HM Treasury consultation:

Industrial and Provident Societies: growth through co-operation

Ian Snaith's personal response with feedback on draft statutory instruments

On 26th July 2013 HMT published an "Open Consultation" called "Industrial and Provident Societies: Growth Through Co-operation.

It deals with the Government's plan for six reforms:

1. Increasing the holding limit for withdrawable share capital
2. Applying insolvency rescue procedures to IPS's
3. Applying the Banking Act rescue procedure to Credit Unions
4. Applying company investigation procedures to IPS's
5. Applying Companies Act limits on inspecting the Register of members to IPS's.
6. Electronic Submission of egistration documents

The Consultation then raises 20 questions for respondents to the consultation to address.

This is my submission in response to the consultation and expresses my personal opinion on each of the five proposed "measures". It does not necessarily reflect the views of DWF LLP or any other organisation with which I work.

Measure 1 Question 1: Increasing TheWithdrawable Share Capital Limit

The current limit of £20,000 has been in place since 1994 (see SI 1994/341). Before that it was £1000 in the Industrial and Provident Societies Act (IPSA) 1965, raised to £5000 by the IPSA 1975 1975 which also empowered the Registrar of Friendly Societies (RFS) to increase the limit (s2). In 1981 the limit was raised to £10,000 (SI 1981/395) and in 1994 to the current £20,000 (SI 1994/341). In 2000 the power to increase the limit was transferred to HMT and no increase has been made since.

One traditional rationale for having a limit at all is the need to prevent one member or a small proportion of the membership having disproportionate influence by threatening to withdraw a large proportion of the society's total capital. That is reflected in the present consultation document which states that the limit is:

"to prevent any one member having undue influence over that society."

It has always been open to society rules to deal with that directly without having a statutory limit imposed on them and, in principle, that could be one of the range of factors considered by the

Financial Conduct Authority when deciding whether or not a society was entitled to be registered as a bona fide co-operative or a bencom. However, the abolition of the limit or its replacement with a limit based on the proportion of total issued withdrawable share capital held by a member is not on the agenda as this consultation is about how the power to vary the limit conferred by section 2 of the IPSA 1975 is to be used and not about new primary legislation.

Some societies still operate withdrawable share capital as an account with money being invested and withdrawn on demand but WSC is risk capital not covered by the Financial Services Compensation Scheme or the Financial Services Ombudsman Service and enjoys exemptions from financial promotion, prospectus and money laundering rules. That makes the authorities understandably nervous of abolishing the limit - especially in the light of the embarrassing problems raised for regulators by the failure of the Presbyterian Mutual Society in Northern Ireland.

The historical basis for the limit was linked to the origins of the co-op movement as a working class organisation in Victorian times. In those days a rather "hands on", paternalistic approach was taken to the registration and regulation of societies. In that context, and bearing in mind the use of co-op shares as small scale savings by relatively poor people, it is understandable that alimit was imposed by law. So the question to be addressed here is the level of the limit and not either whether it should be a fixed figure rather than a proportion of WSC or whether it should be abolished.

In the consultation document, the figure of £31,000 is given as the amount that would reflect an increase of the 1994 figure in line with inflation. However, the document states that:

> “the government accepts that there are arguments for raising the limit to a higher level than £31,000. In particular, this could facilitate greater investment in industries requiring higher capital input such as agriculture.”

A group of farming businesses co-operating to market their products and wanting to build and invest in facilities for processing or storage obviously need substantial capital and the holding limit is a serious obstacle for them. More generally, there should be no “no go” areas for the sector just because of the limit on holdings of share capital. If the IPS sector is to meet the government's vision of:

> “a diverse, healthy and successful sector which is able to continue to offer abroad range of services to an ever-growing number of members”
> - section 2.3. of the Consultation document

a large increase in the limit is required.

Research commissioned by Co-operatives UK based on changes to earnings and asset prices since 1975 and on the estimated current annual loss to co-operatives due to the limit suggests that a limit of £100,000 is needed to eliminate the £1.5.m to £2.5m estimated loss to co-ops.

However, the government asks about the risks as well as the benefits of raising the limit. It seems clear that the rationale for having a limit is a combination of both the need to protect the liquidity of societies from a “run” on withdrawable share capital and a fear of a small number of members having inappropriate dominance in a society.

The liquidity issue is already addressed in a number of ways. Most societies have provisions in their own rules for the suspension of withdrawals by a decision of their board at any time. In addition,

many societies will require notice of a withdrawal or limit withdrawals to particular dates or periods. This means that the liquidity risk is covered as long as societies make appropriate provision in their rules.

The same answer is available to the risk of de facto dominance by one member or a few of them together. Societies are already able to have rules limiting the maximum holding in their society to less than the full amount permitted by law. That might be more widely used by smaller societies if the limit were raised to £100,000. In addition, or as an alternative strategy, any society could include a rule adding a limit based on the proportion of total withdrawable share capital held by a member to their fixed maximum holding limit and preventing holdings which breach either of the limits. Again, if the limit were as high as £100,000 more societies would do that and, for example the Community Shares Unit could include such provisions in its best practice recommendations for smaller societies.

It is also important to bear in mind that societies with withdrawable share capital are prohibited from engaging in the "business of banking" by section 7 of IPSA 1965 and that any society involved in any other regulated activity would be subject to the same regulatory framework as other enterprises in that field.

For these reasons, it is hard to justify a limit much lower than £100,000.

Measure 2 and Questions 2 to 16: Applying Insolvency Rescue Procedures

This measure is based on section 255 of the Enterprise Act 2002 and is long over due – see my blog post in November 2012 (http://snaithsco-oplawnews.blogspot.co.uk/2012_11_01_archive.html). It was foreshadowed in the Budget Speech earlier this year and fits into the wider picture of law reform that will be unfolding for societies over the next couple of years. This part of the consultation document deals with the introduction of Insolvency Act 1986 provisions on company voluntary arrangements and the administration procedure plus the Companies Act provisions on arrangements and reconstructions. This is designed to make it easier to rescue insolvent societies so as to protect members and jobs. It will also allow a Supporters' Trust registered as an IPS to own a football club by meeting the FA requirements that clubs must be able to go into administration. It will also clarify access to the Pension Protection Fund for members of IPS sponsored pension schemes (see text under heading 3.2. in the consultation document).

3.2. General approach to drafting s255 order

Question 2 asks whether the general approach of applying these provisions to IPS's as they apply to building societies is appropriate or whether there are differences between IPS's and building societies that make that inappropriate.

The guiding principle in applying the rescue procedures to IPS's should be to make precisely the same provision for societies as applies to an equivalent company, unless there is a very good reason to depart from that approach. An IPS, whether it is a co-operative or a bencom, operates a business in the market place. The differences that define these societies mainly concern their internal governance arrangements and the relative power of different stakeholders, the destination of any profits or surpluses and the ethical values that inform their way of doing business.

If a society is subject to insolvency procedures and in fact proves to be insolvent, the only question will be how assets are allocated among the creditors as there will, by definition be no surplus after

debts and expenses are paid. If there is a possibility of rescuing all or part of the business as a going concern, or of realisaing the assets at a higher value for the creditors, then the appropriate mechanisms, such as a voluntary arrangement with creditors supported by statutory provisions, or the administration procedure supported by a moratorium, should be available to the society on the same terms and subject to the same conditions as apply to companies. It is only on a solvent liquidation that the destination of any surplus after all debts and expenses have been paid will arise and the rescue procedures do not deal with that. Hence, there is generally no justification for an approach different to that applied to companies

Question 2 refers to Schedule 15A of the Building Societies Act 1986. That schedule is clearly a convenient model for those drafting an order under section 255 and it applies the rescue procedures to those societies broadly in the way they apply to companies. Therefore, in general, that approach is desirable. The remaining 17 questions in this part of the document deal with the key ways in which the Schedule can be applied to IPS's.

Question 2 also asks for comments on the differences between building societies and IPS's.

Building societies were, like co-operatives, a form of self help organisation, developed in Victorian times. Like IPS's, they operate as mutuals with one member one vote, can use transfers of engagements, amalgamation and conversion to a company as methods of restructuring, and use withdrawable share capital as one form of member account. They also differ from IPS's in a number of ways.

Most fundamentally, building societies are constrained in the types of business they are permitted to do and IPS's are not. Building societies are limited to lending on the security of residential property with funds provided by their members alongside a strictly limited range of other activities explicitly allowed by the legislation and also limited in scale and strictly regulated by the Building Societies Acts - ss 5-9B BSA 1986 [link to BSA 86 s5-9B]. IPS's are free to carry on “any industry business or trade” -s1(1) IPSA 1965 [link to s1(1) IPSA 1965].

As a result, all building societies, by definition, are regulated by the Prudential Regulation Authority (PRA) as financial services businesses but only those IPS's that actually operate in financial services (most obviously credit unions) are subject to PRA regulation. It is a historical accident that the registration of all IPS's happens to be the responsibility of the Financial Conduct Authority (FCA).

One specific consequence of this difference is that withdrawable shares, or share accounts, in building societies are effectively treated as deposits for all purposes - they are protected by the FSCS and rank as if they were creditors' claims in a liquidation. In the case of all IPS's, except credit unions, withdrawable shares, if a society chooses to offer them, are risk capital. In that respect lthey resemble company shares, and are not protected as deposits. For that reason, it is not appropriate that the holders of any shares in an IPS should enjoy any priority in the insolvency rescue procedures or on the liquidation of the society that is not enjoyed by holders of shares in a company.

A difference that impacts on members' meetings and governance is that, in building societies, since both the funding and the borrowing are carried out by members, all building societies have two classes of member (although many people will belong to both classes) and so member decision-making under statutory procedures such as administration and voluntary arrangements will involve separate meetings of each class. That does not apply to all IPS's by definition, although some

societies may divide members into different categories in their rules. This suggests that where a members' meeting is required as part of the statutory rescue procedures, IPS's like companies should simply have one such meeting and not be specifically required to have one for each class of members, as is required for building societies.

These differences clearly affect the relevance of Schedule 15A of the BSA 1986 to the application of insolvency rescue regimes to IPS's. However, the later questions deal with most of the key points of detail.

Question 3 References to the registrar of companies

The consultation document indicates that references to the registrar of companies should, for societies be read as references to the FCA and the reference should only include the PRA if the particular society is an authorised person under section 31 of FSMA 2000. That is consistent with the principle of parity between IPS's and companies and is clearly appropriate. So is the proposed application of section 4A and paragraph 44 of Schedule A1 of IA 1986 which deal with companies for which the PRA is no longer the regulator as that treats an IPS in the same way as a company.

However, the proposed approach to Part 2 of IA 1986 appears to be different. If companies formerly regulated by the PRA are omitted from the requirement that the statement of proposals prepared under paragraphs 49 or 54 of Schedule B1 to the Insolvency Act 1986 be sent to the FCA, PRA and FSCS manager, it seems inappropriate to correct the anomaly for IPS's just because a legislative opportunity has arisen, if no correction has been made for companies in the same position. That is not a strong enough reason to depart from the principle of parity between IPS's and companies.

Part 3.4. Part 1 of the Insolvency Act 1986

Question 4: Company voluntary arrangements should apply to societies on the same terms as they apply to companies. The application of sections 1 to 7B of IA 1986 will enable societies, through their committees, to propose and conclude binding and effective arrangements with creditors. That would be beneficial for societies which are in financial difficulties but are not insolvent or which are insolvent but have prospects for recovery. It would place them in the same position in that respect as companies with which they are competing and would rectify an unjustifiable anomaly that has persisted since 1986.

Prosecution of delinquent officers

Question 5:

It is suggested that section 7A of IA 1986 should be changed for societies so that investigation of offences in connection with a moratorium of voluntary arrangement goes to the FCA and prosecution to the FCA and DPP. The potential problem with this is that the Insolvency Service of BIS, which has many years' experience and specialised resources to deal with these matters, is replaced by the FCA. This is only justifiable if specifically co-operative or mutual issues will be involved AND there is a guarantee that the resources available to the FCA to do this work will be adequate. The financial difficulties of an IPS not operating in financial services needs no different treatment from the equivalent problem in the case of a company so the same investigating and prosecution authorities should be responsible so long as they are required to consult the FCA and each body shares any information that they hold if an issue about the co-operative or community benefit aspect of the society is relevant. Thesde arguments also apply to any application of the

CDDA 1986 to society committee members and shadow directors.

The Moratorium

Question 6

The suggestion that this process should be available to small societies is welcome. It is consistent and logical that the criteria for this should be the same as those that define a “small” society for accounting purposes – currently an asset value not above £2.8 million and a turnover of not more than £5.6. million. Other, presumably higher, limits would apply to aggregate group asset value and turnover. The current limit for “small” companies is any two of the three criteria of balance sheet total of £3.6 million, turnover of £6.5 million and having no more than 50 employees. Some societies might benefit if this more generous provision were applied and, despite involving a measure of complexity pending the alignment of the definitions for all accounting purposes, that would be desirable.

3.5. Part 2 of the Insolvency Act 1986 – Administration Procedure

Question 7

The proposal to allow court administration orders and the appointment of an administrator by an IPS committee or a floating charge holder is very welcome and is at the core of these measures. It should apply to societies in financial difficulties which are not actually insolvent and those which are insolvent but have prospects of recovery. This should be done in accordance with the principle of parity between societies and companies.

Question 8

(a) Do you agree that the holder of a floating charge given by an IPS should be entitled to appoint an administrator?

The replacement of receivership with administration for IPS's is welcome. The proposed transitional arrangments are the equivalent of those that applied when this was introduced for companies – floating charge holders whose security was created before a certain date may still appoint a receiver but those with charges created later must appoint a administrator. These measures will ensure that the process of enforcing a floating charge is carried out by a administrator with duties to all creditors and not a receiver with duties only to only to the floating charge holder.

(i) Should the holder of the charge be prohibited from appointing a receiver?

Yes, for the reason given above.

(ii) Are any of the exceptions in sections 72B to 72GA relevant so that a qualifying charge holder should be able to appoint a receiver under an equivalent provision?

Co-operatives and community benefit societies can be involved in any area of business on any scale. As a result, the principle in considering these detailed exceptions should be that societies will be treated in the same way as a registered company unless there are very strong reasons for different treatment.

S 72B Capital Market Exception should apply to societies as it concerns capital market instruments which include debt securities listed on capital markets. The Co-operative Group issues such instruments and it is important that any society can access finance in this way, including arrangements in excess of £50 million if necessary, on the same terms as a company .

S72C to 72E Public-Private Partnerships, Utility Projects, Urban Regeneration, and Finance Project Exceptions Each of these exceptions should apply to societies for similar reasons – societies should have the opportunity to be involved in such projects, including those with "step in" rights, just as companies are. It is also vital that societies can participate on the same terms as companies. "Step in" rights apply where the financier may, if certain conditions arise, "step in" to run the whole project and administrative receivership is a convenient way to achieve that. As a result the possibility of administrative receivership should remain for societies in these cases.

S72F Financial Market Exceptions despite the fact that few societies are likely to be involved with the charges dealt with by this provision, it would be wise to maintain this exception for them in the same terms as it applies to companies. Most co-operative and community benefit societies are unlikely to be issuers of shares traded on the markets referred to in section 173 of the Companies Act 1989 or covered by SI 1996/1469 or SI 1999/2979. However, as noted above they may issue debt securities traded on markets and may well participate in such markets by holding securities of any kind or trading in them. It is important to facilitate the future development of society businesses by applying this exception to them as it applies to companies.

S72G Social Landlord and Registered Provider of Social Housing Exception This should apply to societies as it fits well with the limitation on the power given by section 255 of the Enterprise Act 2002 which does not permit the application of the insolvency rescue procedures to societies that are social landlords. This continues the availability of cheaper finance to social landlords due to the absence of the administration procedure moratorium for such societies. The exception in this section continues the power of lenders to appoint an administrative receiver in such cases.

S72GA Rail, Aviation and Water Company Exception On the grounds that societies should be free to engage in any business whatsoever, and, in doing so, should be subject to the same regulatory rules as other businesses, these exceptions should apply to societies which have the status referred to in this section as they apply to such companies.

Q8 (iii) Definition of Administrative Receiver

At present societies are not subject to administrative receivership but to receivership wholly governed by the contract granting the floating charge and the power to appoint a receiver – Dairy Farmers of Britain [2009] EWHC 1389 Ch. However, if one were applying administrative receivership to societies, one would wish to use the definition that applies to companies. These measures do not make such a receiver an administrative receiver. However, societies are now skipping the step that companies went through from 1986 to 2002 when administrative receivership existed and was used unversally by floating charge holders but administration was an option if an application were made to court and the floating charge holder agreed to the order.

The key principle to be applied to societies now is that a floating charge holder with security over a society's assets under the Industrial and Provident Societies Act 1967 allowing them to appoint "a receiver or manager of the whole (or substantially the whole)" of the society's property (see S 29(2) Insolvency Act 1986) must appoint an administrator. On that basis, the definition in s 29(2) should apply to societies to determine when a floating charge holder must appoint an administrator instead

of a receiver, although technically that receiver would not have been an administrative receiver (see Dairy Farmers of Britain [2009] EWHC 1389 Ch).

Question 9 Floating Charges and the Prescibed Part

Section 176A should apply to an administrator so as to make a prescribed part of the society's property available to unsecured creditors. This ensures parity with companies.

Question 10 Application for administration order and notification of appointment

It is appropriate that the FCA should have power to apply for an administration order under a modification to Schedule B1 of IA 1986 but only on grounds linked to its role as the registrar of societies and regulator of their continued co-operative or community benefit nature which is a condition of ongoing registration under the mutuals legislation. It should not have power on other grounds unless it would also have such power over a company under other aspects of the FCA's role. Similarly, it is welcome that a role for the PRA is proposed only where a society is PRA-registered.

On the question of petitions by members for administration, that should be permitted only on the "just and equitable" ground – i.e. the court is of the view that it is just and equitable that the society should be wound up (see s 89(1)(h) of BSA 1986). This is because IPS members, under IA 1986 as applied by section 55 of IPSA 1965, are able to petition for winding up on this ground but not on any other. To allow an application for an administration order on this ground is therefore useful as it gives a court an additional option in place of making a winding up order if it decides to provide a remedy. Unlike members of companies, society members do not have a right to petition under any equivalent to sections 994-996 of the Companies Act 2006 on "unfair prejudice". The other grounds for administration of building societies on the petition of a member do not seem to be relevant to IPS's or, as with reductions in the nuimber of members below the minimum, have traditionally been remedied by action by the registrar (now the FCA).

Question 11 Process of Administration (involvement of members)

The proposed approach on the calling of meetings of members and the notification of members is welcome as acknowledging that the democratic nature of societies, as member controlled organisations, makes them closer, in this respect, to building societies than they are to companies. On this question the rules for building societies should be followed in preference to those that apply to companies. However, unless a society is regulated by the PRA under FSMA 2000 and FSA 2012, the PRA should not have a role here, as it does for building societies under paragraphs 21, 23 and 24 of Schedule 15A of the Building Societies Act 1986. The FCA, on the other hand, should have appropriate powers as the registrar of mutuals under the mutuals legislation.

Question 12 Powers of the Administrator (general)

The proposal to make the exercise of powers by the administrator subject to the co-opertaive or bencom nature of the society and to its rules is welcome as an important protection for mutuality. The particular provisions pointed to in the document seem to be the main ones needing modification to achieve this objective.

Once the safeguard is in place it is important that the FCA should have a supervisory function in this respect and both the powers and the information it needs to exercise those powers effectively.

Question 13 Powers of an administrator

It is acceptable that an administrator should have power to achieve amalgamations, transfers of engagements and conversions of societies without the need for a special resolution, subject to certain conditions. The reason for permitting such an extensive power is the desirability of permitting and facilitating the rescue of the business of a society in difficulties without inappropriate constraints and the importance of a greater role for creditors in the process when a society is, or is about the become, insolvent.

However, this is only acceptable if the FCA has the duty, the powers and the resources to prevent such steps in cases where they do not appear to be necessary as part of a rescue but merely a device to achieve demutualisation. The adapted provisions should particularly emphasise a power for the FCA to veto such changes where a conversion, amalgamation or transfer of engagements involves an investor controlled company rather than another society or, for example, a CIC. This is important as the power of a society committee to appoint an administrator out of court, combined with this power of the administrator could be used as a route to demutualisation. For that reason, an FCA veto power would be useful in addition to the modification of the administrator's powers proposed under Question 12 (above).

3.6. Part 26 of the Companies Act 2006

Question 14 Applying Part 26 of CA 2006

The proposal to apply Part 26 of the Companies Act 2006 to societies is welcome as it will open up further mechanisms and possibilities for rescue and reconstruction if a society is in financial difficulties. While the need for a court sanctioned plan and for class meetings makes this a relatively expensive and slow process, it may be appropriate in certain circumstances and should certainly be available to societies. Similarly, it will be helpful for the power use the Part to agree schemes wholly applicable to members to apply to societies, although they are even less likely use that.

Question 15 Provision to ensure that Part 26 measures are compatible with governing legislation and principles and rules for mutual status

It is essential that the order provides a safeguard for this purpose and that the FCA has a supervisory function in respect of that. The requirement for FCA approval as a precondition for a court order under the section and the prevention of inappropriate rule changes when demutualisation is not intended are particularly helpful.

Other modifications include the fact that it is unnecessary to refer to Part 27 of CA 2006 as that can never apply to societies, otherwise the amendment of sections 900 and 901 as envisaged in the consultation document will be the only modification required. IPS's can have both different classes of creditor and different classes of member so there is no need for substantial modification of the provisions in that respect.

3.7. Insolvency Rules 1986 and Insolvency (Scotland) Rules 1986

Question 16 on modifications to distribution rules and rights of set off for mutual dealings

On distributions, it seems odd on the face of it to include IPS members in the definition of

“creditors” in rule 2.68 as members are not creditors but contributories. However, the exclusion of any amount owed to a member in respect of a share from the definition of “debts” seems to remedy that effectively by preventing a member from enjoying equal ranking with creditors. It is not entirely clear why the modification to rule 2.68 is necessary – is it to accommodate those societies to which the FSCS applies or to deal with a perceived risk of reciprocity if IPS rules provide for offset against the member's share account when a member owes money to the society other than as a holder of shares?

Similarly, the effect of modifying rule 2.85 will be to prevent IPS members from being able to set off debts that they owe to the society against amounts owed to them by the society in their capacity as a shareholder. This clarifies the position of members as owners of the business and not creditors even if society's rules give the society the right to offset amounts due from the member against the amount due to them as holders of shares, as most rules do when the shares are withdrawable. The other modification to rule 2.85 would only apply to IPS's (such as credit unions) that are covered by FSCS and protects the claim of members only in that context. Presumably the reference to rule 49 of SI 2010/2580 on Building Society Special Administration applies only to cases where the FSCS applies.

An important point to bear in mind in dealing with these issues of set-off is that in many co-operatives there will be a contractual relationship between the society and the member over and above the role of the member as a holder of shares. The member may hold debt securities or loan notes, they may sell to or buy from the co-operative, or be employees as well as members. Any amounts due to or from members in those other capacities must be dealt with in the same way as if they were a debtor or creditor of a company or other corporate body. That is why it is important to refer, as the consultation document does, to amounts due “in respect of shares” or “in the capacity of shareholder” so as to leave other contractual arrangements to be dealt with as debts.

Measure 3: Application of Part 2 of the Banking Act 2009 to Credit Unions

This is a welcome proposal. It should speed up FSCS pay outs in the event of the failure of a credit union and ensure that services to all credit union depositors are maintained during the administration procedure. That would be particularly helpful where current account services are offered but would generally put credit union members in no worse a position than depositors in other banks. This proposal would apply across the whole UK as bank regulation is a UK matter not devolved to the Northern Ireland Assembly. It is only to be implemented once the previous measures applying the administration procedure to IPS's, including credit unions are in place. In Northern Ireland, that assumes that the Northern Ireland Assembly passes measures to apply the administration procedure to societies. If that did not happen, there would be no first stage there on which this second stage could be built.

The advantages of applying the Banking Act insolvency provisions to credit unions are outlined in the consultation document but it also points to the potential risks from that step such as

> “a negative impact on the ordinary course of business (for example, terms of trade and costs of capital) or …..[undermining]...creditors' rights on normal insolvency or ….[creating... uncertainty about the outcome where a credit union faces financial difficulty.”

I do not have the expertise or experience to comment on those risks in detail but I would imagine that increased costs of capital and the impact of those other issues would be sufficiently small to be

outweighed by the benefits to credit union members and account holders. Those groups, unlike holders of withdrawable shares in other IPS's which do not carry on financial services or banking businesses, are already protected as depositors under FSMA 2000 and FSA 2012 for the purposes of the FSCS and benefit from both the role of the PRA as regulator and the financial services ombudsman scheme. The avoidance of problems such as a "run" on a credit union in the time between the beginning of winding up proceedings and final liquidation, hardship to members with state benefits or salaries paid into credit union accounts and the disruption of direct debits or standing orders by insolvency proceedings are all important. Without those benefits, credit unions are at a competitive disadvantage compared to credit institutions that benefit from Banking Act insolvency procedures. Those benefits would all flow from requiring an insolvency practitioner dealing with a credit union insolvency to achieve Objective 1 under Part 2 of BA 2009. That Objective is:

> "to work with the FSCS so as to ensure that as soon as is reasonably practicable each eligible depositor—
> (a) has the relevant account transferred to another financial institution, or
>
> (b) receives payment from (or on behalf of) the FSCS"

Measure 4: Application of Parts 14 and 15 of the Companies Act 1985 (investigations) to IPS's

This proposals is intended to increase confidence in the IPS structure as a way of conducting business by giving the FCA, as their registrar and regulator, the stronger investigation powers conferred on BIS under the Companies Act. Before this can be done, section 4(2)(a) of the Co-operative and Community Benefit Societies and Credit Unions Act 2010 will have to be commenced. The FCA would have power to appoint an inspector where it believed that a society had operated with the intention of defrauding creditors, in a way that unfairly prejudiced a group of members or for unlawful purposes. They would also be required to appoint an inspector if a court ordered them to do so.

The main issue about the grounds on which an inspector might be appointed is the retention of the "unfair prejudice of members" ground. In the company context that fits in with the wide power of the court on the petition of any member of a company to make such order as it thinks fit to deal with a situation in which the company has been, is being, or will be, run in a way unfairly prejudicial to members. There is no equivalent power under the IPSA's so while an investigation could take place on that ground, the members would have no remedy at the end of it.

A better approach would be to add words to section 432, as it applies to a society, so that for the purpose of the power to appoint an inspector and their powers to act once appointed, any failure to operate the society in accordance with the registration requirements in section 1 of IPSA 1965 as either a bona fide co-operative or for the benefit of the community, was deemed to be unfairly prejudicial to the society's members.

That would leave open the possibility of an investigation on the basis of general unfair prejudice to members as it is defined for Companies Act purposes but would clarify the importance of the fundamental mutual basis of societies. It would point to the remedies within the FCA's control if that form of unfairness were found to exist, including the power to suspend or terminate registration.

To achieve that in the draft statutory instrument an addition would be made to the "Modification"

column of the "Table of applied provisions of Part 14 of the Companies Act 1985" in respect of subsection 432(2) after the words "if it appears to it":

> "and add after paragraph 432(1)(d): '(e) For the purposes of such an appointment under this subsection and of the powers and actions of an inspector so appointed in respect of a society, any failure to operate the society in accordance with the registration requirements in section 1 of IPSA 1965 as either a bona fide co-operative or for the benefit of the community, as the case may be, shall be deemed to be unfairly prejudicial to the members of the society'"

The inspector would have powers to insist on the production of documents, to investigate society subsidiaries, could apply for a warrant from a magistrate to enter premises, and the disclosure of information gained in this way would be regulated as it is for companies. The FCA could also give inspectors directions about what to investigate. While there would be power for the FCA to recover the costs of an investigation from the society investigated, the document states that the "first intention" of the FCA would be to recover the costs from the periodic fees paid by all IPS's.

These proposals are all helpful and appropriate and will improve considerably on the existing section 48 of IPSA 1965 which gives much narrower and more limited powers of investigation. Section 49 of IPSA 1965 would be retained as a way in which members of the society could seek an investigation by the FCA and so the equivalent Companies Act provision (s431 CA 1989) will not be applied. This makes sense.

Question 18 Investigations Regulations

The response to the various parts of the question:

(a) Yes as long as the addition recommended above is made to section 432(2) as applied to societies.

(b) Yes

(c) Yes

(d) All of the persons specified in Schedule 15C seem to be relevant there are no others who need to be included.

Most of the discosures listed in Schedule 15D are relevant and there seem to be no others that might be added. However, the following paragraphs may be irrelevant to IPS's unless they need to be included because an inspecton report on an IPS might contain information useful to an investigation of another body:
Paragraph 3 – as s 84 CA 1989 concerns overseas companies and paragraphs 6 and 39 concern overseas regulators;
Paragraphs 7 and 8 concern collective investment schemes and open ended investment companies and an IPS can be neither of those;
Paragraph 9(a), like other references to accounting requirements such as 9(da), could only apply through F & IPSA 1968;
Paragraph 9(b) could be relevant if an IPS were engaged in insider dealing in the shares of a company as could paragraph 15 if an IPS were involved in a takeover or merger involving a PLC;
Paragraph 9(e) is relevant insofar as it deals with Part 7 of CA 1989 - if the exceptions referred to in question 8(ii) are applied to IPS administrations. However its concern with Part 3 appears to be

irrelevant to societies.

(e) It is appropriate to apply all the sanctions in Part 14 of CA 1985 to IPS inspections as this is an important aspect of strengthening the power of investigation and creating a level playing field with companies.That includes making obstruction of inspectors contempt of court (s 436), and punishment for destroying documents (s 450), providing false information (s451), or failing to comply with requirements imposed by an inspector or investigator under ss 447 or 453A (s 453C).

(f) Section 48 of IPSA 1965 can be repealed as the proposed application of Part 14 of CA 1985 provides greater powers than that section.

(g) The retention of section 49 of IPSA 1965 makes it unnecessary to apply section 431 of CA 1985 to allow IPS members to request an investigation. However, unlike section 431 of CA 1985, section 49 does not allow the appointment of an inspector on the application of the scoiety itself. It would be helpful if the FCA would publicly state that any request from a society itself for the appointment of an inspector, would be given careful consideration. There may also be a need to amend section 49 to ensure that an inspector appointed under that section would have all the powers and status of an inspector appointed under Part 14 of CA 1985 as applied to societies. That would avoid the creation of two parallel but different inspection regimes. Otherwise, the FCA may have to simultaneously appoint the same inspector under both section 49 of IPSA 1965 and Part 14 of CA 1985 to ensure that they have all the necessary powers and support.

The Companies Act powers to investigate the ownership of company shares (ss 442 to 445 and ss 454 to 457) should not be applied. Those provisions are aimed at protecting the market in corporate control from secret accumulations of share stakes in companies and the one member one vote principle that applies to societies makes them irrelevant. Similarly, the omission of the powers concerned with overseas companies (s 453) is appropriate as the FCA does not regulate equivalent IPS's.

Measure 5 Application of provisions of CA 2006 relating to inspection of register by members of IPS's

Unlike most of the other measures, this proposal impacts on the most important internal aspects of the governance of societies and not only their role in the market place competing with companies. It may endanger the democratic control by members that is vital to societies – especially those registered as co-operatives and so must be treated with caution.

To effectively achieve democratic control, members of societies with a large and widely dispersed membership need to be able to contact each other to debate issues concerning their society, to form coalitions e.g. to call a special general meeting or add a matter to the agenda of a members' meeting called by the committee, or to propose the election or removal of committee members. This is a vital counterbalance to the power which will otherwise inevitably tend to be concentrated in the hands of the unelected executives, managers and officials of the society. Those officials have thekey advantages of expertise and control of information. They also have the advantage of full time engagement in the work. Accountability to part time members may be uncomfortable and troublesome but, without it, governance is likely to be less effective and democratic control by members will have little substance.

For these reasons, this proposal should be treated with caution. The present position under the Companies Act, which it is proposed to apply to societies, arose to protect shareholders and

directors from threats and harassment by animal rights campaigners and other groups after the experience of the Huntingdon Life Sciences company. No similar problem has, as far as I know, been experienced by societies.

In the case of companies, the rights of members to information about the share register and other documents are clearly spelt out and include reference to the supply of copies of the information as well as rights of inspection. The Victorian origins of IPSA 1965 mean that its provisions assume the maintenance of a duplicate register to keep detailed financial information confidential while permitting access by other members to basic information about names and addresses. Section 116 of CA 2006 allows free inspection by company members of the register and index to it and only allows a charge for the provision of a copy. It is important that no more restrictive provisions, such as charging members who inspect the duplicate register, are applied to society members. They must have at least the same opportunity for control as company shareholders. All members must retain the right to inspect the duplicate register free of charge.

Even a proposal to allow societies to charge a “reasonable” fee to members for a copy of this information seems excessive. Societies escape the expense which many companies face of providing every member with a set of annual accounts – they are not required to provide those directly to individual members at all. They are also free from any detailed statutory rules or requirements about the provision of information to members or the procedure to be followed in elections or at meetings. This is a very low level of legal obligation compared with Companies Act 2006 and the Listing Rules requirements for listed companies (to which the biggest societies are comparable in scale) and to the statutory rules that apply to the elections and meetings of building societies and friendly societies, under the Building Societies Act 1986 and Friendly Societies Act 1992.

If this proposal does go ahead, the level of any fee must be fixed on the basis of the importance of the democratic control of the society by its members and the FCA must lay down a maximum fee rather than letting societies decide what is “reasonable”.

However, the benefit of this proposal should only be provided for IPS's after the specific legal requirements for the provision of information and participation rights to members of IPS's reach the same level as those of other corporate bodies of similar size or similar member controlled structure and that requires a full review and not the partial application of a provision from a different system.

On the provision of reasons for needing the information and the right of a society to go to court to gain the right not to provide it, the proposals are less controversial. However, these steps impose another obstacle to members obtaining information. The provision of a reason may not be too onerous and societies will presumably only go to the expense and trouble of applying to court for permission to refuse the request if they feel they have good reason to do so. However, if a court application is made, the society uses members' money to pursue it while the minority seeking the information have to pay their own legal costs – and the society's if they lose. This imposes a burden and allows the society to use that financial pressure to withold information, even if the case never gets to court. In the case of a company, the motive of gaining corporate control or the role of the institutional investor may mean that shareholders are better equipped to finance such litigation. By definition IPS members are unlikely to have much financial stake in obtaining the information and they do not benefit from the clear right to receive requested information, backed by a sanction to be found in section 118 of CA 2006.

The conclusion follows that this proposal should be shelved until the full balance of the legal

obligations of societies and the statutory rights of their members to information can be reviewed. At present it is a partial change which is likely to tip the balance against democratic control by members too far – particularly in large societies where the biggest problems about democratic control inevitably arise.

Measure 6: Amendment of section 2(1) of Industrial and Provident Societies Act (IPSA) 1965 to amend requirements for registration documents to be submitted electronically for new IPSs

This overdue measure will clearly be beneficial to societies and will bring their registration systems into line with companies and make them fit for purpose in the twentyfirst century. There are no obvious disadvantages to such a measure.

Summary Responses to Questions:

Measure 1: Withdrawable share capital

Question 1 Withdrawable Share Capital limit: what the limit should be

	The government welcomes views on whether the limit for the WSC should be raised, and if so, views on the appropriate level for the WSC limit. It would also welcome supporting evidence and rationale for raising the limit to a particular level, and evidence on the benefits and risks of doing so.
Answer	It should be raised, ideally to £100,000. For how this relates to the risks see above at pages 2-3.

Measure 2: Application of provisions of the Insolvency Act 1986 for company voluntary arrangements and administration to IPSs

Question 2 General approach to drafting s255 order

	Do you agree that legislation which applies Parts 1 and 2 of IA 1986 to IPSs should be broadly in line with what has been done with respect to building societies? Can you draw attention to differences between building societies and IPSs which would require different provision for the IPSs?
Answer	This is a convenient model so long as the key differences in the regulatory status and governance structures are reflected in its adaptation – see pages 3-4 above.
Question 3	**References to registrar of companies and the role of the PRA and the scheme manager**
	For the purposes of Part 2 (administration) is it appropriate that the PRA should generally cease to be empowered to do anything or have anything done in relation to it under a provision of that Part if it has revoked its authorisation of a society? If yes, are there any exceptions?

Question 3	**References to registrar of companies and the role of the PRA and the scheme manager**
	Yes, that is appropriate. The only exception should be where it would have power in the case of a company. See the detailed comment above on the approach to Part 2 of IA 1986 – see page 5 above.
Question 4	**Applying Part 1 of IA 1986**
	Do you agree that enabling IPSs to conclude binding and effective arrangements with creditors would be beneficial, particularly for societies which are in financial difficulty but are not actually insolvent or which are insolvent but have prospects for recovery?
	Yes. See page 5 above.
Question 5	**Prosecution of delinquent officers**
	Do you agree that this is an appropriate modification of section 7A?
	Yes. See page 5.
Question 6	**Schedule A1 to the 1986 Act (the moratorium)**
	Do you agree that smaller IPSs ought to be able to obtain a moratorium? Do you agree with these proposals on qualifying limits?
	They should be able to obtain the moratorium and the limits applicable to companies should apply. See page 5.
Question 7	**Applying Part 2 of IA 1986**
	Do you agree that enabling IPSs to go into administration upon the appointment of an administrator or the making of an administration order would be beneficial, particularly for societies which are in financial difficulty but are not actually insolvent or which are insolvent but have prospects for recovery?
	Yes. See page 6.
Question 8	**Appointment of administrator by holder of floating charge**
	Do you agree that the holder of a floating charge given by an IPS should be entitled to appoint an administrator?
	Yes. See pages 6-7.
If yes:	(i) should the holder of the charge be prohibited from appointing a receiver?
	Yes.
	(ii) are any of the exceptions made for companies in sections 72B to 72GA of IA 1986 relevant (so that a qualifying charge holder should be able to appoint a receiver under any equivalent provision)?

Question 8	**Appointment of administrator by holder of floating charge**
	Most of them should. For full details see above. At pages 6-7.
	(iii) should ‘administrative receiver’ have the same meaning in substance as it does for England and Wales and for Scotland in Part 3 of IA 1986?
	Yes but see page 7 above for full discussion of technical issues.
Question 9	**Floating charges and the prescribed part (section 176A of IA 1986)**
	Do you agree that the administrator of an IPS should be required to comply with section 176A?
	Yes. See page 7.
Question 10	**Application for administration order and notification of appointment**
	Do you agree that the regulators should be entitled to apply for an administration order? Are there any circumstances under which a member of an IPS (as a contributory or otherwise) should be entitled to apply for an administration order?
	For detail see above at pages 8 onwards. A member should be able to seek this as an alternative to winding up on the just and equitable ground
Question 11	**Process of administration (involvement of members)**
	Do you agree that these are appropriate modifications for meetings and the participation of members in the process of administration? How should the expenses of a members’ meeting under paragraph 52(2) or 56 (1) (as modified for an IPS) be met? Should they be payable out of the assets of the IPS as an expense of the administration?
	They are appropriate and it seems reasonable to treat them as an expense of the administration. The PRA should have no role unless it would have a role in respect of a company in an equivalent position i.e. because it is a regulated person.
Question 12	**Powers of the administrator – general**
	Do you agree that the order should provide a safeguard for this purpose in the legislation? (paragraph 3.29) Do you agree that the order should provide a safeguard for this purpose and that the FCA should have a supervisory function? (paragraph 3.30)
	The safeguard is welcome and necessary but FCA enforcement powers and resources must be adequate as well. See pages 8-9.
Question 13	**Powers of the administrator**
	Do you agree that the administrator of an IPS should have power to effect

Question 13	Powers of the administrator
	amalgamation, transfer of engagements and conversion into companies?
	Only if the FCA has powerr and resources to veto such a step where it appears not to be necessary as part of a rescue but merely a device to achieve demutualisation. There should be particularly strict scrutiny where to transfer, conversion or amalgamation will involve an investor controlled company rather than a co-operative, a bencom or a CIC. See pages 8-9.

Question 14	Applying Part 26 of CA 2006
	Do you agree that the application of Part 26 would be beneficial for IPSs?
	Yes – see page 9.

Question 15	Provision to ensure that Part 26 measures are compatible with governing legislation and principles and rules for mutual status
	Do you agree that the order should provide a safeguard for this purpose and that the FCA should have a supervisory function? Are any other modifications required?
	The FCA role is vital and is welcome. There will be no need to refer to Part 27. Otherwise the modifications appear to be suitable.

Question 16	Distributions to creditors
	Do you agree that these are necessary modifications of rules relating to distributions?
	The approach to distributuions looks convoluted but probably works. It is vital to bear in mind that in many societies members will routinely have other contractual relations with their societies in addition to the role that flows from holding shares.

Measure 3: Application of Part 2 of the Banking Act 2009 (bank insolvency) to Credit Unions

Question 17	Applying Part 2 of the Banking Act 2009 to Credit Unions
	Do you agree that applying Part 2 of BA 2009 to credit unions would provide a more effective and flexible procedure for dealing with financial difficulties and insolvency? Do you agree with the benefits identified above? How far would this measure carry risks of prejudicing credit unions in the ordinary course of business?
	I agree that applying the Part to credit unions will be very beneficial and those benefits clearly outweigh any downside risks. See pages 10-11.

Measure 4: Application of Parts 14 & 15 of the Companies Act 1985 (investigations) to IPSs
Question 18 Investigations regulations

The government welcomes views on the application of the powers of investigation from the Companies Act 1985 to IPSs. In particular do you agree:
(a) that the circumstances for appointment of inspectors set out in section 432(2) of the Companies Act 1985 are suitable for IPSs?
Yes, as long as section 432(2) is applied with the addition of the words recommended on pages 11-12 above for the reasons given there.
(b) with the proposal that the costs of the inspection should be recoverable from the IPS? (recognising that the FCA will first try to soak these costs up into their existing budget)
Yes.
(c) that the FCA, inspectors and section 447 investigators should be given the proposed powers?
Yes.
(d) that Schedules 15C and 15D (permitted disclosures of information) need to be adapted for IPSs, and if so, how?
Yes, I agree. Most paragraphs of both Schedule 15C and Schedule 15D should be applied but see page 12 above for detailed comments.
(e) that the sanctions and penalties in the Companies Act 1985 are suitable for IPSs?
Yes.
(f) that section 48 of the Industrial and Provident Societies Act 1965 could be repealed?
Yes.
(g) with the proposal not to apply the sections of the Companies Act 1985 listed in 3.51?
Yes but note that while section 431 of CA 1985 allows the company itself to ask for the appointment of an inspector, section 49 does not provide that right to a society. Section 431(2)(c) (and no other part of the section) should be applied to societies to plug this gap. Failing that, the FCA should make a formal statement to the effect that they will carefully consider making an appointment if the society requests one. It is also important not to leave two parallel inspection regimes in existence so maybe s 49 (or CA 1985 as applied to societies) should be amended to confer all the powers of a

Question 18 Investigations regulations

CA 1985 inspector on one appointed under that provision.

Measure 5: Application of provisions in the Companies Act 2006 relating to inspection of register of members to IPSs

Question 19 Inspection of the register provisions

The government welcomes views on the application of Companies Act 2006 provisions about the inspection of the duplicate register of members to IPSs. In particular do you think that:
(a) IPSs should be given the right to apply to the court where they believe an application by a member to view the duplicate register is for an improper purpose?
No. This represents an unacceptable dilution of the rights of members by the application of one part of a Companies Act regime which confers clearer and more extensive rights on members. Any such change should await a full consideration of the balance between member rights and society obligations in the context of societies. This relates to the internal democratic control of societies by members and not competition with companies in the market place.
(b) there should there be choice of applying to the High Court or county court as in the Companies Act 2006?
If this measure goes ahead at all, only the county court should be permitted as that will reduce to costs faced by members seeking to exercise their democratic rights against a society management and committee using the members' money for legal fees.
(c) IPSs should be able to charge a fee for inspections of the duplicate register by members and interested persons?
No. Any power to charge fees for inspection is unacceptable (and perhaps beyond the powers being exercised here) as companies are not permitted to levy such a charge (sees 116(1)(a) CA 2006). Fees for copies should be subject to a very limited maximum limit, if they are permitted at all.
(d) the proposed penalties are appropriate?
If reasons have to be given for a request, it is inevitable that a requirement not to mislead in the statement of them would follow. However, the equivalent specific offence for the society to fail to provide the requested information unless they have court permission to do so should also be imported from section 118 of the 2006 Act.

Question 20	Electronic submission of registration documents
	The government welcomes views on the amendment of section 2(1) of the IPSA 1965 to allow IPSs to submit registration documents electronically.
	This overdue measure will clearly be beneficial to societies and will bring their registration systems into line with companies and make them fit for purpose in the twentyfirst century. There are no obvious disadvantages to such a measure so long as it remains an option for societies and they have the alternative of submitting in hard copy only if they choose.

Comments on Draft Statutory Instruments Released in August 2013

The Co-operative and Community Benefit Societies (Investigations) Regulations 2013

The Preamble cites the relevant subsections of the 2010 Act.

The general modifications to Part XIV set out appear to work and I see no other obvious general modifications that are needed.

The Table should include the application of section 431(2)(c) (and no other part of that section) to address the omission of a power to appoint at the request of the society in section 49 of IPSA 1965. That would then leave the rest of s49 to operate for requests from members while also giving express power to appoint on the request of the society as a corporate body via its committee.

For the reasons given above (pp11-12) the following should be included in the Table in respect of subsection 432(2) after the words "if it appears to it" in column 2 of the SI:

> "and add after paragraph 432(1)(d): '(e) For the purposes of such an appointment under this subsection and of the powers and actions of an inspector so appointed in respect of a society, any failure to operate the society in accordance with the registration requirements in section 1 of IPSA 1965 as either a bona fide co-operative or for the benefit of the community, as the case may be, shall be deemed to be unfairly prejudicial to the members of the society'"

On section 433(1) I agree with the omission of “431 or” but believe that nothing else should be omitted. Although there is an argument that a co-operative society should never be a subsidiary, I suspect that research in the register at the FCA would show that some are. e.g. CIS Ltd is a de facto wholly owned subsidiary of the Co-op Group. I believe that many consumer co-ops have a structure sold to them by KPMG to minimise VAT liability which involves subsidiary societies and companies for property, trading etc. Also, could a bencom not be a subsidiary? Some societies will engage in joint ventures through subsidiaries and investigation of the subsidiary and/or its other holding company or society might be appropriate. On that basis, why exclude this extension of the powers of an inspector and hamper her work by preventing investigation of a holding company or society or a holding company of a JV subsidiary of a society? Once the powers are removed they do not exist, despite the reality that societies do exist to which the omitted words could apply. If they

are left in and turn out not to be needed then nothing is lost.

On section 437, why omit (3)(b)(iv)? Are the applicants for investigation not to be entitled to a copy? If the intention is that they should not be charged for a copy, that is good but you need to say "free of charge" in relation to them.

In sections 452 (1) & (1B) the reference the s 431 needs to be kept if my suggestion above is accepted.

The Industrial and Provident Societies Act 1965 (Inspection of Register) Order 2013

As noted above I am of the view that this change should not be implemented.

In particular, the proposed section 46A(1) may well be ultra vires section 2(1) of IPSA 2002. That section empowers HMT to modify IPSA "for the purpose of assimilating the law relating to companies and the law relating to industrial and provident societies". The proposed section 46A(1) does not do so as it creates a new statutory power to levy fees for the inspection by members of the register of members which does not exist in Companies Act 2006 section 116. That is not "assimilation".

Any attempt to permit charging for copies, which is allowed under Companies Act 2006, will first have to change IPSA 1965 to explicitly refer to the provision of copies, as CA 2006 does. That will require a more radical redrafting of sections 44 to 46. Given the serious policy issues about the impact of this whole proposal on the democratic control of societies by their members, it is preferable to drop this proposal and await a full review of the statutory framework for member participation and democratic control.

I am also against importing the right for societies to apply to court to prevent disclosure of information on the register, although that seems to be intra vires. If that is to go ahead, it is important that proposed section 46B(7) refers to only the county court and sheriff court to keep costs down. Proposed section 46C should also be changed to include an offence, carrying a daily fine, for a society and its officers if they fail to provide the requested information without court permission. The court should also have power order the society to comply with the request (see s118 CA 2006). That would bolster the existing sections 61-63 of IPSA 1965 which do not have such severe penalties. That is the minimum needed to maintain members' rights.

The Industrial and Provident Societies (Increase in Shareholding Limit) Order 2013

This draft works well and maintains the time honoured tradition of allowing fast change by committee resolution pending rule amendment.

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