

## Notes on points for consultation

A draft Order was circulated for consultation with stakeholders on 6 September. This note brings together a number of outstanding issues and points of detail which need to be addressed and may form a useful focus for considering the instrument.

IA 1986 = the Insolvency Act 1986; CA 2006 = the Companies Act 2006; BSA 1986 = the Building Societies Act 1986; BA 2009 = the Banking Act 2009; BS(SA) Rules = the Building Society Special Administration (England and Wales) Rules 2010.

### *POINT 1*

#### *Prosecutions in Scotland under section 7A(2) of IA 1986 [ Schedule 1, paragraph 5 ]*

Section 7A is modified in line with paragraph 9A of Schedule 15A to BSA 1986. If it appears that an officer of the society has committed an offence, the nominee or supervisor must report the matter to the FCA (as the appropriate authority) and provide such information and access to facilities as the FCA requires for the investigatory role. The prosecuting authority for the purposes of section 7A(8) is the DPP, the FCA or the Lord Advocate.

The Order removes investigatory functions from the Secretary of State and the Lord Advocate, but recognises the long standing role of the Lord Advocate as head of the system of public prosecution in Scotland and the exclusive jurisdiction of the Lord Advocate as regards the bringing of public prosecutions in Scotland. But if the Lord Advocate remains a “prosecuting authority”, how he will receive a report of an investigation so that he can decide on the merits of prosecution?

Issue:

- 1) Do we follow building society legislation, which vests the investigatory and prosecutorial functions in Scotland in different persons without provision for reporting to the Lord Advocate, or do we close the gap? How otherwise will the Lord Advocate obtain information to decide whether to prosecute?

### *POINT 2*

#### *Eligibility for obtaining a moratorium: new paragraphs 3 and 3A of Schedule A1 to IA 1986 [ Schedule 1, paragraph 8 ]*

Conditions of eligibility for obtaining a moratorium and how they apply over time are modelled on sections 382 and 383 of CA 2006. The conditions are in paragraph 3(3) and refer to total value of assets and turnover.

Under paragraph 3(2)(c) a company may qualify as small in relation to a financial year (say year 3) without meeting the qualifying conditions. It must have met the conditions and qualified as small in year 2. If it meets the conditions in year 4, it will qualify under

paragraph 3(2)(b), which only requires it to have qualified as small in year 3. If it does not meet the conditions in years 4 and 5, it will not qualify in those years. If it meets the conditions in years 6 and 7, it will qualify in year 7 under paragraph 3(2)(a).

An example may be helpful. In this example “yes” = meets qualifying conditions; “no” = does not do so. Year 1: yes; Year 2: yes; Year 3: no; Year 4: yes; Year 5: no; Year 6: no; Year 7: yes; Year 8 yes.

The company qualifies as small as follows:

Year 1: qualifies under paragraph 3(1); Year 2: qualifies under paragraph 3(2)(a);  
Year 3: qualifies under paragraph 3(2)(c); Year 4: qualifies under paragraph 3(2)(b);  
Year 5: qualifies under paragraph 3(2)(c); Year 6: does not qualify; Year 7: does not qualify; Year 8: qualifies under paragraph 3(2)(a).

Issues:

2) Are these qualifying conditions suitable for relevant societies and for applying the conditions in moving from one year of account to another?

3) Are you happy with paragraph 3A which applies the conditions to a parent society and its group?

### *POINT 3*

*Administrator’s power to borrow: paragraph 3 of Schedule 1 to IA 1986 (which applies by virtue of paragraph 60 of Schedule B1) [ Schedule 1, paragraph 44 ]*

Power to borrow is broadly expressed, as you would expect for a company, but applying it in relation to a registered society does not enable the administrator to borrow free of restrictions to which the society itself would be subject outside administration. Paragraph 44 of Schedule 1 refers expressly to the constraints on borrowing. This does not mean that the administrator’s power to borrow would otherwise be unfettered. But it removes all room for doubt by modifying the power compatibly with the legal position.

Accordingly, the power is subject to specific enactments for credit unions and for other societies and in either such case to such other enactments and rules as restrict or regulate power to borrow.

Issues:

4) Are stakeholders aware of any further statutory constraints?

5) Does FSMA constrain borrowing of any registered societies which have Part 4A permission?

## *POINT 4*

### *When are members creditors in relation to deposits rather than just shareholders?*

If the members of a registered society are to be regarded under any circumstances as creditors in relation to amounts owed in respect of shares rather than just shareholders, who may be liable as contributories, how are we to modify insolvency (rescue) legislation to define the circumstances and provide creditor rights under them?

The fact that members are shareholders in relation to deposits and any other amounts due in respect of shares does not necessarily mean that they are not “creditors”. The matter was made clear for the sake of legal certainty when Schedule B1 was applied for building society special administration under section 158 of BA 2009. For example, see paragraph 25 of Schedule 1 to the Building Societies (Insolvency and Special Administration) Order 2009 (S.I. 2009/805), which ensured that administration would be for the benefit of shareholding members within the category “creditors as a whole”; and paragraph 27(3), which ensured that shareholding members would be entitled to a distribution.

The starting point is that generally in Parts 1 and 2 of IA 1986 “creditors” does not include members to whom sums are due by reason of their shareholding. This is necessary because most references to creditors are in provision that is not applicable to members. The general rule is then displaced by further modification.

“Member”: We propose that “member” in the Order should generally mean every member whose name is registered as a member in the register kept under section 44(1) of IPSA 1965.

Section 1 of IA 1986: Amounts owed “in respect of shares” are classed as “debts” for the purpose of section 1 (proposal for composition in satisfaction of debts), but only in so far as the member is a creditor in relation to the amounts concerned. This excludes dividends and other sums mentioned in section 74(2)(f) of IA 1986.

Paragraph 3 of Schedule B1: Further modification makes it clear that administration is also for the benefit of members who are creditors in relation to amounts owed in respect of shares (as part of the category of “creditors as a whole”). This does not extend the scope of administration. It makes it clear that members are creditors in respect of deposits as well as sums to which they are entitled in any other capacity.

Paragraphs 54 & 55 of Schedule B1: We provide that the report prepared under paragraph 54 (revision of proposals) must be prepared after the conclusion of both meetings and that the consequences of failure to approve proposals or a revision of proposals (a court order under paragraph 55) are triggered where either meeting fails to give approval. The building society modifications of equivalent provisions in old Part 2 (sections 23 to 26) do not provide for this; is the administrator discharged when one meeting disapproves proposals?

Paragraph 65 of Schedule B1: The administrator may make a distribution to a member of the society in relation to any amounts owed by the society in respect of the

member's shares, but only in so far as the member is a creditor of the society in relation to the amounts concerned.

Rule 2.69 of the Insolvency Rules 1986: BS(SA) Rules modify Rule 2.69 (debts of the insolvent company to rank equally) to provide that "debts" do not include any amounts owing from the society to a member in respect of shares. But is this right; why are a depositor's rights subordinated to ordinary creditors' claims (see below)?

Rule 2.85: As for building societies, Rule 2.85 (provision for set-off in relation to mutual dealings) is modified to exclude mutual dealings between a society and member who is a creditor in relation to amounts owed in respect of shares. Taking advantage of set-off would effectively elevate members' claims above the claims of general creditors.

Like shareholding and borrowing members of a building society, depositors in a registered society may receive compensation from FSCS. We do not make provision equivalent to Rule 49 of BS(SA) Rules, which disapplies set-off for protected deposits held by a building society which do not include a share in the society held by an eligible depositor. [ Rule 63 of BS(SA) Rules modifies Rule 2.85 to disapply set-off for deposits which are shares ]. A registered society's deposits are generally held by shareholders; credit unions may have deposits which are not shares (deposits by young persons and borrowing).

Issues:

6) Do you agree with the modifications mentioned above?

7) Should the general rule that "creditors" does not include members who are creditors in relation to amounts owed in respect of shares be displaced for any other provisions?

8) To denote the debt due to a member in respect of deposits, we use the formula "amounts owed by the society in respect of the member's shares, but only in so far as the member is a creditor in relation to the amounts concerned". This follows the BS(SA) Rules. Is this appropriate to capture deposits with a credit union?

9) Does the expression "amounts due in respect of shares" capture debts other than deposits with a credit union? Do other liabilities fall into this category? Do other types of society accept deposits?

10) In a credit union depositors may be members (shareholders treated as creditors) or, in the case of children under the minimum age for membership, non-members (simply creditors). Can a person be a member of a deposit-taking society without being a depositor?

11) In relation to deposits by young people, do we need to consider the modifications made in Rule 49 of BS(SA) Rules? How do FSCS rights operate for them?

12) How should we apply insolvency rules for voting at meetings under paragraphs 53 and 54 of Schedule B1 (entitlement to vote and how votes are calculated) and

meetings under section 899 of CA 2006 (court sanction for compromise or arrangement)? Modifications of Chapter 6 of Part 2 of the Insolvency Rules 1986 (paragraphs 10 to 17 of Schedule 1) do not address this. Modification of section 899 is in paragraph 5 of Schedule 2. Should votes be counted according to share value or the principle of mutual status? While member control should not generally take account of different levels of shareholding, is this principle appropriate for members' rights in administration or under Part 26?

## *POINT 6*

### *Changes to Part 1 of Schedule 4 of draft circulated on 04 September 2013: (modified application of insolvency rules in relation to relevant societies)*

Paragraphs 1 and 3(e): We define “relevant member” to distinguish between members who are creditors because they are depositors and members of societies which do not take deposits and have only the rights of shareholders. The definition is in line with the modifications in paragraphs 2(e) and 31 of Schedule 1 to the Order. It has no impact on a member who is a creditor in relation to amounts owed other than in respect of shares.

We also provide that relevant members are to be regarded as a single class of creditors. This makes it clear that depositors are creditors and that there should be no further division of relevant members as a class for the purpose of Part 2 of the Rules. Unlike references to “creditor” there is no reference to “class of creditors” from which we would want to exclude “relevant member”.

#### **1. In this Schedule—**

“applied provisions”—

(a) in Part 2 of this Schedule, means the provisions referred to in paragraph 2;

(b) in Part 3 of this Schedule, means the provisions referred to in paragraph [ 33 ]; and

“relevant member”, in relation to a relevant society, means a member of the society who is a creditor in relation to amounts owed by the society in respect of the member’s shares.

#### **Issues:**

13) Under what circumstances would an administrator make a distribution for one class of creditors and not another? What distinguishes classes for this purpose? Under what circumstances might the administrator of a relevant society make a distribution for creditors apart from “relevant members” or the other way round?

14) See issue 10. If a society has relevant members, is it possible that it might also have members who are not relevant members? Can a person be a member of a deposit-taking society without being a depositor? This may affect the drafting of modifications. For example, in paragraph 18 of Schedule 4 consider the reference to “those members”; should we be modifying the legislation instead by making different provision for the whole membership of a credit union and any other society that is a deposit-taker?

## Changes to Part 2 of Schedule 4 - Insolvency Rules 1986

### Paragraph 3

3. Unless the context otherwise requires and subject to any further modification in this Part, the applied provisions have effect with the following general modifications—

- .....
- (e) a reference to a class of creditors includes a reference to a single class of creditors that consists of the relevant members of a relevant society, but only in so far as they are creditors in relation to the amounts owed in respect of their shares;
  - (a) a reference to a company includes a reference to a relevant society;
  - (b) a reference to a company's creditors, other than in a reference to a class of creditors, does not include a reference to a member of a relevant society in so far as the member is a creditor in relation to amounts owed by the society in respect of the member's shares;

### Paragraph 13 (Rule 2.13)

13. Rule 2.37 (meeting requisitioned by creditors) has effect as if it required the expenses of summoning and holding a members' meeting requested under paragraph 52(2) or 56(1) ~~of Schedule B1 to the 1986 Act (as applied in relation to a relevant society)~~ to be payable out of the assets of the society as an expense of the administration.

The words struck out are not needed. The reference to these paragraphs of Schedule B1 is a reference to them as modified, by virtue of paragraph 3(a) of Schedule 4.

Issue:

15) Is this the right provision to make for meeting members' expenses?

### Paragraph 10 (Rules 2.34, 2.35, 2.36 & 2.46)

#### Meetings and reports

10. In the following Rules a reference to a creditors' meeting includes a reference to a members' meeting—

- (a) Rule 2.34 (meetings to consider administrator's proposals);
- (b) Rule 2.35 (creditors' meetings generally);
- (c) Rule 2.36 (the chairman at meetings); and
- (d) Rule 2.46 (notice to creditors); and
- (e) ~~Rule 2.48 (correspondence instead of creditors' meetings), except paragraph (7).~~

### Paragraph 12 (Rule 2.35)

12. Rule 2.35 has effect as if—

- (a) paragraph (3) required the administrator, in fixing the venue for the meeting, to have regard to the convenience—
  - (i) in the case of a members' meeting, of the members;
  - (ii) of the FCA and, where relevant, the PRA and the scheme manager; and
- (b) paragraph (4) required 14 days' notice of a members' meeting to be given to all the members.

## Paragraph 16 (Rule 2.48)

**16.** In Rule 2.48—

- (a) in paragraph (1)—
  - (i) the reference to the creditors includes a reference to the members of the society;
  - (ii) in the case of a members’ resolution the reference to every creditor who is entitled to be notified of a creditors’ meeting is a reference to every member;
- (b) in paragraph (2), in relation to correspondence with members, ignore the reference to the statement on entitlement to vote required by Rule 2.38; and
- (c) in paragraph (6) the reference to a meeting of the creditors is a reference to a meeting of the members.

## Paragraphs 18 & 19 (Rules 2.68 & 2.69)

### Distributions to creditors

**18.** Rule 2.68 (distributions to creditors — introduction) has effect in relation to a distribution, or a proposal to make a distribution, to relevant members as if—

- (a) in paragraph (1) the words from “Where the distribution” to the end were omitted; and
- (b) paragraph (2) required the administrator to give the notice referred to also to those members.

~~—19. Rule 2.69 (debts of insolvent company to rank equally) has effect as if it provided that “debts” do not include any amounts owed by a relevant society to a member of the society in respect of the member’s shares.~~

The further modification of Rule 2.68 differs from equivalent provision for shareholding members of building societies in BS(SA) Rules. The effect of saying that “creditor” includes “relevant member” in relation to the reference to classes of creditor is unclear. Paragraph 3(e) of Schedule 1 has the effect that relevant members may be regarded as a single class of creditor for the purpose of making a distribution. We do not need the words omitted.

The further modification of Rule 2.69 is omitted. BS(SA) Rules provide that “debts” do not include any amounts owing from the society to a member in respect of shares. But don’t we want depositors to be treated as unsecured creditors?

Issue:

16) Is there any reason why debts to relevant members (as shareholders) should not rank equally with other debts? Where do they rank if not equally?

## Paragraph 20 (Rule 2.95)

**20.** Rule 2.95 (notice of proposed distribution) has effect as if—

- (a) paragraph (1) required the administrator also to give notice where the administrator is proposing to make a distribution to relevant members; and
- (b) paragraph (2)—
  - (i) required the notice to be sent also to—
    - (i.a) every relevant member;
    - (i.b) the FCA;
    - (i.c) in the case of a relevant society which is a PRA-authorized person, also the PRA;
    - (i.d) in the case of a relevant society which is a relevant person, also the scheme manager;

- (ii) required the notice to contain the statements mentioned in paragraph (2)(b) and (c);
- (iii) provided that the relevant members are unsecured creditors for the purpose of those statements.

#### Paragraph 21 (Rule 2.97)

**21.** In Rule 2.97 (declaration of dividend), in paragraph (1) the reference to one or more classes of creditor includes a reference to one or more classes of relevant member.

#### Paragraph 22 (Rule 2.98)

**22.** Rule 2.98 (notice of declaration of dividend) has effect as if—

- (a) the persons who are entitled to receive notice under paragraph (1) included—
  - (i) every relevant member;
  - (ii) the FCA;
  - (iii) in the case of a relevant society which is a PRA-authorised person, also the PRA;
  - (iv) in the case of a relevant society which is a relevant person, also the scheme manager; and
- (b) paragraph (2)—
  - (i) required that notice to give particulars of any distribution to relevant members; and
  - (ii) provided that the relevant members are unsecured creditors for the purpose of sub-paragraph (c).

#### Paragraph 23 (Rule 2.99)

**23.** In Rule 2.99 (payment of dividends and related matters), in paragraph (2) the reference to any creditor includes a reference to any relevant member.

#### Paragraph 24 (Rule 2.100)

**24.** Rule 2.100 (notice of no dividend, or no further dividend) has effect as if—

- (a) .....
- (b) the reference to creditors included a reference to relevant members.

### *Changes to Part 2 of Schedule 4 - Insolvency (Scotland) Rules 1986*

#### Paragraph 42 (Rule 2.28)

**42.** In Rule 2.28—

- (a) in paragraphs (3), (4) and (10) a reference to the creditors includes a reference to the members of the society;
- (b) in paragraph (3), in the case of a members' resolution, the reference to every creditor is a reference to every member; and...

#### Paragraph 45 (Rule 2.35)

**45.** In Rule 2.35, in paragraph (1)(a), in the case of a members' meeting the reference to every creditor is a reference to every member of the society.



## Paragraphs 46 to 48 (Rules 2.40 to 2.41B)

### Distributions to creditors

46. In Rules 2.40 (distributions to creditors — introduction) and Rule 2.41A (payments of dividends) a reference to creditors includes a reference to relevant members.

47. Rule 2.40 has effect in relation to a proposal to make a distribution to relevant members as if paragraph (2) were omitted.

48. Rule 2.41 (distributions to creditors) has effect in relation to a proposal to make a distribution to relevant members as if—

(a) for paragraph (1) there were substituted—

Ⓐ(1) Subject to the modifications specified below and to any other necessary modifications, Chapter 9 of Part 4 (distribution of company's assets by liquidator), except Rule 4.67 (order of priority of expenses of liquidation), applies with regard to a proposal to make a distribution to the relevant members of a relevant society as it applies with regard to claims to a dividend out of the assets of a company in liquidation. ↓

(b) for paragraph (2) there were substituted—

Ⓐ(2) Subject to paragraphs (2A), (2B) and (5) below, in relation to a relevant society, in Chapter 9 of Part 4 or in any provision of the Bankruptcy Act as modified by Rule 4.16 or Rule 4.68 (application of the Bankruptcy Act)—

(a) a reference to the articles of a company is a reference to the rules of the society;

(b) a reference to a company is a reference to the society;

(c) a reference to a creditor does not include a reference to a member of a relevant society in so far as the member is a creditor in relation to amounts owed by the society in respect of the member's shares;

(d) a reference to the date of commencement of winding up is a reference to the date on which the society entered administration;

(e) a reference to the liquidation is a reference to the administration of the society;

(f) a reference to the liquidation committee is a reference to the creditors' committee in the administration; and

(g) a reference to the liquidator is a reference to the administrator of the society.

(2A) In Rule 4.66 (order of priority in distribution)—

(a) a reference to ordinary debts includes a reference to any amounts owed by the society in respect of a member's shares, but only in so far as the member is a creditor of the society in relation to the amounts concerned; and

(b) in paragraph (2) the reference to section 242 (gratuitous alienations — Scotland) is a reference to that section as applied in relation to a relevant society by an order made under section 255 of the Enterprise Act 2002<sup>(1)</sup>.

(2B) In section 52 of the Bankruptcy Act (estate to be distributed in respect of accounting periods), in subsection (3) a reference to a creditor includes a reference to a member of a relevant society in so far as the member is a creditor in relation to amounts owed by the society in respect of the member's shares. ↓

(c) in paragraph (4) the reference to the administrator's statement of proposals, as approved by the creditors, is a reference to that statement, as approved by the creditors and members; and

(d) at the end there were added—

Ⓐ(6) In this Rule—

“relevant member”, in relation to a relevant society, means a member of the society who is a creditor in relation to amounts owed by the society in respect of the member's shares; and

“relevant society” has the meaning given in section 74(1) of the Industrial and Provident Societies Act 1965(?).↓.

Part 2 of Schedule 4 will be considered by the Office of the Advocate General.

The modification of Rule 2.40 is equivalent to that of Rule 2.68 of the Insolvency Rules 1986 (see above).

The modification of Rule 2.41 (distribution) presents particular difficulty, not least because there are already two levels of modification. For this reason, except for paragraph (4), we make textual modification. Notes:

To read rule 2.41 with substituted provision it is necessary to confine the scope of the modification to a proposal to make a distribution to relevant members; so that rule 2.41 is untouched in its application to a distribution to other creditors.

Substituted paragraph (1): Chapter 5 of Part 4 (claims in liquidation) is not relevant.

Substituted paragraph (2):

The reference to Rule 4.16(2) (in Chapter 5) in Rule 4.68(1) works without applying Rule 4.16 (Chapter 5). The reference to Rule 4.32(2) and (3) can be ignored.

It is necessary to modify additional references in Chapter 9 of Part 4 or the Bankruptcy (Scotland) Act; in particular, reference to a creditor is modified to exclude a reference to a relevant member (subject to (2A) and (2B)). This is equivalent to the general modification in paragraph 3(g) of Schedule 4.

Rule 4.68 applies sections 52, 53 and 58 of the Bankruptcy Act. The relevant provisions are sections 52 and 58; the reference to section 53 can be ignored as it is disappplied by Rule 2.41(1A).

Section 52 provides for the distribution of the “debtor’s estate” (i.e. “the society’s assets”, by virtue of Rule 4.16(2) as modified by paragraph (2)(b)). The reference to creditors in subsection (3) does include a reference to members in so far as they are creditors in relation to amounts owed in respect of shares (paragraph (2B)). Subsections (7) to (9) have no effect, by virtue of paragraph (2)(c) (modified meaning of “creditor”). Subsection (11) as modified by Rule 4.68(2)(d) has no effect for the same reason.

Section 52 is further modified by Rule 4.68(2). Paragraphs (c) and (d) can be ignored. Paragraph (b) is self-explanatory. Paragraph (a) modifies section 52(4)(a), but this does not work for administration and is not modified by Rule 2.41. The effect of this modification is unclear.

Section 58, which provides for unclaimed dividends, applies.

New paragraphs (2A) & (2B): The modifications of Rules 4.66 and section 52(3) reverse the effect of paragraph (2)(c) (meaning of “creditor”).

Paragraph (4): In context (as a modification of section 52(3), because “creditors” is modified to include “members in so far as they are creditors in relation to amounts owed in respect of shares”, the reference to unsecured creditors includes a relevant member without modification. But it is necessary to modify the reference to the statement of proposals, as approved by the creditors. The reference to class of creditors is modified by paragraph 3(e) of Schedule 4.

Issue:

17) Will the Rules on distribution, as modified above, work effectively for relevant societies?