Co-operative and Community Benefit Societies and Credit Unions Bill – Bill 14 2008/09

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This note provides background to a Private Members Bill being introduced by Malcolm Wicks MP which has government support. 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.

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2 Introduction

- Interest in what is collectively called the third sector" has been heightened in recent months because of the problems with the mainstream financial service providers. Building societies are openly advertising 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 lower level of activity credit unions – often tiny organisations, run with volunteers at times, serving micro-areas – are being touted as the next 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 it does now.

- 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.

3 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 Member's Bills of which this Bill is one.

3.1 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 as is the Bill itself

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

- The Co-Operative Party

    - 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.

- Other issues put forward by the industry in the consultation on the legislative reform order (LRO) (see below) are included in the Bill but not in the LRO.

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

They will be renamed (as will references in statute) as both Industrial and Provident are seen as being old fashioned. Henceforth they will be called the "more modern" co-operative society;

New societies will have to register – not be regulated – with the FSA;

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 - will in future apply to societies – it already does to other mutuals; and

Company law concerning the investigation of companies and their affairs and share dealings and the regulation of company names may be applied to societies by Order of the Treasury.

- The Bill also has implications for credit unions:

    - 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.

3.2 Legislative Reform Order

Of considerable importance to the mutual sector has been the Government's proposals, following consultation, on a Legislative Reform Order for credit unions and Industrial and Provident societies (IPS). These were published by the Treasury on 14 April 2009.[1] The main proposals for IPS's and credit unions are shown below:

Industrial and Provident societies

- **Proposal A2: Modify the rules on share capital**

- 2.8 IPSs may issue shares which are transferable (i.e. which can be transferred to another person who qualifies for membership of the society) or withdrawable (i.e. which the member can "withdraw" and receive the value of the shares from the society).

[1] http://www.hm-treasury.gov.uk/d/consult_lro230708.pdf

Societies must specify in their rules whether shares are transferable or withdrawable (or both) and on what terms.

- 2.9 Under IPSA 65 the maximum shareholding a member may have in an IPS (subject to certain limited exceptions) is restricted to £20,000. The Government's view is that this is unduly restrictive and creates an obstacle to productivity.

- 2.10 The Government therefore proposed that the legislation be amended so that the £20,000 limit only applies to withdrawable shares. There would therefore be no limit on shareholding for transferable shares. As a separate measure the Government proposed to exercise its power under the IPSA 65 to increase the £20,000 limit on withdrawable shares in line with inflation.

- 2.14 The Government proposes to increase the withdrawable share capital limit in line with inflation, using its existing power in IPSA 65, later this year. It will at the same time consider whether to build a periodic review into the legislation.

- 2.15 The Government will use the LRO to change IPSA 65 to enable members to invest more than £20,000 where the shares are transferable. This would create much needed scope for societies to raise capital, provide further investment opportunities for societies and increase the potential for the development of new markets. It is worth noting however that apart from certain available exemptions, a society, which issues transferable shares, may be subject to the FSA's prospectus requirements.

- **Proposal A4: Facilitate the easier dissolution of registered societies.**

- 2.21 Under current legislation, a solvent IPS 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. The requirement to obtain the signature of three-quarters of the members makes it difficult for dormant 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 conform to statutory requirements such as filing annual returns. In addition the FSA is still required to perform its statutory functions as registrar even for a dormant society.

- 2.22 The Government proposed to make it easier for dormant societies to dissolve by providing an alternative procedure to that set out above. The alternative option would enable societies to dissolve, where the instrument of dissolution was approved by special resolution, aligning the procedure with that for conversion or transfer of engagements to a company.

- 2.26 The Government agrees that appropriate safeguards should be in place to prevent an extant society being dissolved but is also mindful of the fact that the retention of dormant societies on the register poses an administrative burden for the registrar. On reflection therefore and at the request of the registrar, the Government will provide an easier route to dissolution for societies based on the model of transfer of engagements to another society and not to a company as was proposed in the consultation. Under this revised 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 added safeguard is that the Order will provide that only dormant societies can use this procedure.

- **Proposal A6: Remove the requirement on societies to have interim accounts audited**

- 2.31 Under current legislation those IPSs which choose to publish interim accounts are required to have them audited. This puts IPSs at a competitive disadvantage with other bodies corporate such as companies, which are not required to have their interim accounts audited.

- 2.32 The Government therefore proposed to modify the legislation so that any society can publish interim accounts; provided they are published alongside the last published year-end accounts and are clearly identified as unaudited interim accounts. This would also apply to credit unions, which are currently subject to a more limited exemption.

- 2.34 The Government will amend the legislation so that an IPS or credit union can publish unaudited interim accounts provided they are clearly identified as such and are published alongside the most recent audited annual accounts.

Credit unions

The proposals for credit unions are more radical than those for IPS in terms of their operational impact and the opportunities they give for unions to move away from their traditional structures and operations. ABCUL representing credit unions was very enthusiastic. It said:

  - It's great news that, following a comprehensive consultation to which we and our members responded, the Government has now finalised proposals for a Legislative Reform Order to update credit union legislation in Britain," says Mark Lyonette, Chief Executive of ABCUL. "This reaffirms the Government's commitment to updating credit union legislation, which is badly needed by the sector if we are to fulfil our true potential in Britain.

  - "In particular, we are delighted that the Government has listened to our calls to increase the limit for a common bond (which determines who can join a credit union) to two million people for geographical common bonds only and not to impose a numerical limit on common bonds which only cover people with an employment or associational link. This will enable credit unions to meet the needs of many more people.

  - "We are also very happy that the Government has decided to allow credit unions to choose whether to offer ordinary shares or deferred shares to corporate bodies. This means that companies and social enterprises, as well as unincorporated bodies and partnerships, will be able to become full members of credit unions, allowing large numbers of organisations to benefit from credit union services for the first time."[2]

- The proposals and conclusions are shown below. Where there is no "respondents views" shown, it indicates broad assent with the proposal.

- **Proposal B1: Replace the "common bond" requirement for credit unions with a "field of membership" test.**

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[2] ABCUL press release 15 April 2009

- 3.4 Under current legislation membership of a credit union is based on the concept of a “common bond”. Section 1 of the CUA 79 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”.
- 3.5 The Government considers that in today’s modern society this definition is overly restrictive and, in addition, creates administrative burdens for the FSA, which must apply the common bond test to any application for registration as a credit union.
- 3.6 The Government proposed to simplify the membership criteria by integrating the “appropriate membership qualification” and the “common bond”. This would create a field of membership requirement, which will be called the common bond, (in keeping with common usage).
- 3.7 The Government further proposed to alter the requirements relating to membership qualifications to allow for more combinations of membership qualifications (to be known as common bonds), to enable credit union membership to be open to more people.
- 3.8 As a safeguard for ensuring that credit union membership and size still stayed within appropriate limits it proposed a new “field of potential members test” under which the FSA would have to be satisfied that the field of potential members was appropriate to a credit union.
- 3.13 The Government notes respondents’ views and agrees that a 2 million membership limit would strike an appropriate balance between giving greater access to credit unions while ensuring that there would be a genuine connection between members of an individual union. The Government agrees that the limit should only apply to credit unions with geographical common bonds and not to those with common bonds based on association or employment. The 2 million limit will also apply where there are different types of bond, and any of them is geographical. In effect where other common bonds are combined with geographical common bonds the overall potential membership limit will be 2 million.
- **Proposal B2: Reform the requirements relating to membership qualifications and rename them “common bonds”**
- 3.14 The Government sought views on two options for amending the requirement relating to membership qualifications:
- • Option A: to allow the combination of only two membership qualifications, unless a further addition of a membership qualification was necessary to allow amalgamation or transfer of engagements (i.e. merger)
- • Option B: to allow a combination of any number of membership qualifications. This would allow for instance a credit union to serve a geographical area along with tenants of two housing associations and employees of two companies.
- 3.17 The Government notes respondents’ concerns in relation to Option B, but considers that there are adequate safeguards in the proposed membership qualifications. It also notes that a majority of respondents favoured Option B. The Government considers that

deferring a decision would unacceptably delay access to credit union services for a wider section of the population. It therefore intends to implement Option B in the LRO.

- **Proposal B3: Reform restrictions on non-qualifying members of credit unions.**
- 3.18 The CUA 79 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.
- 3.19 The Government considered that this artificial restriction was unhelpful especially due to the high mobility of labour. The Government proposed repealing the 10 per cent limit on nonqualifying members and instead allowing credit unions to set their own limits on non-qualifying members via their rules.
- 3.21 The Government will use the LRO to repeal the 10 per cent 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, unincorporated associations or partnerships to membership.**
- 3.22 Under current legislation only individuals can become members of a credit union; bodies corporate cannot become members. Allowing credit unions the flexibility to admit bodies corporate, unincorporated associations and partnerships (‘corporate members’) to their membership would boost the involvement of organisations such as boy scouts/girl guides and other community groups and small businesses, as well as engender community cohesion. The Government therefore proposed to remove the current restriction and make related changes:
- • Repeal the prohibition on bodies corporate becoming members at the discretion of individual credit unions, subject to a maximum of 10 percent of the total membership;
- • Allow unincorporated associations and partnerships to become members of credit unions at the discretion of individual credit unions; and
- • Create a new class of deferred shares that only bodies corporate would be able to subscribe to, and provide limits on the amounts corporate members may deposit with, and borrow from, a credit union.
- **Respondents’ views**
- 3.23 Respondents were divided on this proposal. Some welcomed the potential for corporate membership. Others took the view that credit union membership should at all times be based on individual membership and that the inclusion of corporate members would create a burden on societies and detract from the core principles of one member one vote.
- 3.24 A number of respondents were concerned that only allowing credit unions to offer 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. A

number of respondents suggested that credit unions should be able to choose whether to offer ordinary shares or deferred shares to corporate members.

- 3.25 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.

- 3.26 The Government intends to use the LRO to allow credit unions to admit corporate members. The Government accepts the case for allowing flexibility for credit unions to be able to choose to offer either ordinary shares or deferred shares to corporate members.

- 3.27 The Government agrees with the views expressed by some respondents that there is a risk that corporate membership could crowd out individual member involvement. The Government therefore intends to cap the proportion of membership which is not individual to 10% and to limit the proportion of total assets, and of lending, which may be held by corporate members. The limits in the legislation will be variable by order made by the Treasury. It is the Government's intention to give the FSA the power to amend credit union permissions unilaterally to permit both corporate and private members. This will save credit unions from having to apply individually to seek a variation of their permission.

- **Proposal B5: Allow credit unions to offer interest on deposits, provided certain requirements are met.**

- 3.28 Under current legislation, credit unions cannot offer interest on members' deposits. They can only offer a discretionary dividend. The Government considered that this put credit unions at a disadvantage in comparison with banks and building societies, which do not have this restriction.

- 3.29 The Government proposed to allow credit unions to be able to offer interest on members' deposits, subject to certain safeguards such as a requirement to hold reserves of £50,000 or 5 per cent of its total assets, (whichever is higher) as well as demonstrating that it had adequate systems in place to manage the greater risk of offering interest. Credit unions would then be able to offer both dividend and interest bearing share accounts (although individual accounts would only be able to offer interest or dividends, not both). The figures of £50,000 and 5 per cent will be capable of being varied by an Order made by the Treasury and subject to the negative resolution parliamentary procedure.

- 3.31 The Government will implement this proposal in the LRO, allowing credit unions wishing to retain the dividend to do so. This way only credit unions which wish to pay interest on members' deposits and which can show that they have the financial strength and operational ability to offer interest will be able to do so. In addition, the FSA will consider whether rules covering, for example, systems and controls and liquidity would need strengthening to address risks arising from the contractual obligation to pay interest on an individual's account. The Government recognises that it is important to distinguish between the legislative framework of credit unions and FSA rules that maintain appropriate regulatory safeguards.

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

- 3.32 Credit unions are prevented under the current legislation from paying a dividend in excess of 8 per cent per annum.

- 3.33 The Government proposal sought to remove this restriction and to allow credit unions the flexibility to award an appropriate dividend.

- 3.35 The Government notes respondents' views and will as proposed abolish the 8 per cent per annum limit on dividends and allow societies the flexibility to award an appropriate dividend.