Ian Snaith's Supplementary Submission in response to "notes on points for consultation" on the draft "Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014"

This response has been prepared over a short time and with limited resources. I hope it will be helpful despite those limitations.

Point 1 Prosecutions in Scotland under Section 7A(2) IA 1986

As stated at pages 5-6 of my original submission in response to Question 5 of the Consultation, I prefer to leave the investigation and prosecution function with the BIS insolvency service on the basis that in most cases issues about the mutual nature of the society will not arise as the insolvency will be triggered by commercial failure. The expertise and skill reside with the Insolvency Service and all that is required is an obligation to consult the FCA where issues about mutuality arise or prosecution under the mutuals legislation is considered. The most likely legal process would be director disqualification so it makes sense to put these powers where that will be dealt with. Of course, for credit unions or other societies regulated by them, the PRA would need to be consulted as well.

In this respect IPS's are closer to companies than they are to building societies. This would allow the Scottish system applicable to companies to apply to IPS's. If that view is not taken, a provision for reporting to the Lord Advocate is needed to close the gap in Scotland.

Point 2 Eligibility for Moratorium

I favour the application of the small company criteria to IPS's (see my response to question 6). However, whichever figures are used, there is still the issue of moving from one year of account to another. I think that paragraph 8 does successfully apply the rules to be found in sections 382 & 383 of CA 2006 to societies as you indicate in your text. I think that it would, however, be possible to apply sections 382 and 383 more directly by adopting their "two out of three" criteria on this issue in advance of the application of the same criteria to the accounting requirements imposed on societies.

Point 3 Borrowing powers

Paragraph 44 seems to cover all the specific constraints on society borrowing as far as I can see and paragraph 3(fff) catches any that we have all missed. For those with section 4A permission under FSMA, it would be Rules made under the Act that provided the constraint. In case they are not "enactments" (e.g. rules in the PRA Handbook) could you redraft (fff) to try to catch them thus:

"in either such case, is subject to any provisions of, or binding requirements laid down under, any enactment, and any rules of the society that govern or restrict the exercise of that power"?

Point 4 When are members creditors in relation to deposits rather than just shareholders?

The short answer is rarely. In almost all cases, members' shares are "risk capital" and should have the same priority as company shareholders i.e. no claim until all debts and the costs of the insolvency procedure have been met. I am also unclear what the legal authority is for any member

ever being a creditor in respect of any amount due in respect of their shares in an insolvent society.

Maybe an exception should apply where the shares themselves operate and are regulated as deposit accounts under FSMA. That is the case for credit unions. Any other society having withdrawable share capital is prohibited from engaging in the business of banking and so is unlikely to be regulated under FSMA. Acceptance of any deposit other than in the form of withdrawable share capital requires regulation by PRA under FSMA unless it falls outside the statutory definition of a deposit or some general exemption applies. This is the position that applies to companies. If, which I doubt, any societies still operate a fund under section 11 of IPSA 1965 for the purchase of Government Securities, any such fund is clearly not share capital and would probably not consist of deposits.

From those considerations, I suspect that there are probably no cases, other than credit unions, in which shareholders should be regarded as creditors in respect of their share accounts. It would be interesting to know if the FCA and PRA take the same view. If that were clearly the case, the circumstances in which shareholders would be treated as creditors in respect of their share accounts could be limited explicitly to credit unions and equivalent provisions to e.g. paragraphs 25 and 27(3) of Schedule 1 of SI 2009/805 could be applied only to credit union members. That would reflect the principle that only credit union members as shareholder-depositors should have the status of creditors in respect of their share account. In other societies members may have other relationships as customers or suppliers which make them creditors in the society's insolvency but that is no different from a shareholder in a company who happens to also be a supplier or customer and therefore a creditor of the company when it enters and insolvency procedure.

If it is felt to be dangerous to limit these provisions explicitly to credit union members, the only extension should be holders of shares in an IPS which is authorised by the PRA as a deposit taking institution under FSMA in respect of deposits in the form of shares (that is the position of building societies). Any extension beyond credit unions is only justified if it is at least theoretically possible for an IPS to be accepting deposits in the form of share capital. Even then, any such society should be properly authorised under FSMA.

Turning to the specific questions and detailed proposals:

- if it is necessary to define members, reference to s44 of IPSA 1965 works;

- only in the case of credit unions or other societies (if any) regulated by the PRA as deposit takers in respect of their share accounts should section 1 of IA 1986 include amounts owed in respect of shares “as a creditor” and even in that case I do not understand what legal authority there is to state that a credit union member is ever owed money “as a creditor” in respect of any amount due on their share – there is no provision in CUA 1979 stating that, nor does CREDS seem to have that effect;

- Similarly, the modification to make it clear that the administration is for the benefit of members who are creditors in relation to amounts owed in respect of shares and the suggestion in respect of paragraph 65 of Schedule B1 are needed only for those societies mentioned above, assuming a member is ever a creditor for such amounts.

- I accept that the proposed treatment of paragraphs 54 & 55 improves on the building society

model for the purpose of the discharge of the administrator and the suggested draft is therefore helpful.

- I see the difficulty you raise about the way Rule 2.69 of the Insolvency Rules is modified by SI 2010/2580. Isn't this provision is always subject to contracts which confer effective security rights against property which take that property out of an insolvent liquidation but leave the property in the administration by preventing enforcement by the secured creditor but maintaining the status of the claim after the end of the administration. I have not had time to look at this point very thoroughly but the status of creditor normally arises as a result of a contract other than the contract in the rules about shares or in the terms of a share issue. Members are regarded as owners and not creditors for public policy reasons and under the statutory provisions governing insolvency where their status is as contributories. I think FSCS and Banking Act insolvency procedures with their different objectives protect depositors. That is not achieved by changing in their status as (usually unsecured) creditors.

- I agree with the need to modify Rule 2.85 for the reasons given.

Questions:

6) Do you agree with the modifications mentioned?

See above for my reservations if they could apply beyond credit unions.

7) Should the general rule that “creditors” does not include members be displaced elsewhere?

Not as far as I can tell.

8) As stated above, I am not clear how a member would ever be a creditor in relation to any amount due to a member in respect of shares, if the society were insolvent. If the society turned out in the end to be solvent, then a member holding withdrawable share capital who had already applied to withdraw it and was entitled to do so under the contract in the rules might well be a creditor at that point. I am not sure that even in a credit union the member is a creditor in respect of their share if the credit union is insolvent. Aren't they are paid by FSCS which is then entitled to claim in the insolvency? I haven't looked into this very thoroughly and could be wrong.

9) I think “amounts due in respect of shares” would cover the amount in the share account, interest, and any dividend or bonus linked to the share. I can't think of anything else it would cover.
As stated above, I am not sure whether any societies other than credit unions do accept deposits covered by FSMA and so are or should be subject to any policy favouring depositor protection. However, I am not certain about that. The FCA (especially Michael Cook or Ramona Taylor) might know more. The Presbyterian Mutual Society in Northern Ireland was apparently accepting deposits unlawfully as it was not authorised by the FSA. I think any special treatment of holders of shares in IPS's as “depositors” should only apply where the society is authorised under FSMA and regulated lawfully. In other cases, the members have provided risk capital and should be treated accordingly. They are owners of the business and the limitation of their liability to the amount represented by their shares is enough protection.

10) All credit union members will be depositors and there will be some non-member depositors, as

you say. I do not know the answer about any others but a way through this might be found if these special provisions were applied only to credit unions and other societies (if any) authorised as deposit takers under FSMA. Non-member depositors will be creditors and none of these special rules about depositor members would apply to them. The issue for them would be whether or not they were covered by FSCS.

11) Rule 49 of SI 2010/2580 would assist with young non-member depositors. I assume FSCS rights apply to them as they do to other protected depositors but I have not checked that out.

12) In administration and under Part 26 the voting rights of members should be as they are under the society's rules – usually one member one vote – I see no reason for switching to votes according to shareholding at this stage. That is the basis on which they knew the society would operate and is key to the mutual nature of the society.

Point 6 Changes to Part 1 of Schedule 4

13) I have not had time or resources to research this question at length.

“Off the top of my head” obvious categories of creditor paid out by the administrator might include secured and preferential creditors and those who need to be paid off as part of a deal negotiated under the administration to rescue part or all of the business. The key issue is flexibility for the administrator within the established statutory order of payout.

All you are addressing here is whether, and in what circumstances, holders of shares should feature in that other than after everyone else is paid off. That should only apply in credit unions and any other societies operating a lawful deposit taking business under FSMA. In those cases the rights “as creditors” of the depositors will depend ultimately on the contract they make to deposit with the society which may be partly in the terms of the shares, and partly in the society's rules. That could make them secured creditors at least in theory, I suppose. Then their rights would depend on the form of security they had e.g. fixed charge, floating charge etc.. Normally, I imagine, they will be unsecured creditors apart from any specific statutory depositor protection provisions which place them higher up the ranking.

I'm not sure that member-creditors per se need to be a class on their own except to the extent that you need to do that to draft appropriate provisions. If we are only talking about societies whose depositors are covered by the FSCS and which go into Banking Act administration or liquidation, the real issue on the ground would be the status of FSCS's claim after it has paid out the protected depositors. I have not had time to research that.

I hope that these thoughts help with the analysis of the issues raised in ***Question 13***.

14) See my response to Issue 10.

15) The expenses of a members' meeting should be borne by the society as a cost of the administration.

16) They should rank equally unless they are secured creditors as a result of the contract which created the deposit or share and compliance with registration procedures (if any). That would take

the property that secured the debt out of any insolvent liquidation. This only applies to credit unions and other societies properly regulated under FSMA as deposit taking institutions. In all other cases members should not rank as creditors at all and should be treated in the same way as company shareholders for the purpose of ranking on insolvency.

17) On the basis of the limited time and resources available to me, the changes for England and Wales look as if they will work, but I cannot comment on the changes for Scotland.

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