still meet the standards of technology and service required by consumers and, increasingly, the state?[35]

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[34] Building Better Credit Unions, Joseph Rowntree Foundation, 2006

[35] *Social Movements or pseudo banks?* J. Mcarthur, Simon Fraser University p11

Faced with the demands of an expanding political agenda on financial capability, social and financial exclusion, encouragement of the third sector and social entrepreneurship plus the willingness of at least significant segments of the credit union movement to maintain the pace of change, the Treasury produced a further document detailing proposals for further change based on consultations held in 2007. In December 2007, it published *Review of the cooperative and credit union legislation in Great Britain.*[36] The key Government commitments are:

Issue	Government response	Implementation options
Q 17 Expansion of membership.	Accepts the view that credit unions need to embrace wider sections of society	No requirement for change.
Q 18 Use of the term "credit union".	No case for change.	
Q 19 Change to "community banks"	No case for change.	
Q 20 a. expansion of Common bond	Accepts the need for liberalisation. Work on housing Association tenants underway.	Further changes would require amendment to the act by a Legislative Reform Order (LRO) or primary legislation.
b. Non qualifying member rules	Agrees non-qualifying member rules can be abolished without undermining common bond concept	Would require changes to the Act via LRO or primary legislation.
c. Minimum age	Is of the view that there should be conformity with Company law	Amend via LRO or primary legislation
d. Restriction on number of members	No case for change.	
e. Prohibition of corporate membership	Accepts the case for corporate membership. Believes this should be subject to a limit.	Would require amendment to Act or primary legislation.
Q 21 Interest on savings.	Accepts the case, subject to safeguards.	Would require amendment to Act by LRO or primary legislation.
Q 22 Auxiliary services	Accepts the need for some flexibility.	Would require amendment to Act by LRO or primary legislation.
Q 23 Electronic communications	Accepts the case. Work underway	Amend using the Electronic Communications Act 2000.
Q 24 Proxy voting.	Accepts the case for larger credit unions.	Would require amendment to Act or primary legislation.
Q 25 Restrictions on transactions with directors.	Accepts the case for aligning with company law.	Amend legislation to allow power to assimilate the law for companies to credit unions, similar to the "Gareth Thomas" power currently available for IPSs.
Q 26 Company Directors Disqualification Act.	Accepts the case for application to credit unions.	Amend legislation to allow power to assimilate the law for companies to credit unions, similar to the "Gareth Thomas" power currently available for IPSs.
Q 27 Assimilation of company and building societies law	Considers such a power should exist.	Amend legislation to allow power to assimilate the law for companies to credit unions, power currently available for IPSs.
Q 28 Copy charges.	Agrees charges should ideally be limited to cost recovery, with provision for credit union membership to decide the figure	Should be at society's discretion and democratic vote.
Q 29 Audited accounts.	Believes audited accounts should be compulsory for all credit unions.	Would require amendment to Act by LRO or primary legislation
Q 30 Reporting issues of concern	Agrees with the sector's views about auditor's ability to report directly to registrar.	Would require amendment to Act by LRO or primary legislation

Source: *Review of the cooperative and credit union legislation in Great Britain.*

[36] Review of the cooperative and credit union legislation in Great Britain. HM Treasury 2007. (ret'd 1 May 2008)

Industrial & Provident Societies

An industrial and provident society is an organisation conducting an industry, business or trade, either as a co-operative or for the benefit of the community, and is registered under the *Industrial and Provident Societies Act 1965*. Industrial and Provident Societies, are not companies, though they may convert themselves into ones. They can only be used by co-operatives societies who have as their object the improvement of the conditions of members of the working classes or otherwise of their community.[37] There are currently over 9,000 such societies. Many of the Friendly Societies are regulated by the Financial Services Authority though only because they undertake authorised activities, such as deposit taking or make loans. Societies such as working men's clubs would not normally be regulated by the FSA. Organisations registered under the 1965 Act cover a wide range of activities. The Treasury 2007 consultation document highlighted the number (140) of football supporters' trusts who own some part of their club.[38]

A recurring feature of the regulation of such companies is how to ensure, in return for favourable treatment, the companies retain their community or charitable focus, and importantly how the profits and assets employed by the organisations remain locked into the community network.

In 2004 the Treasury issued a consultation paper, *Regulatory Issues for Industrial and Provident Societies.* The document noted:

> The community benefit society is one of a number of legal forms available to social enterprises. It is a body run and managed by its members where profits are distributed not back to members (as with co-operatives) nor to external shareholders (as with companies) but to the wider community. The Government recognises the importance of community benefit societies and welcomes their tradition of member engagement, their contribution to the economy and their service to the community. We are keen for community benefit societies to flourish as part of a thriving and strong social enterprise sector.
>
> **1.2** Community benefit societies are incorporated under the Industrial and Provident Societies Act 1965. This provides a legal framework for community benefit societies to operate in and pursue their community goals. However, there is currently nothing in law to prevent societies' assets being distributed to members following conversion to company status. In theory, carpetbaggers could seek to become members of a community benefit society with the aim of forcing a vote on conversion of the society to company status and making windfall profits from accumulated investments over the years. This risk may act as a deterrent to investors keen to ensure that their investments are used as intended and may serve as a barrier to further community benefit society growth.
>
> **1.3** The Co-operatives and Community Benefit Societies Act 2003 contains a provision that gives the Treasury the power, by secondary legislation, to allow community benefit societies to protect their assets for community benefit. This proposal was one of the recommendations of the September 2002 Strategy Unit Report, "Private Action, Public Benefit". The Government supported the 2003 Act in its passage through Parliament as a Private Member's Bill.

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[37] Section 1 Industrial & Provident Societies Act 1965

[38] The future role of the third sector in social and economic regeneration: final report. Cabinet Office. July 2007Jul p47

1.4 This consultation puts forward the Government's proposals for establishing this asset lock option for Industrial and Provident Societies registered as community benefit societies. The Government seeks views from respondents on a range of issues ranging from the procedures for setting up an asset lock to how use of locked assets will be regulated.[39]

[39] Regulatory issues for Industrial and Provident Societies; a consultation document. HM Treasury July 2004.