

Regulatory issues for Industrial and Provident Societies

A consultation document

July 2004



HM TREASURY



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INTRODUCTION

Asset lock for community benefit societies

1.1 The community benefit society is one of a number of legal forms available to social enterprises. It is a body run and managed by its members where profits are distributed not back to members (as with co-operatives) nor to external shareholders (as with companies) but to the wider community. The Government recognises the importance of community benefit societies and welcomes their tradition of member engagement, their contribution to the economy and their service to the community. We are keen for community benefit societies to flourish as part of a thriving and strong social enterprise sector.

1.2 Community benefit societies are incorporated under the Industrial and Provident Societies Act 1965. This provides a legal framework for community benefit societies to operate in and pursue their community goals. However, there is currently nothing in law to prevent societies' assets being distributed to members following conversion to company status. In theory, carpetbaggers could seek to become members of a community benefit society with the aim of forcing a vote on conversion of the society to company status and making windfall profits from accumulated investments over the years. This risk may act as a deterrent to investors keen to ensure that their investments are used as intended and may serve as a barrier to further community benefit society growth.

1.3 The Co-operatives and Community Benefit Societies Act 2003 contains a provision that gives the Treasury the power, by secondary legislation, to allow community benefit societies to protect their assets for community benefit. This proposal was one of the recommendations of the September 2002 Strategy Unit Report, "Private Action, Public Benefit". The Government supported the 2003 Act in its passage through Parliament as a Private Member's Bill.

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

Further questions

1.5 This consultation also takes the opportunity to canvass the views of stakeholders on issues related to the wider legal and regulatory framework for the sector. It asks for views on the Government's proposal to raise the **audit threshold** for non-charitable Industrial and Provident Societies, and for general views on the **preferred location for the registration function** for Industrial and Provident Societies.

Who is being consulted?

1.6 This consultation document invites views from all stakeholders within the Industrial and Provident Society sector on these proposals. Consultees should be aware that while the proposed provisions introducing the asset lock would, if adopted, only apply to community benefit societies, the proposal to raise the IPS audit threshold will apply to all non-charitable societies (both co-operatives and community benefit societies) with a turnover below the new proposed threshold. The question on the preferred location for the registration function will apply to all societies.

Devolution 1.7 Industrial and Provident Society law is an area which is reserved to Westminster under the Scottish and Welsh devolution legislation and therefore these proposed changes will apply to Industrial and Provident Societies in Great Britain¹. In Northern Ireland, matters arising from the proposal would normally be the responsibility of the Northern Ireland Executive Ministers. Whilst the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by the Northern Ireland Departments subject to the direction and control of the Secretary of State for Northern Ireland. The Department for Enterprise, Trade and Investment in the Northern Ireland Executive is currently conducting a review of Industrial and Provident Society legislation for Northern Ireland².

Disclosure of responses 1.8 We will ensure the confidentiality of any information which respondents clearly tell us is confidential in nature. With this exception, you should be aware that all responses received may be made public unless specifically requested otherwise. General confidentiality disclaimers that often appear at the end of emails will be disregarded for the purposes of publishing responses unless an explicit request is made in the body of the response.

How to respond 1.9 We would welcome responses by e-mail, fax or post to Ian Noon at the following addresses:

Email:	ian.noon@hm-treasury.gov.uk
Fax:	0207 270 4694
By post:	Regulatory Issues for Industrial and Provident Societies General Insurance, Mutuals and Inclusion HM Treasury 1 Horse Guards Road London SW1A 2HQ

1.10 The deadline for responses is **29 October 2004**. All responses will be acknowledged.

¹ The provisions of the Co-operatives and Community Benefit Societies Act 2003 may be extended to the Channel Islands by Order in Council. The proposed asset lock Regulations would not apply to the Channel Islands unless and until this Order has been made.

² *Credit Unions and Industrial and Provident Society Review*; DETI; 17 May 2004. Available at www.detini.gov.uk/publications or by calling 028 9090 5332

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SUMMARY OF QUESTIONS

2.1 This consultation document seeks the views of consultees on a number of issues related to its proposals on the asset lock for community benefit societies and the audit threshold for all non-charitable societies. It also seeks the views of consultees on the future location of regulation for the sector. Key questions on these issues are summarised below.

Operation of the asset lock

1. Do you agree that the option to make use of the asset lock provision should be available to all community benefit societies with the exception of charitable community benefit societies and Registered Social Landlords?
2. Do you agree that the value of all assets, except withdrawable share capital, should be included in the asset lock?

Procedures for setting up the asset lock

3. Do you agree that, to apply the asset lock, societies should adopt a new, unalterable rule into their constitutions? Do you agree with the suggested wording for that rule set out in Schedule 1 to the draft Regulations?
4. Do you agree with the Government's proposals for the procedures that a community benefit society will need to follow in order to set up an asset lock?

Regulatory framework

5. How should the asset lock be enforced? Is it necessary for the enforcement framework to regulate the use of assets during the life of the society, or is it enough simply for there to be a restriction on the transfer of assets when the society dissolves, with the power to cancel the registration of a society in breach of the lock?
6. If consultees feel that the enforcement framework should regulate the use of assets during the lifetime of the society, should the role of enforcement authority be filled by:
 - a) the CIC Regulator;
 - b) a sponsoring body; or
 - c) another body (please indicate which)?

Dissolution

7. Do you believe that societies should be able to name in the rule applying the asset lock a future beneficiary to whom assets should be transferred on dissolution? Would this be more useful as an option or as a requirement?

Compensation

8. What, if any, member interests, rights or liabilities could be altered by the application of an asset lock? Do you agree with the proposed compensation regime for this?

Practical issues

9. Are you going to use the asset lock? Have the issues we have raised in this document influenced your views on whether or not to apply the lock? How?

10. Can you:

a) identify any costs or benefits for your organisation or more generally resulting from these proposals?

b) quantify these costs or benefits?

See Annex C for details on these costs and benefits.

11. Do you have any comments or suggestions on the drafting of the Regulations at Annexes E and F?

Further questions

12. Do you have views on the preferred location for the registration function for Industrial and Provident Societies?

13. Do you agree that the audit thresholds for non-charitable societies should be raised to bring them into line with those for companies and CICs – ie £5.6m turnover and £2.8m assets?

14. Can you:

a) identify any costs or benefits for your organisation or more generally resulting from these proposals?

b) quantify these costs or benefits?

See Annex D for details on these costs and benefits.

ANNEX A – Option B: asset lock enforcement framework

A1. Do you agree with the proposed procedure for handling investigations?

A2. Are all of these sanctions needed as part of the regulatory framework for the asset lock, or would a combination of the options set out below deliver a more proportionate system of regulation? If so, which of these possible sanctions do you believe would be most effective?

A3. Can you suggest any further sanctions which should be available to the enforcement authority in regulating the asset lock?

A4. Are the proposed maximum sentence (of two years) and fine (of £100,000) for breach of the asset lock set at the right level for this offence?

A5. Do you agree with the proposed procedure for applying sanctions?

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POLICY PROPOSALS

Current situation **3.1** Industrial and Provident Society legislation and regulatory practice already place a number of restrictions on the way community benefit societies deal with their assets. FSA guidance prohibits distributions of profits or assets during the life of a community benefit society, and requires that, on dissolution, the assets should be transferred to some other body with similar objects, or (if no such body exists) used for similar charitable or philanthropic purposes. In addition, the democratic ethos of many community benefit societies gives members themselves a degree of control over how assets are used.

3.2 However, where a society converts to company status, there is currently nothing in law to stop the members then voting to change the company's objects to allow distributions of assets to members – in effect, to demutualise. A central objective of the asset lock for societies is to prohibit the transfer of assets to any body without similar objects and an equivalent, irrevocable asset lock.

Application of the asset lock **3.3** The Government believes that the asset lock should be an option that community benefit societies can choose to take up if it is something that they believe can add value to their organisation. However, the Government proposes to apply a number of restrictions on the types of community benefit societies that can make use of the asset lock provision and the assets that can be subject to the asset lock¹:

- **Charitable community benefit societies** are already subject to a restriction on the use of their assets, through their compliance with charity law;
- Assets belonging to **Registered Social Landlords** incorporated as community benefit societies are already 'locked' through the Housing Act 1996 and, for Scotland, the Housing (Scotland) Act 2001.

3.4 The Government considers that allowing these societies to make use of the asset lock constitutes unnecessary duplication and could lead to confusion. We therefore propose to exclude charitable community benefit societies and Registered Social Landlords incorporated as community benefit societies from making use of the asset lock.

1. Do you agree that the option to make use of the asset lock provision should be available to all community benefit societies, with the exception of charitable community benefit societies and Registered Social Landlords?

Assets covered by the lock **3.5** The purpose of the asset lock is not to prevent societies from using the assets they hold. The attached draft Regulations permit community benefit societies to use or deal with locked assets to further their community benefit aims². The effect of these provisions is that it is the value of the assets that will be locked, rather than the assets themselves.

¹ See Regulation 7 – prescription of community benefit societies (Versions A and B of the attached draft Regulations).

² See Regulation 9 (Versions A and B).

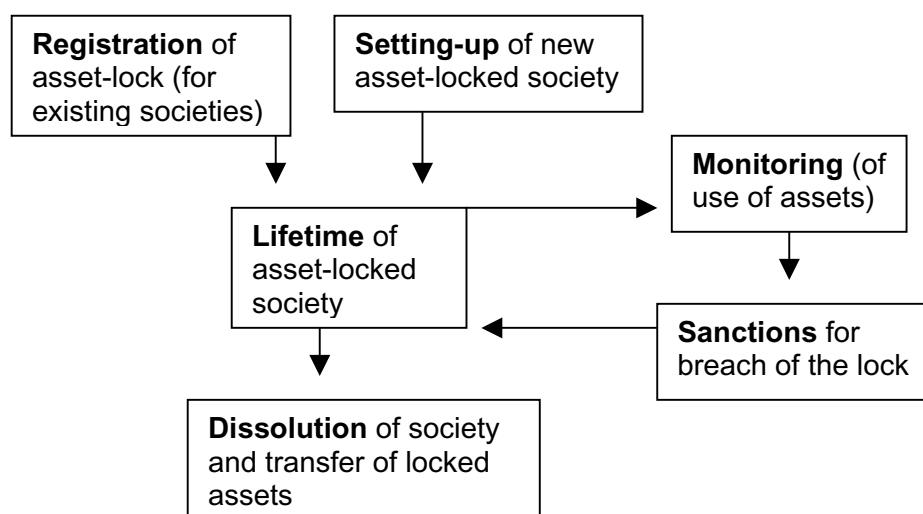
3.6 The Treasury has the power to prescribe what types of asset are subject to the asset lock. The Government has only identified one type of asset where a lock on its use may be inappropriate. This is withdrawable share capital – a type of share societies can issue (up to the value of £20,000 per member) and which members have the right to withdraw, usually after a short period of notice. Since members are free to remove their capital, subject to certain conditions, it would seem inappropriate to include withdrawable share capital within the asset lock³.

2. Do you agree that the value of all assets, except withdrawable share capital, should be included in the asset lock?

Operation of the asset lock

3.7 The diagram below sets out key elements in the ‘life’ of an asset-locked society: for assets to be protected, consultees may wish to consider what provision is needed in the areas identified in the diagram. This provision does not necessarily need to come from formal systems of regulation – the democratic governance structures common to many community benefit societies may already provide a sufficient level of assurance on the use of locked assets. At key points in what follows we will seek your views on whether the framework described can best be delivered through formal regulatory engagement, or whether it can be/is being provided by members themselves.

Lifetime of an asset-locked society



3.8 The draft sets of Regulations attached to this document set out two alternative models for regulation of the asset lock – one with a more light-touch (**Version A**), and one with a more interventionist (**Version B**) approach to enforcement of the lock during the lifetime of an asset-locked society. The ‘light touch’ approach is based around the FSA’s current powers as Registrar for community benefit societies. The second enforcement option requires the involvement of an external enforcement body, with its own powers to enforce the asset lock. This document sets out in detail how these two alternative approaches would work in practice. A partial Regulatory Impact Assessment setting out the respective costs and benefits of the proposed enforcement options is also attached

³ See Regulation 6 (Versions A and B).

Community Interest Companies **3.9** As envisaged, the Community Interest Company (CIC) form currently being debated in Parliament as part of the Companies (Audit, Investigations and Community Enterprise) Bill will also have an asset lock⁴. Since the CIC form is based on company law, the asset lock for CICs will have a different legislative framework to that for societies (which is based on Industrial and Provident Society law). But in both cases the overall intention is the same: to ensure that assets are protected for public benefit.

Consistency between asset locks **3.10** The asset lock for the Community Interest Company will be regulated by the CIC Regulator, which will have relatively wide-ranging powers of enforcement, including a power to appoint and remove a director, to appoint a manager and to make provision for the holding of property on trust. Annex B to this document sets out the operation of the asset lock for CICs. In initial discussions on the asset lock for community benefit societies, some stakeholders have raised the issue of **consistency** between the asset locks for societies and CICs. In practical terms, the issue of consistency between the two locks may have an impact on the ability to **transfer assets** from a CIC to an asset-locked society⁵. In addition, some stakeholders have suggested that consistency between the two locks is important as a matter of principle, in maintaining a **level playing field** between the CIC and community benefit society forms. Although the legal and regulatory frameworks underpinning the two asset locks are likely to be very different, we believe that their effect – in terms of ensuring that assets are protected, should be consistent.

PROCEDURES FOR SETTING UP AN ASSET LOCK

3.11 The Treasury may specify the procedure by which a society may adopt an asset lock. We believe that, to be effective, the asset lock must take the form of an unalterable rule in a society's constitution. To minimise uncertainty over the precise wording of such a rule, we believe it is sensible to set out a proforma version of the rule in the Regulations, which societies can adopt within their rules. Suggested wording for this is set out in Schedule 1 to the attached draft Regulations (Versions A and B).

3. Do you agree that, to apply the asset lock, societies should adopt a new, unalterable rule into their constitutions? Do you agree with the suggested wording for this rule set out in Schedule 1 to the draft Regulations?

3.12 The Government believes the option to apply the asset lock should be open both to new and existing community benefit societies (except charitable societies and those registered as Registered Social Landlords, as above). New societies (those registered after the asset lock Regulations come into force) will be able to adopt the 'restriction on use' rule within their constitution at registration. Existing societies will need to register the rule as an amendment to their constitutions. In both cases, the FSA will only register the rule if it is satisfied that this meets the requirements of the 2003 Act and asset lock Regulations (as well as the requirements of the 1965 IPS Act with respect to registrations). Under the 'light touch' model for regulation of the asset lock set out below, this is all that would be needed for registration of the asset lock rule. Under the

⁴ All references to the provisions establishing a Community Interest Company relate to Part 2 of the Companies (Audit, Investigations and Community Enterprise) Bill as introduced to the House of Commons in July 2004.

⁵ Under the legislation setting up the CIC form, DTI has the power to make regulations permitting the transfer of assets from a CIC to an asset-locked society. This power will only be used if the Government and the social enterprise sector are satisfied that such assets will be adequately safeguarded in the community interest if transferred. Any regulations made under this power will themselves be the subject of consultation with the wider social enterprise sector.

external enforcement model, the FSA would also be required to consult the enforcement body before registering the rule⁶.

3.13 The Government considers that a decision to adopt an asset lock should only be passed by an existing community benefit society if it has put this question to a vote of members, and a majority of the members has voted in favour. The Government has considered what voting procedures to apply to this vote. We propose that a vote to adopt an asset lock should be passed by not less than 75% of the qualifying members of a society, where not less than half of the qualifying members have voted, before the society can apply the asset lock. This decision must then be confirmed by a majority of those voting at a subsequent general meeting of the society. These are the same thresholds required for conversion into, amalgamation with, or transfer of engagements to company by an Industrial and Provident Society (section 52 of the Industrial and Provident Societies Act 1965)⁷.

4. Do you agree with the Government's proposals for the procedures that a community benefit society will need to follow in order to set up an asset lock?

Use of assets during the lifetime of a society

3.14 A further key element in the asset lock framework is a means of ensuring that the locked assets of a society are protected for community benefit purposes during its lifetime. Accordingly, the attached draft Regulations provide that an asset-locked society may only use or deal with locked assets in the following ways⁸:

- For a purpose which falls within one or more of the objects of the society (as set out in its rules);
- For a purpose which is outside its objects, provided market value is obtained for all transactions (so, in effect, the value of the assets is unchanged);
- Where assets are transferred to another body with an unalterable asset lock (ie another asset-locked society, a CIC, a Registered Social Landlord with an equivalent asset lock or a charity within the meaning of section 5A(7) of the Industrial and Provident Societies Act 1965)⁹;
- Where a society dissolves or becomes insolvent, to the extent necessary to pay any creditors of the society (where payment cannot be made out of assets which are not locked);
- To pay compensation; or
- (Under Option B for enforcement of the asset lock) to pay a financial penalty or in order to comply with an order of a court.

⁶ See Version A of the draft Regulations – Schedule 2 and in particular the modification of sections 2 and 10 of the Industrial and Provident Societies Act 1965; and Version B – Schedule 3 and in particular the modification of sections 2 and 10 of the Industrial and Provident Societies Act 1965.

⁷ See Regulation 4 (Versions A and B).

⁸ See Regulations 9 and 10 (Versions A and B) and, for Version B, Regulation 11.

⁹ In this case, under Version B of the draft Regulations, it would only be possible for a society to make such a transfer where it has notified the asset lock enforcement body and this body has not objected within 21 days.

3.15 We have the option of further restricting how a society may use or deal with its assets for purposes which are not within its objects (second bullet above). Use or dealing with assets for purposes outside the objects of a society may be restricted to community benefit purposes only. We would be interested in the views of consultees on whether this would be a useful restriction.

3.16 In addition, as currently drafted, the Regulations would permit **any use or dealing** of locked assets for purposes not within the objects of a society, provided market value is obtained. This would allow a society to **use** assets for purposes outside its objects - for instance, by renting them out at market rates. But there is the possibility that, in some cases, this may threaten access to assets for those the society is set up to help (for instance, in a case where a society set up to support elderly people rented out all of its equipment at market value to working-age disabled people, thereby depriving its elderly 'clients' of access to the equipment). Instead, consultees may wish to consider whether the 'use or dealing' provision should be narrowed to allow societies only to **dispose of** locked assets for purposes outside their objects (where, for instance, a society set up to support the elderly sold some of its spare equipment to disabled people).

LIFETIME ENFORCEMENT

3.17 We have identified two broad options for enforcement of the asset lock during the lifetime of community benefit societies. These are set out below.

Option A 3.18 The democratic ethos common to many Community Benefit Societies means that in many cases the members of a society are well-equipped to call members of the Board to account for their actions. So one option for enforcement of the lock during the lifetime of the society would be to leave it to members to monitor the use of locked assets and take action under the rules of the society where appropriate, through the usual democratic channels. The unalterable rule in a society's constitution would commit societies to transferring locked assets to a body with a similar asset lock on dissolution.

3.19 Version A¹⁰ of the attached draft Regulations sets up this model framework for enforcing the lock (Option A in this document). Under the draft Regulations, the FSA would have powers to cancel the registration of a society in breach of the asset lock. However, since the power to cancel registrations would represent an extreme sanction for breach of the asset lock (and may, as a result, be used only infrequently), we would be grateful for the views of consultees on whether this would present a credible threat to societies.

3.20 Where a society dissolves as a result of a breach of the asset lock, the draft Regulations give the FSA the power to require a society to transfer its remaining locked assets to a body with an equivalent restriction of the use of assets: i.e. another asset-locked community benefit society, a charity, a CIC, or a Registered Social Landlord. Under the draft Regulations, any person in breach of this requirement would be subject to imprisonment for up to three months or a fine of up to £1,000¹¹.

¹⁰ See Schedule 2 of Version A of the Regulations and in particular the modification to section 16 of the Industrial and Provident Societies Act 1965.

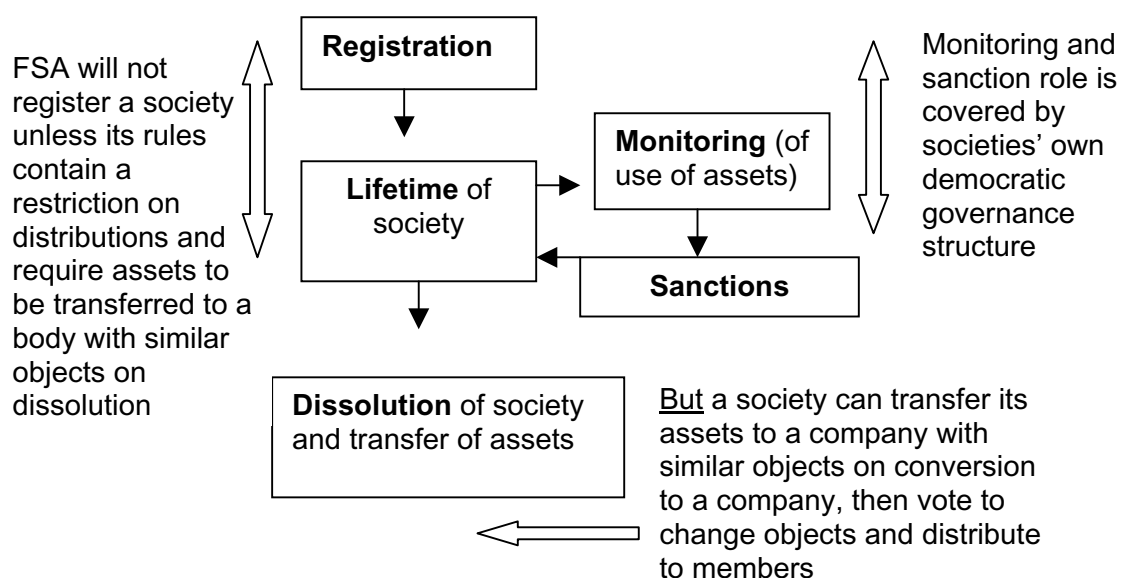
¹¹ See Schedule 2 of Version A, and in particular the modification to section 16 of the Industrial and Provident Societies Act 1965.

3.21 We would be grateful for the views of consultees on whether Option A for enforcement of the lock, as described above, is sufficient to ensure that assets are locked in during the lifetime of a society. Consultees may also have views on the consistency of this option with the enforcement framework for the CIC asset lock¹².

Option B 3.22 Alternatively we have the option to create an external enforcement framework for regulating the use of assets during the lifetime of the society (as well as on dissolution), in addition to the opportunities for monitoring and redress provided by societies' own democratic governance structure. This would provide an alternative option to the internal processes of the society in resolving concerns about the asset lock. Version B of the attached draft Regulations sets up this alternative framework for enforcement (Option B in this document). Further detail on the options for investigation and sanction under this model is set out in **Annex A**.

3.23 Diagram 1 below sets out how assets are protected under the existing legal and regulatory framework for community benefit societies. Diagram 2A shows how the enforcement option outlined in paragraph 3.19-3.21 (above) would work. Diagram 2B sets out the alternative, more interventionist enforcement framework outlined in paragraph 3.22. This includes provision for an external enforcement body to regulate the use of assets during the lifetime of the society, as well as on dissolution.

Diagram 1 – existing framework (without asset lock)



¹² See footnote 5 above. Subject to the outcome of consultation with the wider social enterprise sector, the Government's provisional view is that if the present consultation indicates that Option A for enforcement of the asset lock is considered acceptable to protect IPS assets, it would be reasonable to allow CICs to transfer assets to asset-locked IPSs. Such transfers would need to be subject to certain conditions to ensure that CIC assets could not be applied to activities which will not satisfy the CIC community interest test, such as political activities. The Government will however wish to keep these arrangements under review to ensure that they provide adequate protection for the assets of both CICs and asset-locked societies

Diagram 2A – restrictions on dissolution

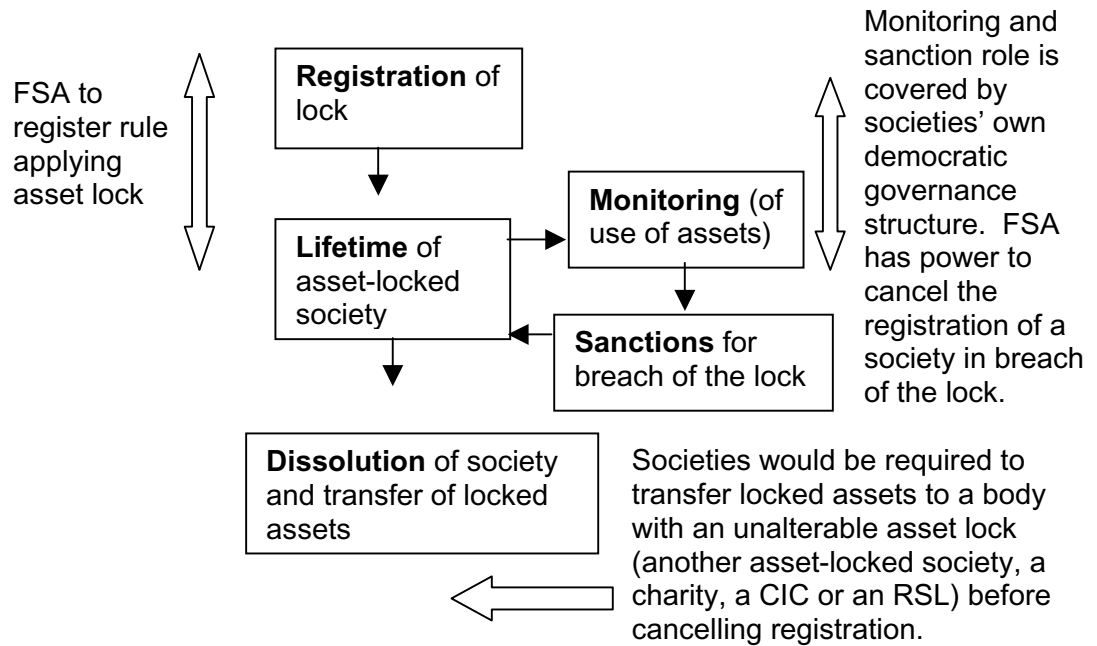
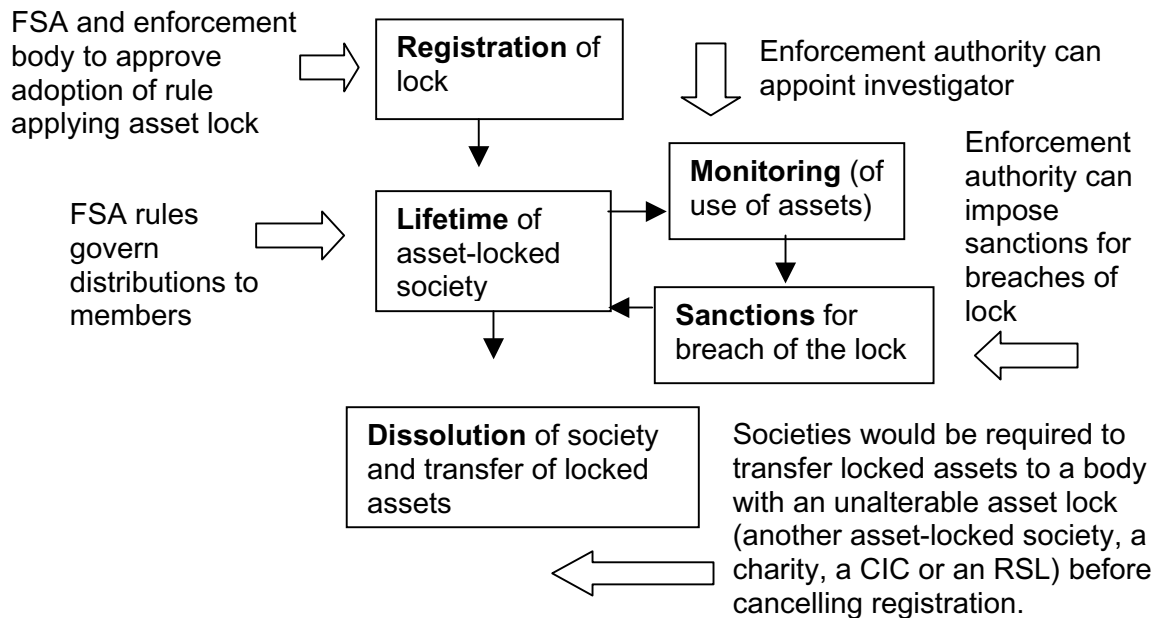


Diagram 2B – external enforcement framework



3.24 Option B above (as outlined in Diagram 2B) would require an **enforcement body** to bring it into effect. The Government has considered the options for this carefully. Since the Regulator for Community Interest Companies will be responsible for regulating the asset lock for CICs, there may be some high-level synergies in bringing together the enforcement roles for the two asset locks. One option, therefore, is for the **CIC Regulator** to take on this role.

3.25 Bringing the enforcement roles for CICs and societies together in this way may allow for the development of a collective understanding of how locked assets can be protected for the benefit of the community. However, the very different legal frameworks for these two asset lock regimes may allow little scope for synergy in the practical aspects of enforcement of the lock. For example, the enforcement powers available in respect of breaches of the asset lock will be different for each form; and the underlying legal environment will be that of company law in the case of CICs and IPS law in the case of societies.

3.26 An alternative option is for the role of enforcement authority to be taken on by one of the existing ‘sponsoring bodies’ for Industrial and Provident Societies. We would be interested in the views of consultees on this. We would also be grateful for an indication of whether any sponsoring bodies would be interested in taking on this role.

3.27 The Government is interested in the views of consultees on the suitability of these bodies to take on the role of ‘enforcement body’ under Option B above, taking into account the practical issues of timing and cost discussed below. We also would be grateful for thoughts on other existing bodies which may be suitable for this. Consultees should note that, under the 2003 Act, we do not have the power to set up a new statutory corporation for the purpose of enforcing the asset lock, but we can confer functions on any body that is already in existence.

3.28 The table below summarises the key differences between these models.

	Existing framework	Option A	Option B
Registration	FSA will not register a society unless its rules contain a restriction on distributions and require assets to be transferred to a body with similar objects on dissolution	FSA to register rule applying asset lock	FSA and enforcement body to approve adoption of rule applying asset lock
Lifetime (monitoring and sanctions)	Monitoring and sanction role is covered by societies’ own democratic governance structure	Monitoring and sanction role is covered by societies’ own democratic governance structure. FSA has power to cancel the registration of a society in breach of the lock.	Enforcement body can appoint an investigator, and impose sanctions for breaches of lock.
Dissolution	Nothing in law to prevent a society transferring its assets to a company with similar objects on conversion to a company, then voting to change objects and distributing to members	Societies would be required to transfer locked assets to a body with an unalterable asset lock (another asset-locked society, a charity, a CIC or an RSL) before cancelling registration.	Societies would be required to transfer locked assets to a body with an unalterable asset lock (another asset-locked society, a charity, a CIC or an RSL) before cancelling registration.

Comparison of enforcement options **3.29** Key elements in a comparison of these two alternative options are the robustness of the regulatory framework, the likely cost to societies, and practicalities such as the timing of implementation.

Option A **3.30** Option A above would represent a more ‘light-touch’ regulatory option than the formal enforcement framework set out in Option B. The cost to societies of this option is likely to be lower than that for Option B. However, the eventual cost of this option is likely to depend on the procedure whereby the FSA satisfies itself that a society is in breach of the lock.

3.31 Under Version A of the Regulations as currently drafted, the FSA can only act ‘on proof to [its] satisfaction’ that a society is in breach of the lock. It is likely that some kind of investigation would be required to provide this proof. Under the principle of full cost recovery, the cost of running investigations would need to be met by societies themselves (though it would be for the FSA to determine exactly how these costs should be recovered). It is extremely difficult to predict how much such investigations would cost, since much would hang on the complexity of the issues involved, and whether the investigation might result in criminal sanctions and/or publicity. The cost of an investigation into a relatively complex issue, such as insider trading in a company, can run to tens of thousands of pounds. If the issues to be investigated in a case of concern that a Society had breached the asset lock were simpler, the costs of investigation could of course be significantly lower. We would therefore welcome the views of consultees as to the likely level of complexity involved in investigating a suspected breach of the asset lock by a Society.

3.32 Alternatively, we have the option of leaving it to the courts to adjudicate over an alleged breach and to order the FSA to take action as necessary on the basis of this. Again, this would be likely to lead to high costs for members making allegations, and societies fighting them. We would be grateful for the views of consultees on the most appropriate model to adopt for investigations under this enforcement model.

Option B **3.33** By contrast, the enforcement framework set out in Option B involves the possibility of regulatory action during the lifetime of the society. This model would provide a more interventionist regulatory framework than the model outlined in Option A.

3.34 This option may involve set-up and ongoing costs. The ongoing cost of this option would depend heavily on the enforcement body chosen, on the number of societies registering an asset lock, and on the procedures adopted for handling investigations, but may be higher than that for the enforcement framework outlined in Option A. Under the principle of full cost recovery, the ongoing costs of this option would need to be met by those societies using the lock

3.35 If the CIC Regulator were chosen to take on the role of enforcement body, and depending on the number of asset lock registrations, and the procedure adopted for handling investigations, running costs for the enforcement framework would include a range of items including staff, administration and IT costs, and the cost of legal support and investigations. The level of the last two items, in particular, will depend heavily on the frequency and complexity of investigations, as with Option A above. The partial Regulatory Impact Assessment at Annex A suggests possible costs as a basis for discussion, but these are highly provisional and as with Option A, we would welcome consultees’ views on the likely level of complexity involved in investigations of breaches of the asset lock.

3.36 Using the CIC Regulator to perform this function could also have issues for the timing of introduction of the asset lock. Since the CIC Regulator will be independent of Government, has not yet been appointed, and will need some time to establish the CIC regulatory regime before preparing to take on this additional responsibility, enforcement of the asset lock through the CIC Regulator is unlikely to be possible in the short term. We do not envisage that the CIC Regulator would be ready to take on this role until late 2007 or early 2008.

3.37 If instead a sponsoring body were to take on the role of enforcing the CIC asset lock, the cost of enforcement for the asset lock, and the way in which this cost would be recouped from societies, would be a matter for the body itself to determine. The costs of this may be lower than those for enforcement via the CIC Regulator. It may also be possible to set in place an enforcement option involving a sponsoring body more quickly than if the CIC Regulator were to take on this role.

5. How should the asset lock be enforced? Is it necessary for the enforcement framework to regulate the use of assets during the life of the society, as in Option B, or is it enough simply for there to be a restriction on the transfer of assets when the society dissolves (as in Option A), with the power to cancel the registration of a society in breach of the lock? (Consultees considering Option B may wish to turn to Annex A, which contains further questions on the enforcement framework during the lifetime of societies under Option B).

6. If consultees feel that the enforcement framework should regulate the use of assets during the lifetime of the society, as set out in Option B above, should the role of enforcement authority be filled by:

- a) the CIC Regulator;
- b) a sponsoring body; or
- c) another body (please indicate which)?

TRANSFER OF ASSETS ON DISSOLUTION OR CONVERSION

3.38 The 'life' of a community benefit society ends either: (a) where it has its registration cancelled (either at its own request or at the request of the FSA); (b) where it is forced to dissolve as a result of insolvency; (c) where it transfers its engagements to or amalgamates with another society, or (d) where it converts into, amalgamates with, or transfers its engagements to a company¹³. At present, where a society dissolves or transfers its engagements to a company or to another society, the FSA may not cancel the registration of the society until the society has lodged an instrument of dissolution with the Authority confirming that its property has been duly transferred in accordance with its community benefit purposes¹⁴. But as discussed at the beginning of this chapter, in the case where a society converts to a company with similar objects, there is currently nothing in law to stop the members then voting to change the company's objects to allow distributions to members – in effect, to demutualise.

¹³ See sections 16, 51, 52 and 59 of the Industrial and Provident Societies Act 1965.

¹⁴ See section 59 of the Industrial and Provident Societies Act 1965.

Conversion, amalgamation, transfer of engagements **3.39** The attached draft Regulations (both Version A and Version B) provide that asset-locked societies may only transfer their engagements to another society where the effect of this is that the locked assets will be transferred to another society with an asset lock. The Regulations provide that a society may only transfer its assets to, convert itself into or amalgamate with a company where this is a CIC, a charitable company or a company which is a Registered Social Landlord¹⁵.

Cancellation of registration **3.40** Under the enforcement framework set out in Option A, a society in breach of the lock whose registration is to be cancelled would be required to either:

- Transfer its assets to one or more bodies with an unalterable asset lock, as set out in para 3.43 below; or
- Transfer its engagements to another asset-locked society or company, or convert itself into or amalgamate with a company as set out in para 3.39 above.

3.41 Persons in breach of this requirement one month or more after the FSA has given notice of cancellation of registration would be subject to imprisonment of up to 3 months or a fine of up to £1,000¹⁶.

Dissolution **3.42** For the asset lock to be credible, it is crucial that assets are adequately protected when a community benefit society winds up. But where an asset-locked society becomes insolvent, some locked assets may need to be used to pay off outstanding creditors. Accordingly, the attached draft Regulations allow locked assets to be ‘unlocked’ in the event of insolvency, to the extent necessary to pay off creditors, where all other resources (such as withdrawable share capital) have been exhausted¹⁷.

3.43 In the event of a community benefit society being wound up, voluntarily or otherwise, the value of the assets, once any creditors have been paid off, must be transferred to another body with an equivalent, unalterable asset lock. The attached draft Regulations (Version A and Version B) require that, on the dissolution of a society, assets should be transferred to one or more of:

- A community benefit society with an asset lock (where the assets to be transferred will also fall within the lock);
- A Community Interest Company (once established);
- A registered social landlord with an equivalent asset lock; or
- A charity within the meaning of section 5A(7) of the Industrial and Provident Societies Act 1965¹⁸.

¹⁵ See Version A – Schedule 2 and in particular the modifications to sections 50, 51, 52 and 59 of the Industrial and Provident Societies Act 1965; and Version B – Schedule 3 and in particular the modifications to sections 50, 51, 52 and 59 of the Industrial and Provident Societies Act 1965.

¹⁶ See Version A – Schedule 2 and in particular the modification to section 16 of the Industrial and Provident Societies Act 1965.

¹⁷ See Regulation 10 (Versions A and B).

¹⁸ See Schedule 1 (Versions A and B).

3.44 In addition, we have the option to make provision in the ‘restriction on use’ rule (which societies must adopt to apply the asset lock) to allow or require societies to name a future beneficiary to which its assets should be transferred on dissolution. This beneficiary must have an irrevocable asset lock (so must be one of the four types of body set out above). The rule would also need to provide that, where the named beneficiary had ceased to exist by the time a society dissolved, its assets should be transferred to a body with an irrevocable asset lock (as set out above) and similar purposes to those of the society winding up.

3.45 This provision may offer greater reassurance to investors over the use to which assets would be put on winding-up of the society, but may impose an additional burden on societies at the point of registration. This provision may also give rise to complications on dissolution, either where there is a dispute over the named beneficiary to which assets are to be transferred or, where the named beneficiary has itself dissolved, in identifying an alternative beneficiary with ‘similar purposes’ to which to transfer the assets. An alternative would be to allow assets to be transferred to any body with an irrevocable asset lock (no matter what its purposes) where the named beneficiary has ceased to exist. This would remove potential problems around finding an asset-locked body with ‘similar purposes’ to which to transfer the assets.

7. Do you believe that societies should be able to name in the rule applying the asset lock a future beneficiary to whom assets should be transferred on dissolution? Would this be more useful as an option or as a requirement?

OTHER ISSUES

Branding for the asset lock

3.46 Societies with an asset lock may wish to make their asset-locked status clear to those who deal with them, so that investors are aware that their investments will be protected for public purposes. We have the option, in so far as this is necessary to enforce the asset lock, to require societies to make their asset-locked status clear on their business documentation (in much the same way as the 2003 Act requires charitable societies to make this status clear), to ensure that those dealing with asset-locked societies are aware that the society has an asset lock. We would be grateful for the views of consultees on whether this would be a helpful addition to the asset-lock regime.

Members’ interests

3.47 It is possible that as a result of the application of an asset lock the interests, rights or liabilities of members of a community benefit society could be altered. Where this has occurred, the draft Regulations provide for members to be paid such compensation as may be just, to reflect the diminution in the value of any interests or rights or any increase in burden of their liabilities. However, where members of a society have voted to apply the asset lock, the Government considers them to have waived the right to such compensation. Accordingly, the draft Regulations provide that members of a community benefit society who have voted in favour of adopting the asset lock shall not be entitled to compensation¹⁹.

¹⁹ See Version A – Regulation 11; and Version B - Regulation 24.

8. What, if any, member interests, rights or liabilities could be altered by the application of an asset lock? Do you agree with the proposed compensation regime for this?

Fee structure 3.48 The role of enforcing the asset lock for community benefit societies may require some investment of resources. Under the ‘restrictions on dissolution’ model outlined in Option A, any additional cost of the extra responsibilities associated with this may be reflected through the FSA’s fee structure. Under the external enforcement framework outlined in Option B above, the cost of enforcement would need to be recoverable by the enforcement body. Accordingly, the attached draft Regulations for the formal enforcement framework option give the enforcement body power to make rules charging fees for its services to societies using the asset lock. Before making or revising such rules, the Regulations provide that the enforcement body should consult all parties likely to be affected by them.

PRACTICAL ISSUES

Demand 3.49 At present it is unclear how many community benefit societies will want to apply the asset lock from the date the Regulations come into force. We would be very grateful for an indication of whether existing societies are currently considering applying the asset lock once this option becomes available.

Costs and benefits 3.50 A Regulatory Impact Assessment for the asset lock proposal is attached at Annex C. This attempts to identify and quantify the costs and benefits of this proposal.

9. Are you going to use the asset lock? Have the issues we have raised in this document influenced your views on whether or not to apply the lock? How?

10. Can you:

a) identify any costs or benefits for your organisation or more generally resulting from these proposals?

b) quantify these costs or benefits?

See Annex C for details of these costs and benefits.

11. Do you have any comments or suggestions on the drafting of the Regulations at Annexes E and F?

4

FURTHER QUESTIONS

4.1 As part of our work to develop and refine Government strategy towards the Industrial and Provident Society sector, we would also like to use this consultation document to canvass the views of stakeholders on a number of additional issues related to the wider legal and regulatory framework for the sector. These are set out below.

Future location of registration function

4.2 As you are aware, the FSA took over responsibility for registering Industrial and Provident Societies from the Registry of Friendly Societies on 1 December 2001. We are aware that some organisations within the sector have had alternative views over the most appropriate location for this function and we are interested in the views of consultees on this.

12. Do you have views on the preferred location for this function?

Audit threshold for non-charitable societies

4.3 The Friendly and Industrial and Provident Societies Act 1968 generally requires societies to appoint a qualified auditor to audit their end-year accounts and balance sheet. Non-charitable societies with a turnover of not more than **£350,000**, with assets of not more than **£1.4m**, can choose to disapply this obligation¹. But a society which chooses to disapply the obligation must nevertheless obtain a limited ‘accountant’s report’ from a person qualified as an auditor if its turnover in the relevant year exceeded **£90,000**. By comparison, non-charitable companies registered under the Companies Act 1985 with a turnover of not more than **£5.6m** and whose balance sheet total is not more than **£2.8m** do not need to have their accounts audited². Community Interest Companies (CICs), once introduced, will be subject to the Companies Act audit thresholds for turnover and assets.

4.4 At present, charitable companies and societies with a gross income of more than **£250,000** and assets of not more than **£1.4m** are required to have their accounts audited, and charitable companies and societies with a gross income of more than **£90,000** and assets of not more than **£1.4m** have to obtain an accountant’s report. The draft Charities Bill published by the Home Office in May this year proposes to raise the full ‘audit threshold’ for charitable companies and societies to **£500,000 gross income and assets of £2.8m**³. If the Home Office proposals for charitable societies and companies are implemented as they currently stand, the audit thresholds for charitable societies will therefore be raised above those for non-charitable societies.

4.5 The table below compares the relative audit thresholds for the different legal forms, under current legislation and following implementation of the Home Office proposals.

¹ See section 4A of the Friendly and Industrial and Provident Societies Act 1968. Note that this choice is not open to societies which are credit unions, registered housing associations, registered social landlords or insurers, societies which are or have subsidiaries and societies holding deposits.

² See section 249A(3) of the Companies Act 1985. However, this does not apply to certain categories of companies, including those carrying on insurance or banking or which are or have subsidiaries.

³ http://www.homeoffice.gov.uk/docs3/charitiesbill_foreward040527.pdf

Audit thresholds for companies and charities

	Current situation		Situation following implementation of Home Office proposals	
	Turnover/ gross income	Assets	Turnover/ gross income	Assets
Company/CIC	£5.6m	£2.8m	£5.6m	£2.8m
Charitable company/society	£250K	£1.4m	£500K	£2.8m
Non-charitable society	£350K	£1.4m	?	?

4.6 The Government sees a good case for raising the audit threshold for non-charitable societies – both to even up the playing field between societies and companies in this respect, and to avoid potential legal anomalies arising from the Home Office proposals. In the light of this, the Government proposes to raise the audit threshold for non-charitable Industrial and Provident Societies to **£5.6m** turnover, and **£2.8m** assets, to bring it into line with those for non-charitable companies (and – once they are introduced – CICs)⁴. It would be possible to do this using secondary legislation, under a power in the Industrial and Provident Societies Act 2002⁵. We would be grateful for the views of consultees on the proposal to raise the audit thresholds for non-charitable societies to this level.

13. Do you agree that the audit thresholds for non-charitable societies should be raised to bring them into line with those for companies and CICs – i.e. £5.6m turnover and £2.8m assets?

14. Can you:

- identify any costs or benefits for your organisation or more generally resulting from these proposals?
- quantify these costs or benefits?

See Annex D for details on these costs and benefits.

⁴ Under this proposal, societies with a turnover of between £90,000 and £5.6 million would still have to obtain a limited 'accountant's report' from a person qualified as an auditor, as is currently the case for societies with turnovers between £90,000 and the current audit threshold of £350,000.

⁵ See section 2 of the Industrial and Provident Societies Act 2002. This provision gives HM Treasury the power, by order, to modify Industrial and Provident Society legislation to assimilate it to company law, following a modification of company legislation.

A

OPTION B: ASSET LOCK ENFORCEMENT FRAMEWORK

A.1 This section of the document sets out in detail the formal enforcement framework option (Option B) for regulating the asset lock during the lifetime of community benefit societies – as set out in Version B of the attached draft Regulations. It is of particular relevance for consultees considering Option B for enforcement of the asset lock (see **Question 5** above). This model involves provisions for investigation of suspected breaches, possible sanctions when a breach has been discovered, and related provisions (including appeals).

Investigation A.2 Where the enforcement authority has been informed of a suspected breach of the lock by a member of the society, or identifies a suspected breach on its own initiative, it would have powers to appoint any competent person to investigate the affairs of either the society or any person to whom locked assets have been transferred.

A.3 The investigator would have powers to require those under investigation to produce information connected with the suspected breach. The draft Regulations provide that the enforcement authority may apply to the court to deal with persons failing to comply with this requirement, and that these persons may be treated by the court as if they had been in contempt of court. The draft Regulations also provide that any person providing false information to the enforcement authority will be liable to imprisonment for up to two years. These provisions are modelled on those setting out the powers of the regulator for Community Interest Companies to investigate the affairs of a CIC in the Companies (Audit, Investigations and Community Enterprise) Bill clause 40 and Schedule 7¹.

A1. Do you agree with the proposed procedure for handling investigations?

Sanctions A.4 If, on further investigation, the enforcement authority believes that the society has breached or is currently in breach of the lock, it should have powers to take action to address this. The 2003 Act gives us a number of options for enforcement powers – the draft Regulations set out the full range of available enforcement options (summarised below). These powers are not mutually exclusive, and can be used in any combination. The recruitment of staff qualified to take on certain of these functions, most notably the power to fine, is likely to lead to significantly higher costs for societies.

- Agreements made by a community benefit society in breach of the asset lock can be rendered **unenforceable**. So, for example, an agreement made by a community benefit society to sell locked assets for private gain would be unenforceable. In such circumstances the other party would be entitled to recover any money or property paid as part of the agreement and compensation for any loss sustained².
- An **offence** can be created for persons contravening the asset lock. As an example, the draft Regulations provide that persons committing this offence will be liable to a maximum of two years' imprisonment³.

¹ See Regulation 14 and Schedule 2 of Version B.

² See Regulations 12 and 13 of Version B.

³ See Regulation 15 of Version B.

- The enforcement authority can be given the power to publish a **statement of public censure** if it considers a society to be in breach of the asset lock⁴.
- The enforcement authority may be given the power to give a society which it considers to be in breach of the asset lock an **enforcement notification** requiring that society or person to bring the contravention to an end (and not repeat it) and remedy the consequences of the contravention⁵. For instance, this provision would allow the enforcement authority to require the society to remove or appoint a director to a society in breach of the asset lock, if this were necessary to prevent further contravention.
- The enforcement authority can be given powers to impose a **financial penalty** of up to £100,000 on a society which it considers to be in contravention of the asset lock⁶.

A.5 The Government is interested in the views of consultees on the enforcement options above. One important question to resolve here is whether it makes sense to include provision for fines and compensation payments in an enforcement framework based around the need to protect assets for public purposes. Payment of fines and/or compensation by a society in breach of the lock will itself reduce the total of the assets to be protected.

A2. Are all of these sanctions needed as part of the regulatory framework for the asset lock, or would a combination of the options above deliver a more proportionate system of regulation? If so, which of the possible sanctions above do you believe would be most effective?

A3. Can you suggest any further sanctions which should be available to the enforcement authority in regulating the asset lock?

A4. Are the proposed maximum sentence (of two years) and fine (of £100,000) for breach of the asset lock set at the right level for this offence?

A.6 The Government proposes that the enforcement body should give societies adequate warning, and opportunity to make representations, before publishing a statement of public censure, giving an enforcement notification or imposing a penalty. So the draft Regulations require that the enforcement authority, before taking any of these steps, should send to the society a warning notice setting out details of the proposed action and inviting the society or person to make representations to the enforcement authority. The Regulations do not prescribe a notice period for this, since in some cases the enforcement authority may need the flexibility to act quickly to ensure locked assets are protected.

A.7 Where a decision on sanctions has been taken the Regulations provide that the enforcement body should send the society or person a decision notice setting out what decision has been taken and the reasons for this⁷.

⁴ See Regulation 17 of Version B.

⁵ See Regulation 18 of Version B.

⁶ See Regulation 19 of Version B.

⁷ See Regulations 20-23 of Version B.

A5. Do you agree with the proposed procedure for applying sanctions?

Appeals A.8 The draft Regulations provide that the person or society concerned may appeal against decisions made by the enforcement authority in the following cases:

- Where the enforcement authority has objected to a proposed transfer of locked assets to a community benefit society with a similar restriction on the use of assets⁸; and
- Where the enforcement authority decides to publish a statement of public censure, give an enforcement notification or impose a financial penalty⁹.

A.9 The system for handling appeals, if adopted, would depend on the regulatory framework adopted for the asset lock.

⁸ See Regulation 11(4) of Version B.

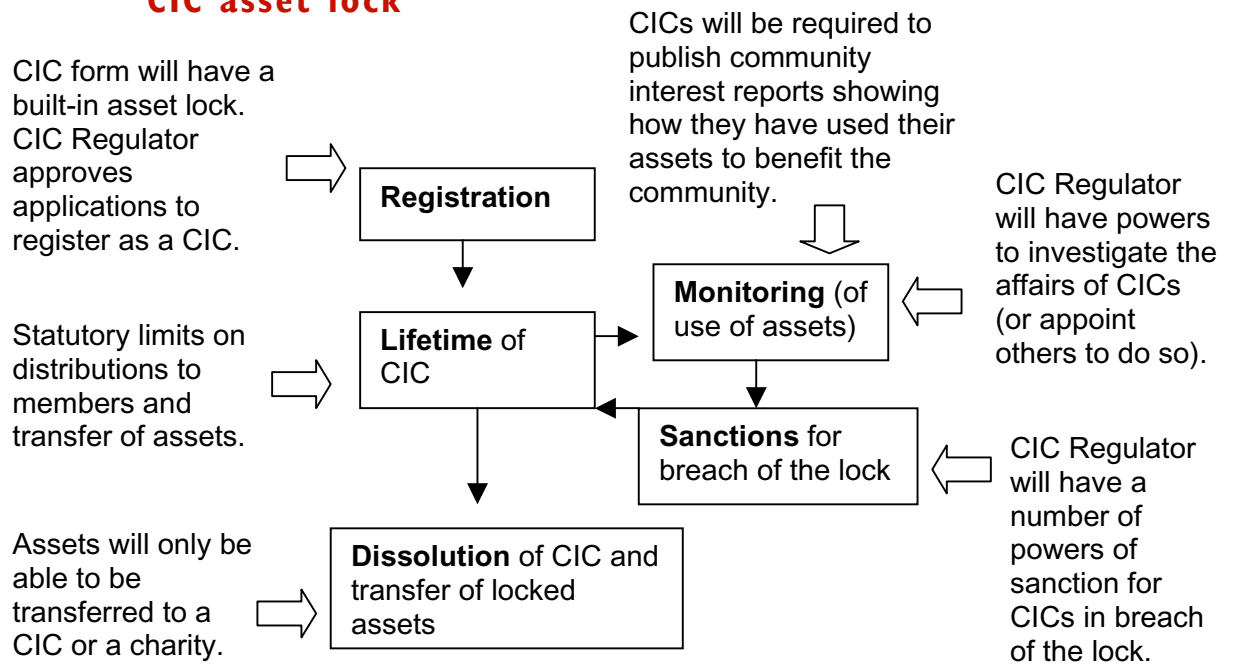
⁹ See Regulation 21(2) of Version B.

B

ASSET LOCK FOR CICs

B.1 The diagram below sets out key elements in the enforcement framework for the Community Interest Company asset lock.

CIC asset lock



B.2 The table below sets out the elements of this enforcement framework in more detail. For further information on the enforcement framework for CICs, please see the explanatory notes to the Companies (Audit, Investigations and Community Enterprise) Bill – clauses 24-61¹.

¹ <http://www.publications.parliament.uk/pa/ld200304/ldbills/008/en/04008x-e.htm>

Registration	CICs will be required to include in their Memorandum and Articles provisions about the transfer and distribution of assets. These will establish the 'asset lock' on distributions to members and will set out the terms on which CICs may transfer assets to third parties. It will not be possible to register a CIC without this 'asset lock'; the CIC Regulator will check the provisions when vetting applications to register as a CIC. The CIC constitution will also include provisions intended to limit the ability of investors to control a CIC with a view to maximising the return on their investment, at the expense of the CIC's community interest purposes.
Lifetime	Legislation will prohibit CICs from making distributions to members, except to the extent permitted by regulations. During their lifetime, CICs will not be allowed to transfer assets to other bodies or individuals for less than the value of the asset, except in pursuit of their community interest aims. However, where a CIC wishes to transfer assets to another organisation with community interest aims and an asset lock (i.e. a CIC or charity), regulations will allow it to do so, subject to certain safeguards.
Monitoring	CICs will be required to produce an annual 'Community Interest Company Report', for publication in the Companies Register, giving details of what the CIC has done during the year to benefit the community, how it has involved its stakeholders in its activities, dividends paid on shares and remuneration of directors. The CIC Regulator will have powers to investigate the affairs of CICs, and to appoint people to carry out such investigations. Since CICs will be companies, they will also be subject to investigation by the DTI's Companies Investigations Branch.
Sanctions	The CIC Regulator will have wide-ranging powers of sanction for CICs in breach of the statutory requirements of CIC status, including the power to bring civil proceedings on behalf of a CIC against its directors, the power to appoint or remove a director, appoint a manager, and vest assets in trust to protect them.
Dissolution	On winding-up, the assets of a CIC will only be able to be transferred to a CIC or a charity. Assets will be transferred under the directions of the Regulator (either whole or in part) (i) to a CIC or charity specified for that purpose in the CIC's memorandum and articles or (ii) to any other CIC or charity specified by the Regulator. It will not be possible for residual assets to be transferred to an Industrial and Provident Society until regulations are made under delegated powers contained in the Bill.



PARTIAL REGULATORY IMPACT ASSESSMENT FOR ASSET LOCK PROPOSALS

I. PROPOSAL

C.1 The Community Benefit Societies (Restriction on Use of Assets) Regulations 2004.

2. PURPOSE AND INTENDED EFFECT OF MEASURE

Objective C.2 The objective of the proposal is to provide community benefit societies (incorporated as a type of Industrial and Provident Society) with the option to protect their assets for community benefit purposes.

Devolution C.3 Responsibility for Industrial and Provident Society law rests with the Chancellor of the Exchequer. It is an area which is reserved to Westminster under the Scottish and Welsh devolution legislation and therefore these changes will apply to Industrial and Provident Societies in Great Britain. In Northern Ireland, matters arising from the proposal would normally be the responsibility of the Northern Ireland Executive Ministers. While the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by the Northern Ireland Departments subject to the direction and control of the Secretary of State for Northern Ireland.

Background C.4 The community benefit society is one of a number of legal forms available to social enterprises. It is a body run and managed by its members where profits are distributed not back to members (as with co-operatives) nor to external shareholders (as with companies) but to the wider community. Community benefit societies operate in a wide range of sectors such as childcare, leisure and football Supporters' Trusts. Community benefit societies are incorporated under the Industrial and Provident Societies Act 1965.

C.5 The Co-operatives and Community Benefit Societies Act 2003 contains a provision that gives the Treasury the power, by secondary legislation, to bring forward provisions allowing IPS community benefit societies to prohibit distribution of their assets other than in specified circumstances, such as to another society with a similar rule on use of assets, or a charity. This is known as an 'asset lock'. The Government supported the 2003 Act in its passage through Parliament as a Private Member's Bill (put forward by Mark Todd MP).

C.6 The proposal to allow community benefit societies to set up an asset lock was one of the recommendations of the September 2002 Strategy Unit Report, "Private Action, Public Benefit". The Government endorsed this recommendation.

C.7 The Strategy Unit Report also recommended the creation of the Community Interest Company (CIC) as a new legal form for social enterprise based on company law. Proposals to establish a Community Interest Company are currently being debated in Parliament as part of the Companies (Audit, Investigations and Community Enterprise) Bill. Once introduced, the CIC will offer a complementary alternative to the existing forms of incorporation available to social entrepreneurs (including the community benefit society). The CIC form will have a built-in asset lock.

Risk assessment C.8 Industrial and Provident Society legislation and regulatory practice already place a number of restrictions on the way community benefit societies deal with their assets. However, where assets are transferred to a company with similar objects on the conversion of a society to company status, there is currently nothing in law to stop the members then voting to change the company's objects to allow distributions to members – in effect, to demutualise. By adopting the asset lock, and thus eliminating the possibility of private individual gain, societies will be better able to attract investors seeking certainty that their investments will be used as intended. In being better able to attract investment, the cost of capital may be reduced for community benefit societies as the need to borrow to finance activities will be less. The asset lock therefore removes a potential barrier to further community benefit society growth.

3. OPTIONS

C.9 In addition to the option of doing nothing, two sets of options are discussed below. The first set discusses whether the option to apply an asset lock should be available to all community benefit societies. The second set discusses what type of regulatory framework is needed to monitor the use of locked assets during the 'lifetime' of a society. These two sets of options are **not mutually exclusive** (i.e. options 2a or 2b can be taken up with options 3a or 3b).

Option 1: No action

C.10 The risks of not allowing community benefit societies to set up an asset lock are discussed in paragraph C.8 above.

Option 2a: Allowing all community benefit societies to establish an asset lock

C.11 As community benefit societies with charitable status and those registered as Registered Social Landlords are already subject to a lock on their assets, allowing these bodies to adopt the community benefit society asset lock set out in these Regulations could, in the view of HMT, ODPM and the Home Office lead to confusion and duplication.

Option 2b: Allowing all community benefit societies to establish an asset lock except for societies incorporated as Registered Social Landlords and those with charitable status.

C.12 This avoids the problem of duplication and confusion mentioned above.

Option 3a: Asset lock with a light-touch regulatory framework

C.13 The democratic ethos common to many community benefit societies means that in many cases the members of a society are well-equipped to call its Board to account for their actions. So one option for enforcement of the lock during the lifetime of the society would be to leave it to members to monitor the use of locked assets take action where appropriate, through the usual democratic channels. The unalterable rule in a society's constitution would commit societies to transferring locked assets to a body with a similar asset lock on dissolution.

C.14 In addition, the FSA would have powers to cancel the registration of a society in breach of the asset lock. Where a society dissolves as a result of a breach of the asset lock, the draft Regulations give the FSA the power to require a society to transfer its remaining locked assets to a body with an unalterable asset lock: i.e. another asset-locked community benefit society, a charity, a CIC, or a Registered Social Landlord. Under the draft Regulations, any person in breach of this requirement would be subject to imprisonment for up to three months or a fine of up to £1000.

C.15 However, since the power to cancel registrations would represent an extreme sanction for breach of the asset lock, we would be interested in the views of consultees on whether this would present a credible threat to societies.

Option 3b: Asset lock with a formal enforcement framework

C.16 An alternative option would be to create a formal enforcement framework for regulating the use of assets during the lifetime of the society, in addition to the opportunities for monitoring and redress provided by societies' own democratic governance structure. This would serve as an alternative option to resolving concerns about the asset lock through the internal processes of the society.

C.17 This option would require an **enforcement body** to bring it into effect. The Government has considered the options for this carefully. Since the Regulator for Community Interest Companies will be responsible for regulating the asset lock for CICs, there may be some high-level synergies in bringing together the enforcement roles for the two asset locks. One option, therefore, is for the **CIC Regulator** to take on this role. Bringing the enforcement roles for CICs and societies together in this way may allow for the development of a collective understanding of how locked assets can be protected for the benefit of the community. However, the very different legal frameworks for these two asset lock regimes may allow little scope for synergy in the practical aspects of enforcement of the lock. For example, the enforcement powers available in respect of breaches of the asset lock will be different for each form; and the underlying legal environment will be that of company law in the case of CICs and IPS law in the case of societies.

C.18 An alternative option would be for one of the sponsoring bodies for Industrial and Provident Societies to take on this role. We would be grateful for an indication of whether any sponsoring bodies would be interested in taking on this role.

4. BENEFITS

Option 1:

C.19 There are no benefits to not giving community benefit societies the option to lock in the value of their assets.

Option 2a:

C.20 All community benefit societies would be able to make use of the option to lock in the value of their assets. But there would be no real benefit to extending this option to charitable community benefit societies and those registered as Registered Social Landlords, since these bodies are already subject to a lock on their assets.

Option 2b:

C.21 All community benefit societies, except Registered Social Landlords and charitable community benefit societies, would be able to make use of the option to lock in the value of their assets. As set out above, this option would have the benefit of preventing unnecessary duplication and confusion in the regulation of asset locks for Registered Social Landlords and charitable societies.

Option 3a:

C.22 The main benefit of this option is that it would give greater flexibility to community benefit societies and presents a more ‘light-touch’ regulatory option. This could result in lower costs, and could come into effect as soon as the Regulations are laid.

Option 3b:

C.23 This option would deliver a more interventionist regulatory framework for the asset lock. It would give members an additional option for investigation and recourse where societies appear to be in breach of the lock during their lifetime, and may offer greater certainty for potential investors that their investment will be used as intended. This could facilitate greater growth in the sector.

Business sectors affected **C.24** These proposals will potentially benefit all community benefit societies. As of 2004, there are around 1,700 Industrial and Provident Societies registered as community benefit societies. Around 1,300 of these are charitable community benefit societies (of which around 700 are Registered Social Landlords); therefore option 2b will apply to around 400 community benefit societies.

C.25 It is not possible to predict how many community benefit societies will seek to take up the option to apply the asset lock. If you are replying on behalf of a community benefit society, we would be grateful for an indication of the likelihood that your society will take up this option.

Issues of equality and fairness **C.26** We do not consider that the proposal will bring any disproportionate benefits or have disproportionate effects on particular groups. Indeed, as Community Interest Companies will have an in-built asset lock, a failure to give community benefit societies the option to apply an asset lock if they wish to do would risk creating an uneven playing field.

5. COSTS**Option 1:**

C.27 There will be no direct financial costs associated with not offering community benefit societies the option to apply a lock on the value of their assets as application of the asset lock is a voluntary decision to be taken if community benefit societies determine that the benefits outweigh the costs. However, there may be indirect costs in the long run if they are not able to assure investors that investments will be used as intended. Without the option of an asset lock, societies may also be disadvantaged in comparison with CICs, in terms of attracting investment.

Option 2a:

C.28 The following costs are associated with the option to adopt an asset lock for societies:

Registering the asset lock

4.7 The 'restriction on use' rule setting up the asset lock would need to be registered with the FSA (and in the case of Option B, the enforcement authority) either as an amendment to existing rules, or as part of a new constitution (for new societies). The costs associated with drawing up this rule should be minimised through the proposal to require community benefit societies to use a proforma 'restriction on use' rule to set up the asset lock. In addition, an existing community benefit society seeking to apply the asset lock as an amendment to its rules would be required to hold a vote at a general meeting, for which notice has been given according to the rules of the society. The main costs to societies here are likely to be administrative costs associated with the need to call a general meeting, and hold a vote of members.

Ongoing management of registrations

C.29 It is possible that community benefit societies may have to change their systems in terms of IT, training and accounting, to take account of the asset lock. For example, community benefit societies may wish to issue guidance or train members and staff on use of locked assets and to raise awareness of the new rules. It is unclear whether such changes would be necessary to the same extent for all societies.

Branding

C.30 Societies with an asset lock may wish to make their asset-locked status clear to those who deal with them, so that investors are aware that their investments will be protected for public purposes. We have the option, in so far as this is necessary to enforce the asset lock, to require societies to make their asset-locked status clear on their business documentation (in much the same way as the 2003 Act requires charitable societies to make this status clear), to ensure that those dealing with asset-locked societies are aware that the society has an asset lock. Were we to adopt such a provision, this may lead to additional costs for societies in terms of changing official documentation, letterheads etc.

C.31 Many of these costs are difficult to quantify. We would welcome the views of respondents on the size of these costs and whether there are any other unanticipated costs.

Option 2b:

C.32 This option would restrict the costs mentioned above to all community benefit societies except those that already have an asset lock through being a Registered Social Landlord or a charitable community benefit society.

Option 3a:

C.33 In addition to costs involved in taking up the asset lock mentioned in option 2a, there may be separate costs associated with the enforcement framework for the asset lock. There are two aspects to this. Firstly, there are potential implications for the community benefit society in terms of the cost of registering the lock. Secondly, community benefit societies will need to consider the costs involved in terms of the enforcement framework that societies must comply with.

C.34 Option 3a would give the FSA powers to cancel the registration of a society in breach of the asset lock. It would also give the FSA the power to require a society, on dissolution, to transfer any remaining locked assets to another body with an unalterable asset lock, or to convert to a body with an asset lock.

C.35 Under the principle of full cost recovery, the costs of enforcement via this option would need to be met by societies themselves. This cost is likely to be lower than that for Option B (as described in (3b) below). But this is likely to depend on the procedure whereby the FSA satisfies itself that a society is in breach of the lock. Under option (3a) the FSA can only act ‘on proof to [its] satisfaction’ that a society is in breach of the lock. It is likely that some kind of investigation would be required to provide this proof. It is extremely difficult to predict how much such investigations would cost, since much would hang on the complexity of the issues involved, and whether the investigation might result in criminal sanctions and/or publicity. The cost of an investigation into a relatively complex issue, such as insider trading in a company, can run to tens of thousands of pounds. If the issues to be investigated in a case of concern that a Society had breached the asset lock were simpler, the costs of investigation could of course be significantly lower. We would therefore welcome the views of consultees as to the likely level of complexity involved in investigating a suspected breach of the asset lock by a society.

C.36 Alternatively, we have the option of leaving it to the courts to adjudicate over an alleged breach and to order the FSA to take action as necessary on the basis of this. Again, this would be likely to lead to high costs for members making allegations, and societies fighting them.

C.37 Option 3a assumes an important role for members of asset-locked societies (through their democratic governance structure) in monitoring the use to which the assets are put. As the FSA’s powers to cancel the registration of a society in breach of the lock are something of a ‘nuclear option’, it could be argued that this option places a heavier responsibility on members of a society to ensure that the community benefit society is acting as intended. For example, there could be costs to individuals in greater scrutiny of the activities of the organisation. It is not possible to quantify what costs these additional member responsibilities and staff resources would involve.

Option 3b

C.38 This option would involve set-up and ongoing costs. The ongoing cost of this option would depend heavily on the enforcement body chosen, on the number of societies registering an asset lock, and on the procedures adopted for handling investigations, but is likely to be higher than that for the enforcement framework outlined in Option A. As with Option A (see (3a) above), the principle of full cost recovery would mean that the ongoing costs of this option would be met by those societies using the lock. This cost would be in addition to the registration and periodic fees already charged by the FSA.

C.39 As set out above, one option is for the **CIC Regulator** to take on the role of enforcement body under Option B. Some preliminary assumptions for the costs of enforcement via the CIC Regulator are set out below. The lower take-up option below is based on an assumption of 50 societies using the lock, whereas the higher take-up option assumes ongoing responsibilities for around 400 societies. The figures for legal support and investigation costs are a very provisional range, reflecting uncertainty as to the level of investigative activity that will be needed and the complexity of investigations. If few investigations are required and they are relatively simple, we would expect the cost to be at the low end of these ranges. We would welcome views on the actual level of investigation activity and complexity (and therefore cost) that might be involved under this option.

Preliminary estimate of costs and enforcement via the CIC Regulator (under Option B)

	Low take-up (£000)	High take-up (£000)
Staff costs	30	50
Admin costs	10	50
IT systems	5	5
Legal support	30	50-100
Investigations	Up to 100 if complex	Up to 200 if complex
Total	Up to 175	Up to 405

C.40 If the CIC Regulator is chosen to take on the role of enforcement body, this could also have issues for the timing of introduction of the asset lock. Since the CIC Regulator will be independent of Government, has not yet been appointed, and will need some time to establish the CIC regulatory regime before taking on this additional responsibility, enforcement of the asset lock through the CIC Regulator is unlikely to be possible in the short term. We do not envisage that the CIC Regulator would be ready to take on this role until late 2007 or early 2008.

C.41 If instead a **sponsoring body** were to take on the role of enforcing the asset lock for societies, the cost of enforcement for the asset lock, and the way in which this cost would be recouped from societies, would be a matter for the body itself to determine. The costs of this may be lower than those for enforcement via the CIC Regulator. It may also be possible to set in place an enforcement option involving a sponsoring body more quickly than if the CIC Regulator were to take on this role.

6. CONSULTATION WITH SMALL BUSINESS

C.42 We have consulted the Small Business Service and we have agreed that there seems to be no impact on small business. However, we will be asking small business representatives for their views during the consultation and any views put forward will be taken into account.

7. COMPETITION ASSESSMENT

C.43 As the proposal merely introduces an option that community benefit societies can choose to take up if they believe it adds value to their business, this proposal in itself has no competition implications.

C.44 However, depending on the extent to which the option is taken up, this proposal may put community benefit societies with an asset lock at an advantage compared to those that have not taken up the asset lock option. This is because investors may be more inclined to invest where they can be confident that assets will be protected for the community benefit. Nevertheless, the Government believes that the option of applying an asset lock for societies will itself better enable the community benefit society sector as a whole to compete with other social enterprise forms for investment.

8. ENFORCEMENT AND SANCTIONS

C.45 Consultees have been asked to consider whether there should be a light-touch regulatory approach or an external enforcement framework (involving monitoring of the use to which assets are put during the lifetime of the society). The Government will consider what enforcement and sanctions will be associated with this proposal in light of consultation responses.

9. MONITORING AND REVIEW

C.46 The Government will consider what, if any, mechanisms are needed to monitor the ongoing effectiveness of the asset lock proposals in light of the consultation responses.

10. CONSULTATION

Within Government **4.8** HM Treasury has consulted with the Department for Trade and Industry, the Financial Services Authority, the Home Office, the Office of the Deputy Prime Minister, the Department for Constitutional Affairs, the Housing Corporation, the Scottish Office, the Welsh Office and the Department for Enterprise, Trade and Investment in Northern Ireland. We have also consulted the Small Business Service and the Office of Fair Trading.

Public consultation **4.9** On 30 July 2004, HM Treasury published a consultation document on the option for community benefit societies to apply an asset lock. The consultation document is available on HM Treasury's website and printed copies are available on request. The deadline for comments is 29 October 2004.

PARTIAL REGULATORY IMPACT ASSESSMENT FOR AUDIT THRESHOLD PROPOSALS

I. PROPOSAL

D.1 To raise the thresholds below which non-charitable Industrial and Provident Societies are required to appoint an auditor to audit their end-year accounts and balance sheet from the current level of £350,000 (turnover) and £1.4m (assets) to £5.6m (turnover) and £2.8m (assets).

2. PURPOSE AND INTENDED EFFECT OF MEASURE

Objective D.2 The objective of the proposal is to provide non-charitable societies with a turnover of between £350,000 and £5.6 million and assets of between £1.4 million and £2.8 million with the option not to have their accounts audited.

Devolution D.3 Responsibility for Industrial and Provident Society law rests with the Chancellor of the Exchequer. It is an area which is reserved to Westminster under the Scottish and Welsh devolution legislation and therefore these changes will apply to Industrial and Provident Societies in Great Britain. In Northern Ireland, matters arising from the proposal would normally be the responsibility of the Northern Ireland Executive Ministers. While the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by the Northern Ireland Departments subject to the direction and control of the Secretary of State for Northern Ireland.

Background D.4 The Friendly and Industrial and Provident Societies Act 1968 generally requires societies to appoint a qualified auditor to audit their end-year accounts and balance sheet. Non-charitable societies with a turnover of not more than £350,000, with assets of not more than £1.4m, can choose to disapply this obligation¹. But a society which chooses to disapply the obligation must nevertheless obtain a limited ‘accountant’s report’ from a person qualified as an auditor if its turnover in the relevant year exceeded £90,000. By comparison, non-charitable companies registered under the Companies Act 1985 with a turnover of not more than £5.6m and whose balance sheet total is not more than £2.8m do not need to have their accounts audited². Community Interest Companies (CICs), once introduced, will be subject to the Companies Act audit thresholds for turnover and assets.

D.5 At present, charitable companies and societies with a gross income of more than £250,000 and assets of not more than £1.4m are required to have their accounts audited, and charitable companies and societies with a gross income of more than £90,000 and assets of not more than £1.4m have to obtain an accountant’s report. The draft Charities Bill published by the Home Office in May this year proposes to raise the full ‘audit threshold’ for charitable companies and societies to £500,000 gross income and assets of £2.8m³.

¹ See section 4A of the Friendly and Industrial and Provident Societies Act 1968. Note that this choice is not open to societies which are credit unions, registered housing associations, registered social landlords or insurers, societies which are or have subsidiaries and societies holding deposits.

² See section 249A(3) of the Companies Act 1985. However, this does not apply to certain categories of companies, including those carrying on insurance or banking or which are or have subsidiaries.

³ http://www.homeoffice.gov.uk/docs3/charitiesbill_foreward040527.pdf

D.6 The table below compares the relative audit thresholds for the different legal forms, under current legislation and following implementation of the Home Office proposals.

	Current situation		Situation following implementation of Home Office proposals	
	Turnover/ gross income	Assets	Turnover/ gross income	Assets
Company/CIC	£5.6m	£2.8m	£5.6m	£2.8m
Charitable company/society	£250K	£1.4m	£500K	£2.8m
Non-charitable society	£350K	£1.4m	?	?

Risk assessment D.7 If the Home Office proposals for charitable societies and companies are implemented as they currently stand, this risks creating a potentially anomalous situation where the audit thresholds for charitable societies are higher than those for non-charitable societies. By raising the audit thresholds for non-charitable societies to the same level as those for non-charitable companies, we would remove this risk.

OPTIONS

D.8 The two main options here are as follows:

Option 1: No action

D.9 The risks of not raising the audit threshold for non-charitable societies are discussed in paragraphs D.7 above.

Option 2: The turnover and asset thresholds below which non-charitable societies are exempt from the requirement to appoint a qualified auditor to audit their accounts and balance sheet should be increased to £5.6m (turnover) and £2.8m (assets).

D.10 The principal purpose of a statutory audit for a company or society is to provide a reasonable assurance that the company/society's financial statements are free from material misstatements and fraud and show a true and fair view of the company's state of affairs. For a company, this is first and foremost for the benefit of shareholders. For a society, the audit may provide valuable information for members on the financial well-being of the organisation. Suppliers of finance, goods and services to a society may also place a reliance on the audit.

D.11 The risks of removing the requirement for smaller non-charitable societies to have a statutory audit of their accounts are that:

- There is an increased risk that accounts will include errors or not be prepared in accordance with legal requirements (possibly leading to a loss of confidence in the entire sector);
- Errors in the accounts of societies could lead to a degradation in the quality of information filed by the FSA on registered societies;
- Societies may lose the external, independent check on their financial position, which protects the interests of members and suppliers of finance or goods and services against incompetent or fraudulent managers;
- It could lead to increases in the risk of undetected fraud against societies. (The statutory audit is not designed to detect fraud but it may do so and also acts as a significant deterrent);
- It may facilitate the use of societies for illegal purposes such as money laundering; and
- It may lead to higher costs to societies of borrowing capital from lenders.

D.12 However, it should be noted that an increase to the statutory audit threshold for non-charitable societies would not prevent societies from taking up the option of appointing a qualified auditor to audit their end-year accounts and balance sheet, if they felt this would be useful.

4. BENEFITS

Option 1:

D.13 The benefits of retaining the current audit exemption threshold are that:

- It provides an independent check on the reliability and accuracy of society accounts, for management, members and others;
- It may detect fraud against societies;
- It may prevent societies from incurring a higher cost for credit; and
- It may prevent the degradation of information on registered societies available from the FSA.

Option 2:

D.14 This option gives smaller non-charitable societies the opportunity to decide whether they want to subject their end-year accounts and balance sheet to an independent audit or whether any resulting cost savings can be put to better use within the business.

D.15 There are cost savings to a society in choosing not to have their accounts and balance sheet audited by a qualified auditor. If the threshold was increased from its current level to £5.6 million, up to a further 1,200 societies would no longer be required to have their accounts audited. If all these societies took advantage of the new threshold there would be a cost saving of up to **£2.4 million** (1,200 x £2,000 (cost of audit)) to societies (although it is likely that the larger the company the less inclined it will be to take advantage of the new threshold).

Business sectors affected **D.16** An increase in the audit threshold for non-charitable societies would allow all non-charitable societies with a turnover at or below £5.6 million to take advantage of the exemption from audit.

Issues of equity and fairness **D.17** We do not consider that the proposal will bring any disproportionate benefits or have disproportionate effects on particular groups.

COSTS

(i) Compliance costs

Option 1:

D.18 The requirement to appoint a qualified auditor to audit the end-year accounts and balance sheet places a cost burden on non-charitable societies. The cost of an audit varies depending on the size and complexity of the business. As a guide, the Collis Report into the implications of raising the audit threshold for small non-charitable companies⁴ found that £1,000 was a typical fee for auditing accounts. The report also found that process of having accounts audited (appointing a qualified auditor, etc) could cost companies up to an additional £1,000 in directors' time. So the total cost of audit for small companies has been estimated at, on average, around **£2,000**.

D.19 There are in the region of 1,200 societies in the £350,000 to £5.6 million turnover range. If the audit threshold is retained at its current level of £350,000 the cost to societies in complying with the statutory requirements would be up to **£2.4 million** (1,200 x £2,000 (cost of audit)).

Option 2:

D.20 Increasing the audit threshold for non-charitable societies as proposed above will not impose compliance costs on societies.

(ii) Other costs

D.21 We do not consider that the option to increase the audit threshold for non-charitable societies will impose significant costs on sectors other than the Industrial and Provident Society sector. There may be a small cost to the audit sector in terms of audit fees. But this is unlikely to be significant since this change is only likely to affect up to 1,200 societies⁵.

⁴ http://www.dti.gov.uk/cld/collis_rep.pdf

⁵ If all 1,200 societies were to take advantage of the new threshold, this could lead to an overall cost to the profession of £1.2 million (based on a cost of £1,000 per audit).

CONSULTATION WITH SMALL BUSINESS

D.22 We have consulted with the Small Business Service and they agree with our initial view that this proposal to raise the audit threshold for non-charitable societies will not have an impact on small business. The proposal is to raise the audit threshold to the level for small non-charitable companies, this will, in fact, level the 'playing field' in terms of audit requirements, between non-charitable societies and non-charitable small firms. Notwithstanding, as part of the formal consultation process we would very much welcome the views of small businesses and their representative organisations.

COMPETITION ASSESSMENT

D.23 As the proposal gives non-charitable societies with a turnover of less than £5.6 million the option not to have their accounts audited, this proposal has no competition implications. In exempting smaller non-charitable societies from the cost of an audit, this proposal may in fact enable societies to compete more effectively with other bodies.

ENFORCEMENT AND SANCTIONS

D.24 The proposal to increase the threshold below which non-charitable societies are not required to have their accounts audited removes a burden on societies. No further enforcement is required other than that which already exists for enforcing the standards for small company accounts.

MONITORING AND REVIEW

D.25 The Government will review the thresholds for non-charitable societies in the light of any future changes to the thresholds for charitable companies and societies and to those for non-charitable companies.

CONSULTATION

Within Government **4.10** HM Treasury has consulted the Home Office, the Department for Trade and Industry and the Financial Services Authority.

Public consultation **4.11** On 30 July 2004, HM Treasury published a consultation document on (amongst other proposals) the option to raise the audit threshold for non-charitable Industrial and Provident Societies. The consultation document is available on the HM Treasury website and printed copies are available on request. The deadline for comments is 29 October 2004.

D.26 If consultees are content with the proposal to raise the audit threshold for non-charitable societies as set out above, the Treasury would bring forward secondary legislation (via a power in the Industrial and Provident Societies Act 2002⁶) to bring the thresholds for non-charitable societies into line with those for non-charitable companies. Since secondary legislation to raise the audit threshold would have no further effect than to amend the thresholds set out in primary legislation, we do not plan to consult again on the basis of the draft secondary legislation.

⁶ See section 2 of the Industrial and Provident Societies Act 2002. This provision gives HM Treasury the power, by order, to modify Industrial and Provident Society legislation to assimilate it to company law, following a modification of company legislation.



DRAFT ASSET LOCK REGULATIONS - VERSION A

Draft Regulations laid before Parliament under section 1(8) of the Co-operatives and Community Benefit Societies Act 2003, for approval by resolution of each House of Parliament.

DRAFT STATUTORY INSTRUMENTS

2004 No.

INDUSTRIAL AND PROVIDENT SOCIETIES

The Community Benefit Societies (Restriction on Use of Assets) Regulations 2004

<i>Made</i>	- - - -	<i>2004</i>
<i>Coming into force</i>	- -	<i>2004</i>

Whereas these Regulations have been laid in draft before Parliament in accordance with section 1(8) of the Co-operatives and Community Benefit Societies Act 2003(a) and approved by a resolution of each House;

Now, therefore, the Treasury, in exercise of the powers conferred upon them by section 1 of the Co-operatives and Community Benefit Societies Act 2003 hereby make the following Order:

PART 1

Citation, commencement and interpretation

Citation and commencement

1. These Regulations may be cited as the Community Benefit Societies (Restrictions on Use of Assets) Regulations 2004 and come into force on the [tenth] day after the day on which they are made.

Interpretation

2.—(1) For the purposes of these Regulations—
“the 1965 Act” means the Industrial and Provident Societies Act 1965(b);

(a) 2003 c.15.
(b) 1965 c.12.

“the 2003 Act” means the Co-operatives and Community Benefit Societies Act 2003;

“community interest company” has the meaning given in section [23] of the Companies (Audit, Investigations and Community Enterprise) [Act 2004](a);

“enforcement authority” means the [.....];

“prescribed assets” means the assets of the type prescribed in regulation 6;

“prescribed community benefit society” means a community benefit society of the type prescribed in regulation 7;

“registered social landlord” means—

- (a) a housing association registered in the register maintained by the Housing Corporation under section 1 of the Housing Act 1996(b), or
- (b) a housing association registered in the register maintained by the Secretary of State under section 1 of the Housing Act 1996; and

“restriction on use” means a rule in the rules of a prescribed community benefit society in the terms set out in Schedule 1.

(2) References in these Regulations to a prescribed community benefit society having a restriction on use are references to that society having adopted such a restriction in accordance with regulation 4 or having included such a restriction in its rules at the time when it was registered in accordance with section 2 of the 1965 Act (registration of society).

PART 2

Restriction on use of assets

Restriction on use of assets

3. A prescribed community benefit society shall not use or deal with prescribed assets which are subject to a restriction on use—

- (a) adopted in accordance with regulation 4, or
- (b) included in the rules of that society at the time when it was registered in accordance with section 2 of the 1965 Act,

except in a case mentioned in section 1(2) of the 2003 Act (Community benefit societies: power to restrict use of assets).

Procedure for imposition of restriction on use

4.—(1) A prescribed community benefit society may by special resolution amend that society’s registered rules so as to adopt a restriction on use in respect of its prescribed assets.

(2) In this regulation—

“registered rules” has the meaning given in section 74(1) of the 1965 Act (interpretation-general);

“special resolution” means a resolution—

- (a) which is passed at a general meeting of which notice, specifying the intention to propose the resolution, has been duly given according to the rules of the prescribed community benefit society (“the rules”);

(a) [2004 ???]
(b) 1996 c.52.

- (b) which is passed by not less than 75 per cent. of such of the qualifying members of the prescribed community benefit society as may have voted in person or, where the rules allow proxies, by proxy;
- (c) on which not less than half of the qualifying members of the prescribed community benefit society voted either in person or, where the rules allow proxies, by proxy; and
- (d) which is confirmed by a majority of such of the qualifying members of the prescribed community benefit society as may have voted in person or, where the rules allow proxies, by proxy at a subsequent general meeting of which notice has been duly given not less than 14 days nor more than one month from the day of the meeting at which the resolution was passed in accordance with paragraphs (a) to (c),

and references to the qualifying members of a prescribed community benefit society are references to the members of that society who are for the time being entitled under the community benefit society's rules to vote.

PART 3

Prescriptions

Prescription of authority

5. For the purposes of section 1(4)(g) and (h) and (5)(b), (d) and (f) of the 2003 Act [.....] is prescribed.

Prescription of assets

6.—(1) For the purpose of section 1(1)(a) of the 2003 Act the assets specified in paragraph (2) are prescribed.

(2) All assets except withdrawable share capital.

Prescription of community benefit societies

7.—(1) For the purpose of section 1(1) and (5)(d) of the 2003 Act the community benefit societies specified in paragraph (2) are prescribed.

(2) Any community benefit society except—

- (a) a community benefit society that is a registered social landlord; or
- (b) a community benefit society that is a charity within the meaning of section 5A(7) of the 1965 Act^(a).

Prescription of unalterable rules

8.—(1) For the purpose of section 1(4)(b) of the 2003 Act the rule specified in paragraph (2) is prescribed as an unalterable rule.

(2) A restriction on use.

Prescription of a kind of purpose for the purpose of section 1(2)(a) of the 2003 Act

9.—(1) For the purpose of section 1(2)(a) of the 2003 Act (community benefit societies: power to restrict use of assets), a purpose of the kind specified in paragraph (2) is prescribed.

^(a) section 5A was inserted by the Co-operatives and Community Benefit Societies Act 2003 (c.15).

(2) A purpose which falls within one or more of the objects of the prescribed community benefit society in question as set out in the rules of that society.

Prescription of circumstances for the purpose of section 1(2)(b) of the 2003 Act

10.—(1) For the purpose of section 1(2)(b) of the 2003 Act, the circumstances specified in this regulation are prescribed.

(2) The first circumstance is that market value is received by the prescribed community benefit society in return for the use of or dealing with the prescribed assets.

(3) The second circumstance is that prescribed assets are to be used or dealt with by transferring them to—

- (a) a prescribed community benefit society whose assets are subject to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
- (b) a community interest company;
- (c) a registered social landlord which has a restriction on the use of its assets which is equivalent to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
- (d) a charity within the meaning of section 5A(7) of the 1965 Act; or
- (e) a body, established in a State other than the United Kingdom, that is equivalent to any of those persons.

(4) The third circumstance is that—

- (a) the prescribed community benefit society is to be—
 - (i) dissolved in accordance with section 55(a) or (b) of the 1965 Act (dissolution of registered society);
 - (ii) wound up under the Insolvency Act 1986(a); and
- (b) there will be creditors of that society or persons to whom payment cannot be made out of the other assets of that society not subject to a restriction on use.

(5) The fourth circumstance is that the prescribed assets are to be used or dealt with to the extent necessary to pay compensation in accordance with regulation 11.

PART 4

Miscellaneous and supplemental

Compensation

11.—(1) Where, in consequence of any assets becoming subject to a restriction on use, the interests, rights or liabilities of a member of a prescribed community benefit society are modified that member is, subject to paragraph (3), entitled to such compensation as may be just in respect of—

- (a) any diminution in the value of his interests or rights, and
- (b) any increase in the burden of his liabilities,

which is attributable to that modification.

(2) Where—

- (a) a member has any interest or right in respect of assets of a prescribed community benefit society, and

(a) 1986 c.45.

- (b) a restriction on use is adopted that has the effect of removing or preventing the exercise of that interest or right,

that member is, subject to paragraph (3), entitled to such compensation as may be just.

(3) A member shall not be entitled to compensation if he has voted in favour of the adoption of the restriction on use; and this is a prescribed exception for the purpose of section 1(4)(e) of the 2003 Act.

(4) Compensation due under this regulation shall be paid by the prescribed community benefit society of which that person is a member.

(5) Any dispute as to whether any compensation is to be paid under this regulation, and any dispute as to the amount of compensation to be paid, shall be referred to and determined—

- (a) where the claimant requires the matter to be determined in England or Wales, by an arbitrator appointed by the Lord Chancellor, or
- (b) where the claimant requires the matter to be determined in Scotland, by an arbiter appointed by the Lord President of the Court of Session.

Modifications of Industrial and Provident Societies Act 1965

12. Schedule 2 (which modifies the 1965 Act) shall have effect.

Signatory text

Address
Date

Two of the Lords Commissioners of Her Majesty's Treasury

SCHEDULE 1

Regulation 2

Restriction on Use

1. The rule in a prescribed community benefit society's rules should be in the following terms—

“Restriction on use

(1) The prescribed assets of the society are subject to a restriction on their use.

(2) On the—

- (a) dissolution of the society in accordance with section 55(a) or (b) of the 1965 Act;
or
- (b) cancellation of the registration of the society in accordance with section 16 of the 1965 Act,

the society shall transfer its prescribed assets in accordance with paragraph (4).

(3) On—

- (a) an amalgamation of the society in accordance with section 50 of the 1965 Act;
- (b) a transfer of engagements of the society in accordance with section 51 of the 1965 Act;
- (c) a conversion into, amalgamation with or transfer of its engagements to—
 - (i) a community interest company;;
 - (ii) a Companies Acts (within the meaning of section 74 of the 1965 Act) company that is a registered social landlord; or
 - (iii) a Companies Acts company that is a charity within the meaning of section 5A(7) of the 1965 Act,

in accordance with section 52 of the 1965 Act (as modified by the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004),

the society shall ensure that its prescribed assets remain subject to an unalterable restriction on their use.

(4) The prescribed assets of the society shall be transferred to one or more of the following—

- (a) a prescribed community benefit society whose prescribed assets are subject to a restriction on use and which will apply that restriction to any assets so transferred;
- (b) a community interest company;
- (c) a registered social landlord which has an unalterable restriction on the use of its assets which is equivalent to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
- (d) a charity (within the meaning of section 5A(7) of the 1965 Act); or
- (e) a body established in a member state other than the United Kingdom, that is equivalent to any of those persons.

(5) Any expression used in this rule which is defined for the purposes of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004 shall have the meaning given by those Regulations.”.

SCHEDULE 2

Regulation 12

Modifications of Industrial and Provident Societies Act 1965

Modifications

1. Subsection (3) of section 2 of the 1965 Act^(a) (registration of society) shall, for the purpose of the registration of a society that has included in its rules a restriction on use, have effect as if, after “this Act”, there were inserted “section 1 of the Co-operative and Community Benefit Societies Act 2003 or the provisions of the Community Benefit (Restriction on Use of Assets) Regulations 2004”.

2. Subsection (3) of section 10 of the 1965 Act (amendment of registered rules) shall, for the purpose of an amendment made to the rules of a prescribed community benefit society in accordance with regulation 4(1), have effect as if, after “this Act”, there were inserted “section 1 of the Co-operative and Community Benefit Societies Act 2003 or the provisions of the Community Benefit (Restriction on Use of Assets) Regulations 2004”.

3. Section 16 of the 1965 Act (cancellation of registration of society) shall apply to a prescribed community benefit society that has a restriction on use as if—

- (a) after subsection (1)(c)(iii), there were inserted—

“(iv) on proof to the Authority’s satisfaction that the society has contravened regulation 3 of the Community Benefit (Restriction on Use of Assets) Regulations 2004.”
- (b) in subsection (4), for “referred to in subsection (1)(c)(ii)” there were substituted “referred to in subsection (1)(c)(ii), (iv) or (v)”.

4. Section 23 of the 1965 Act (nomination to property in society) shall, where the registered society of which a person is a member is a prescribed community benefit society that has a restriction on use, have effect as if—

- (a) in subsection (1), for the words “Subject to subsections (2) and (3)” there were substituted “Subject to subsections (2), (2A) and (3)”;
- (b) after subsection (2), there were inserted—

“(2A) A member of a registered society that is a prescribed community benefit society that has adopted a restriction on use (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004), may only make a nomination under subsection (1) in relation to assets of that society which are not prescribed assets (within the meaning of those Regulations).”; and
- (c) after subsection (4), there were inserted—

“(4A) Where a prescribed community benefit society (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004) adopts a restriction on use in accordance with those Regulations, that adoption shall operate as a revocation of any nomination made by a member of that society under subsection (1) that relates to prescribed assets (within the meaning of those Regulations).”.

5. Section 25 of the 1965 Act (provision for intestacy) shall, where the registered society of which a person is a member is a prescribed community benefit society that has a restriction on use, have effect as if the words “his property”, wherever occurring, did not include any property that is a prescribed asset.

^(a) 1965 c.12.

6. Section 26 of the 1965 Act (payments in respect of mentally incapable persons) shall, where the registered society of which a person is a member is a prescribed community benefit society that has adopted a restriction on use, have effect as if, for the words “any shares, loans and deposits” there were substituted “, other than any prescribed assets (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004), any shares, loans and deposits”.

7. Section 50 of the 1965 Act (amalgamation of societies) shall, where one or more of the registered societies referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if—

(a) at the beginning of subsection (1), there were inserted “Subject to subsection (1A)”;

(b) after subsection (1), there were inserted—

“(1A) No registered society that—

(a) is a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004); and

(b) has a restriction on use within the meaning of those Regulations,

shall amalgamate with a registered society that is not a prescribed community benefit society that has a restriction on use.”.

8. Section 51 of the 1965 Act (transfer of engagements between societies) shall, where the registered society referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if—

(a) at the beginning of subsection (1), there were inserted “Subject to subsection (1A)”;

(b) after subsection (1), there were inserted—

“(1A) No registered society that—

(a) is a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004); and

(a) has a restriction on use within the meaning of those Regulations,

shall transfer its engagements in accordance with subsection (1) where the effect of that transfer would be that the whole or any part of the society’s prescribed assets (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) would be transferred to a registered society that does not have a restriction on use.”.

9. Section 52 of the 1965 Act (conversion into, amalgamation with, or transfer of engagements to company) shall, where the registered society referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if, in subsection (1), for “, a company under the Companies Acts” there were substituted—

“—

(a) a community interest company (within the meaning of section [23(1)] of the Companies (Audit, Investigations and Community Enterprise) [Act 2004]”;

(b) a company under the Companies Acts that is a registered social landlord (within the meaning of the Housing Act 1996); or

(c) a company under the Companies Acts that is a charity (within the meaning of section 5A(7)).”.

10. Section 59 of the 1965 Act (restriction on dissolution or cancellation of registration of society) shall, where a prescribed community benefit society has a restriction on use, have effect as if, for the words “that all property vested in the society has been duly conveyed or transferred by the society to the persons entitled” there were substituted—

“that—

(a) all prescribed assets of the society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) have been transferred to one or more of—

(i) a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) whose assets are subject to a restriction on use (within the meaning of those Regulations) and which will apply that restriction to any assets so transferred;

(ii) a community interest company (within the meaning of the Companies (Audit, Investigations and Community Enterprise) [Act 2004];

(iii) a registered social landlord (within the meaning of the Housing Act 1996) which has an unalterable restriction on the use of its assets which is equivalent to a restriction on use (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) and which will apply that restriction to any prescribed assets so transferred;

(iv) a charity (within the meaning of section 5A(7) of the 1965 Act); or

(v) a body established in a State other than the United Kingdom, that is equivalent to any of those persons; and

(b) all other property vested in the society has been duly conveyed or transferred by the society to the persons entitled.”.

EXPLANATORY NOTE

(This note is not part of the Regulations)

Draft Regulations laid before Parliament under section 1(8) of the Co-operatives and Community Benefit Societies Act 2003, for approval by resolution of each House of Parliament.

D R A F T S T A T U T O R Y I N S T R U M E N T S

2004 No.

INDUSTRIAL AND PROVIDENT SOCIETIES

**The Community Benefit Societies (Restriction on Use of Assets)
Regulations 2004**

<i>Made</i>	- - - -	<i>2004</i>
<i>Coming into force</i>	- -	<i>2004</i>

Whereas these Regulations have been laid in draft before Parliament in accordance with section 1(8) of the Co-operatives and Community Benefit Societies Act 2003(a) and approved by a resolution of each House;

Now, therefore, the Treasury, in exercise of the powers conferred upon them by section 1 of the Co-operatives and Community Benefit Societies Act 2003 hereby make the following Order:

:

PART 1

Citation, commencement and interpretation

Citation and commencement

1. These Regulations may be cited as the Community Benefit Societies (Restrictions on Use of Assets) Regulations 2004 and come into force on the [tenth] day after the day on which they are made.

Interpretation

2.—(1) For the purposes of these Regulations—
“the 1965 Act” means the Industrial and Provident Societies Act 1965(b);

(a) 2003 c.15.
(b) 1965 c.12.

“ the 2003 Act” means the Co-operatives and Community Benefit Societies Act 2003;

“community interest company” has the meaning given in section [23] of the Companies (Audit, Investigations and Community Enterprise) [Act 2004](a);

“enforcement authority” means the [.....];

“prescribed assets” means the assets of the type prescribed in regulation 6;

“prescribed community benefit society” means a community benefit society of the type prescribed in regulation 7;

“registered social landlord” means—

- (a) a housing association registered in the register maintained by the Housing Corporation under section 1 of the Housing Act 1996(b), or
- (b) a housing association registered in the register maintained by the Secretary of State under section 1 of the Housing Act 1996; and

“restriction on use” means a rule in the rules of a prescribed community benefit society in the terms set out in Schedule 1.

(2) References in these Regulations to a prescribed community benefit society having a restriction on use are references to that society having adopted such a restriction in accordance with regulation 4 or having included such a restriction in its rules at the time when it was registered in accordance with section 2 of the 1965 Act (registration of society).

PART 2

Restriction on use of assets

Restriction on use of assets

3. A prescribed community benefit society shall not use or deal with prescribed assets which are subject to a restriction on use—

- (a) adopted in accordance with regulation 4, or
- (b) included in the rules of that society at the time when it was registered in accordance with section 2 of the 1965 Act,

except in a case mentioned in section 1(2) of the 2003 Act (Community benefit societies: power to restrict use of assets).

Procedure for imposition of restriction on use

4.—(1) A prescribed community benefit society may by special resolution amend that society’s registered rules so as to adopt a restriction on use in respect of its prescribed assets.

(2) In this regulation—

“registered rules” has the meaning given in section 74(1) of the 1965 Act (interpretation-general);

“special resolution” means a resolution—

- (a) which is passed at a general meeting of which notice, specifying the intention to propose the resolution, has been duly given according to the rules of the prescribed community benefit society (“the rules”);

(a) [2004 ???]
(b) 1996 c.52.

- (b) which is passed by not less than 75 per cent. of such of the qualifying members of the prescribed community benefit society as may have voted in person or, where the rules allow proxies, by proxy;
- (c) on which not less than half of the qualifying members of the prescribed community benefit society voted either in person or, where the rules allow proxies, by proxy; and
- (d) which is confirmed by a majority of such of the qualifying members of the prescribed community benefit society as may have voted in person or, where the rules allow proxies, by proxy at a subsequent general meeting of which notice has been duly given not less than 14 days nor more than one month from the day of the meeting at which the resolution was passed in accordance with paragraphs (a) to (c),

and references to the qualifying members of a prescribed community benefit society are references to the members of that society who are for the time being entitled under the community benefit society's rules to vote.

PART 3

Prescriptions

Prescription of authority

5. For the purposes of section 1(4)(g) and (h) and (5)(b), (d) and (f) of the 2003 Act [.....] is prescribed.

Prescription of assets

6.—(1) For the purpose of section 1(1)(a) of the 2003 Act the assets specified in paragraph (2) are prescribed.

(2) All assets except withdrawable share capital.

Prescription of community benefit societies

7.—(1) For the purpose of section 1(1) and (5)(d) of the 2003 Act the community benefit societies specified in paragraph (2) are prescribed.

(2) Any community benefit society except—

- (a) a community benefit society that is a registered social landlord; or
- (b) a community benefit society that is a charity within the meaning of section 5A(7) of the 1965 Act^(a).

Prescription of unalterable rules

8.—(1) For the purpose of section 1(4)(b) of the 2003 Act the rule specified in paragraph (2) is prescribed as an unalterable rule.

(2) A restriction on use.

Prescription of a kind of purpose for the purpose of section 1(2)(a) of the 2003 Act

9.—(1) For the purpose of section 1(2)(a) of the 2003 Act (community benefit societies: power to restrict use of assets), a purpose of the kind specified in paragraph (2) is prescribed.

^(a) Section 5A was inserted by the Co-operatives and Community Benefit Societies Act 2003 (c.15).

(2) A purpose which falls within one or more of the objects of the prescribed community benefit society in question as set out in the rules of that society.

Prescription of circumstances for the purpose of section 1(2)(b) of the 2003 Act

10.—(1) For the purpose of section 1(2)(b) of the 2003 Act, the circumstances specified in this regulation are prescribed.

(2) The first circumstance is that market value is received by the prescribed community benefit society in return for the use of or dealing with the prescribed assets.

(3) The second circumstance is that—

- (a) prescribed assets are to be used or dealt with by transferring them to—
 - (i) a prescribed community benefit society whose assets are subject to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
 - (ii) a community interest company;
 - (iii) a registered social landlord which has a restriction on the use of its assets which is equivalent to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
 - (iv) a charity within the meaning of section 5A(7) of the 1965 Act; or
 - (v) a body, established in a State other than the United Kingdom, that is equivalent to any of those persons; and
- (b) the enforcement authority—
 - (i) has been notified by the prescribed community benefit society or (as the case may be) the person making the transfer of the intention to carry out that transfer; and
 - (ii) has not, within the period of [21 days] starting on the date on which it received that notification, objected to the transfer.

(4) The third circumstance is that prescribed assets are to be used or dealt with when—

- (a) the prescribed community benefit society is to be—
 - (i) dissolved in accordance with section 55(a) or (b) of the 1965 Act (dissolution of registered society);
 - (ii) wound up under the Insolvency Act 1986(a); and
- (b) there will be creditors of that society or persons to whom payment cannot be made out of the other assets of that society not subject to a restriction on use.

(5) The fourth circumstance is that the prescribed assets are to be used or dealt with to the extent necessary to pay—

- (a) compensation in accordance with regulation 12, 18 or 24; or
- (b) a financial penalty in accordance with regulation 19.

(6) The fifth circumstance is that the prescribed assets are to be used or dealt with to the extent necessary to comply with an order of a court under regulation 13 or 18.

Procedure for objecting under regulation 10

11.—(1) The enforcement authority may only object to a transfer under regulation 10(3)(b) where it considers that the person to whom the prescribed assets are to be transferred will not apply to those assets a restriction on their use that is equivalent to the restriction on their use applied by the person transferring the assets.

(2) An objection by the enforcement authority must be made by notice.

(3) A notice given by the enforcement authority under paragraph (2) must—

(a) 1986 c.45.

- (a) be in writing;
 - (b) give the enforcement authority's reasons for objecting; and
 - (c) give an indication of the right to have the matter referred to [an appropriate appeal body].
- (4) If the enforcement authority decides to object to a transfer the person who was proposing to make that transfer may appeal to [an appropriate appeal body].

PART 4

Enforcement of restriction on use of assets

CHAPTER 1

Enforceability of agreements

Agreements made by prescribed community benefit society

12.—(1) Notwithstanding sections 7A to 7F of the 1965 Act^(a) (capacity of society and power of committee to bind it), an agreement relating to prescribed assets is unenforceable if it is made by a prescribed community benefit society in contravention of regulation 3.

(2) The other party is entitled to recover—

- (a) any money or other property paid or transferred by him under the agreement; and
- (b) compensation for any loss sustained by him as a result of having parted with it.

(3) “Agreement” means an agreement made after these Regulations come into force.

Agreements made unenforceable by regulation 12

13.—(1) This regulation applies to an agreement that is unenforceable because of regulation 12.

(2) The amount of compensation recoverable as a result of that regulation is—

- (a) the amount agreed by the parties; or
- (b) on the application of any party, the amount determined by the court.

(3) If the court is satisfied that it is just and equitable in the circumstances of the case, it may allow—

- (a) the agreement to be enforced; or
- (b) money and property paid or transferred under the agreement to be retained.

(4) In considering whether to allow the agreement to be enforced or (as the case may be) the money or property paid or transferred under the agreement to be retained the court must have regard to whether the prescribed community benefit society reasonably believed that it was not using or dealing with prescribed assets in contravention of regulation 3.

(5) If a person against whom the agreement is unenforceable—

- (a) elects not to perform the agreement, or
- (b) as a result of this regulation, recovers money paid or other property transferred by him under the agreement,

he must repay any money and return any other property received by him under the agreement.

(6) If a prescribed asset transferred under the agreement has passed to a third party, a reference in this regulation or in regulation 12 to that asset is to be read as a reference to its value at the time of its transfer under the agreement.

^(a) Sections 7A to 7F were inserted by section 3 of the Co-operatives and Community Benefit Societies Act 20 03.

CHAPTER 2

Investigation

Investigation

14.—(1) The enforcement authority may, for the purpose of carrying out its functions under these Regulations, appoint any competent person (including a member of the enforcement authority's staff) to investigate the affairs of a prescribed community benefit society.

(2) Schedule 2 (further provision about investigations under this regulation) has effect.

CHAPTER 3

Offences

Contravention of restriction on use etc.

15.—(1) A prescribed community benefit society that contravenes regulation 3 is guilty of an offence.

(2) A person guilty of an offence under this regulation is liable—

- (a) on summary conviction, to imprisonment for a term not exceeding twelve months or a fine not exceeding the statutory maximum, or both;
- (b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

CHAPTER 4

Disciplinary measures

Condition for exercise of disciplinary measures

16. In deciding whether and how to exercise the powers conferred by regulations 17 to 19 the enforcement authority must adopt an approach which is based on the principle that those powers should be exercised only to the extent necessary to maintain confidence in community benefit societies.

Public censure

17. If the enforcement authority considers that a prescribed community benefit society is in contravention of regulation 3, it may publish a statement to that effect.

Enforcement notification

18.—(1) If the enforcement authority considers that a prescribed community benefit society is in contravention of regulation 3, it may give that society an enforcement notification.

(2) An enforcement notification is a notification which imposes requirements on the prescribed community benefit society concerned to take all such steps for—

- (a) securing that the contravention is brought to an end and is not repeated; and
- (b) remedying the consequences of that contravention as may be specified in the notification.

(3) It shall be the duty of a prescribed community benefit society to which an enforcement notification has been given to comply with it.

(4) That duty shall be enforceable in civil proceedings by the enforcement authority—

- (a) for an injunction;

- (b) for specific performance of a statutory duty under section 45 of the Court of Session Act 1988(a); or
- (c) for any other appropriate remedy or relief.

(5) References in this regulation to remedying the consequences of that contravention include references to paying an amount to a person—

- (a) by way of compensation for loss or damage suffered by that person; or
- (b) in respect of annoyance, inconvenience or anxiety to which he has been put.

Financial penalties

19.—(1) If the enforcement authority considers that a prescribed community benefit society is in contravention of regulation 3, it may impose a penalty on that society.

(2) The amount of a penalty imposed is to be such amount not exceeding [£100,000] as the enforcement authority determines to be—

- (a) appropriate; and
- (b) proportionate to the case in respect of which it is imposed.

Proposal to take disciplinary measures

20.—(1) If the enforcement authority proposes—

- (a) to publish a statement under regulation 17;
- (b) to give an enforcement notification under regulation 18; or
- (c) to impose a penalty under regulation 19,

it must give the prescribed community benefit society a warning notice in accordance with regulation 22.

Taking disciplinary measures

21.—(1) If the enforcement authority decides—

- (a) to publish a statement under regulation 16;
- (b) to give an enforcement notification under regulation 17; or
- (c) to impose a penalty under regulation 18,

it must without delay give the prescribed community benefit society a decision notice in accordance with regulation 22.

(2) If the enforcement authority decides—

- (a) to publish a statement under regulation 17;
- (b) to give an enforcement notification under regulation 18; or
- (c) to impose a penalty under regulation 19,

the prescribed community benefit society concerned may appeal to [the appropriate appeal body].

Warning notice

22.—(1) A warning notice must—

- (a) state the action which the enforcement authority proposes to take;
- (b) be in writing; and
- (c) give reasons for the proposed action.

(a) 1988 c.36.

(2) A warning notice about a proposal to publish a statement must set out the terms of that statement.

(3) A warning notice about a proposal to give an enforcement notification must set out the terms of that notification.

(4) A warning notice about a proposal to impose a penalty must state the amount of the penalty.

(5) A warning notice must specify a reasonable period within which the person to whom it is given may make representations to the enforcement authority.

(6) The enforcement authority may extend the period specified in the notice.

(7) The enforcement authority must then decide, within a reasonable period, whether to give the person concerned a decision notice in accordance with regulation 23.

Decision notice

23.—(1) A decision notice must—

(a) be in writing; and

(b) give the enforcement authority's reasons for the decision to take the action to which the notice relates.

(2) In the case of a statement, the decision notice must set out the terms of the statement.

(3) In the case of an enforcement notification, the decision notice must set out the terms of that notification.

(4) In the case of a penalty, the decision notice must state the amount of the penalty.

PART 5

Miscellaneous and supplemental

Compensation

24.—(1) Where, in consequence of any assets becoming subject to a restriction on use, the interests, rights or liabilities of a member of a prescribed community benefit society are modified that member is, subject to paragraph (3), entitled to such compensation as may be just in respect of—

(a) any diminution in the value of his interests or rights, and

(b) any increase in the burden of his liabilities,

which is attributable to that modification.

(2) Where—

(a) a member has any interest or right in respect of assets of a prescribed community benefit society, and

(b) a restriction on use is adopted that has the effect of removing or preventing the exercise of that interest or right,

that member is, subject to paragraph (3), entitled to such compensation as may be just.

(3) A member shall not be entitled to compensation if he has voted in favour of the adoption of the restriction on use; and this is a prescribed exception for the purpose of section 1(4)(e) of the 2003 Act.

(4) Compensation due under this regulation shall be paid by the prescribed community benefit society of which that person is a member.

(5) Any dispute as to whether any compensation is to be paid under this regulation, and any dispute as to the amount of compensation to be paid, shall be referred to and determined—

- (a) where the claimant requires the matter to be determined in England or Wales, by an arbitrator appointed by the Lord Chancellor, or
- (b) where the claimant requires the matter to be determined in Scotland, by an arbiter appointed by the Lord President of the Court of Session.

Fees

25.—(1) The enforcement authority may make (or revise) rules providing for the payment to it by any prescribed community benefit society that has a restriction on use of such fees (“fee rules”) as it considers sufficient to meet the costs of performing any of its functions under these Regulations; and such prescribed community benefit societies are prescribed for the purposes of section 1(5) of the 2003 Act.

(2) In fixing the amount of any fee which is to be payable to the enforcement authority, no account is to be taken of any sums which the enforcement authority receives, or expects to receive, by way of penalties imposed under these Regulations.

(3) Any fee that is owed to the enforcement authority under any provision made by or under these Regulations may be recovered as a debt due to the enforcement authority.

(4) Before making or revising fee rules, the enforcement authority must consult such of the persons who, in the enforcement authority’s opinion, are likely to be affected by those rules as it thinks fit.

(5) The way in which fee rules must be made or may be revised is by the publication of the rules in such manner as the enforcement authority considers appropriate for bringing them to the attention of the person who, in its opinion, are likely to be affected by them.

Destination of penalties

26. Penalties paid to the enforcement authority by virtue of these Regulations shall be paid into the Consolidated Fund of the United Kingdom.

Service of notices and other documents

27.—(1) This regulation applies where provision made (in whatever terms) by or under these Regulations authorises or requires—

- (a) a notice to be given to any person; or
- (b) a document of any other description (including a copy of a document) to be sent to any person.

(2) The notice or document may be given or sent to the person in question—

- (a) by delivering it to him;
- (b) by leaving it at his proper address; or
- (c) by sending it by post to him at that address.

(3) The notice or document may be given or sent to a body corporate by being given or sent to the secretary or clerk of that body.

(4) The notice or document may be given or sent to a firm by being given or sent to—

- (a) a partner in the firm; or
- (b) a person having the control or management of the partnership business.

(5) The notice or document may be given or sent to an unincorporated body or association by being given or sent to a member of the governing body of the body or association.

(6) For the purposes of section 7 of the Interpretation Act 1978^(a) (service of documents by post) in its application to this regulation, the proper address of a person is—

(a) 1978 c.30.

- (a) in the case of a body corporate, the address of the registered or principal office of the body;
- (b) in the case of a firm, unincorporated body or association, the address of the principal office of the partnership, body or association;
- (c) in the case of a person to whom the notice or other document is given or sent in reliance of any paragraphs (3) to (5), the proper address of the body corporate, firm or (as the case may be) other body or association in question; and
- (d) in any other case, the last known address of the person in question.

(7) In the case of—

- (a) a company registered outside the United Kingdom;
- (b) a firm carrying on business outside the United Kingdom, or
- (c) an unincorporated body or association with offices outside the United Kingdom,

the reference in paragraph (6) to its principal office include references to its principal office within the United Kingdom (if any).

(8) In this regulation—

“document” includes anything in writing; and

“notice” includes notification;

and references in this regulation to giving or sending a notice or other document to a person include references to transmitting it to him (by electronic or other means) and to serving it on him.

Criminal liability of company directors etc.

28.—(1) Where an offence under these Regulations is committed by a body corporate and is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of—

- (a) a director, manager, secretary or other similar officer of the body corporate, or
- (b) a person purporting to act in any such capacity,

he (as well as the body corporate) is guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(2) Where an offence under these Regulations is committed by a Scottish firm and is proved to have been committed with the consent or connivance of, or attributable to any neglect on the part of a partner of the firm, he (as well as the firm) is guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(3) In this regulation “director”—

- (a) includes a shadow director, and
- (b) if the affairs of a body corporate are managed by its members, means a member of that body.

Modifications of Industrial and Provident Societies Act 1965

29. Schedule 3 (which modifies the 1965 Act) shall have effect.

Signatory text

Address
Date

Two of the Lords Commissioners of Her Majesty’s Treasury

SCHEDULE 1

Regulation 2

Restriction on Use

1. The rule in a prescribed community benefit society's rules should be in the following terms—

“Restriction on use

(1) The prescribed assets of the society are subject to a restriction on their use. Thus the society must not use or deal with its assets in contravention of regulation 3 of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004.

(2) On the—

- (a) dissolution of the society in accordance with section 55(a) or (b) of the 1965 Act; or
- (b) cancellation of the registration of the society in accordance with section 16 of the 1965 Act,

the society shall transfer its prescribed assets in accordance with paragraph (4).

(3) On—

- (a) an amalgamation of the society in accordance with section 50 of the 1965 Act;
- (b) a transfer of engagements of the society in accordance with section 51 of the 1965 Act;
- (c) a conversion into, amalgamation with or transfer of its engagements to—
 - (i) a community interest company;;
 - (ii) a Companies Acts (within the meaning of section 74 of the 1965 Act) company that is a registered social landlord; or
 - (iii) a Companies Acts company that is a charity within the meaning of section 5A(7) of the 1965 Act,

in accordance with section 52 of the 1965 Act (as modified by the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004),

the society shall ensure that its prescribed assets remain subject to an unalterable restriction on their use.

(4) The prescribed assets of the society shall be transferred to one of the following—

- (a) a prescribed community benefit society whose prescribed assets are subject to a restriction on use and which will apply that restriction to any assets so transferred;
- (b) a community interest company;
- (c) a registered social landlord which has an unalterable restriction on the use of its assets which is equivalent to a restriction on use and which will apply that restriction to any prescribed assets so transferred;
- (d) a charity (within the meaning of section 5A(7) of the 1965 Act); or
- (e) a body established in a State other than the United Kingdom, that is equivalent to any of those persons.

(5) Any expression used in this rule which is defined for the purposes of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004 shall have the meaning given by those Regulations.”.

SCHEDULE 2

Regulation 14

Investigations

Power to require documents and information

1.—(1) The investigator of a prescribed community benefit society may require that society or any other person—

(a) to produce such documents (or documents of such description) as the investigator may specify;

(b) to provide such information (or information of such description) as the investigator may specify.

(2) A person on whom a requirement is imposed under sub-paragraph (1) may require the investigator to produce evidence of his authority.

(3) A requirement under sub-paragraph (1) must be complied with at such time and place as may be specified by the investigator.

(4) The production of a document in pursuance of this paragraph does not effect any lien which a person has on the document.

(5) The investigator may take copies of or extracts from a document produced in pursuance of this paragraph.

(6) In relation to information recorded otherwise than in legible form, the power to require production of it includes power to require the production of a copy of the document, or to provide the information, in legible form or in a form from which it can readily be produced in visible and legible form.

(7) In this Schedule—

“the investigator” means a person appointed in accordance with regulation 13, and

“document” includes information recorded in any form.

Privileged information

2.—(1) Nothing in paragraph 1 requires a person to produce a document, or provide information in respect of which a claim could be maintained—

(a) in an action in the High Court, to legal professional privilege, or

(b) in an action in the Court of Session, to confidentiality of communications,

but a person who is a lawyer may be required to provide the name and address of his client.

(2) Nothing in paragraph 1 requires a person carrying on the business of banking to produce a document, or provide information, relating to the affairs of a customer unless a requirement to produce the document, or provide information, has been imposed on the customer under that paragraph.

Use of information as evidence

3.—(1) A statement made by a person in compliance with a requirement imposed under paragraph 1 may be used in evidence against the person.

(2) But in criminal proceedings—

(a) no evidence relating to the statement may be adduced by or on behalf of the prosecution, and

(b) no question relating to it may be asked by or on behalf of the prosecution,

unless evidence relating to it is adduced or a question relating to it is asked in the proceedings by or on behalf of that person.

(3) However, sub-paragraph (2) does not apply to proceedings in which a person is charged with an offence under—

- (a) paragraph 5,
- (b) section 5 of the Perjury Act 1911^(a) (false statement made otherwise than on oath), or
- (c) section 44(2) of the Criminal Law (Consolidation) (Scotland) Act 1995^(b) (false statement made otherwise than on oath).

Failure to comply with requirement

4.—(1) This paragraph applies if a person fails to comply with a requirement imposed under paragraph 1.

(2) The investigator may certify that fact in writing to the court.

(3) If, after hearing—

- (a) any witnesses who may be produced against or on behalf of the alleged offender, and
- (b) any statement which may be offered in defence,

the court is satisfied that the offender failed without reasonable excuse to comply with the requirement, it may deal with him as if he had been guilty of contempt of court.

False information

5.—(1) A person commits an offence if in purported compliance with a requirement under paragraph 1 to provide information, the person—

- (a) provides information which the person knows to be false in a material particular, or
- (b) recklessly provides information which is false in a material particular,

but a prosecution may only be instituted in England and Wales with the consent of the Director of Public Prosecutions.

(2) A person guilty of an offence under sub-paragraph (1) is liable—

- (a) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both;
- (b) on summary conviction in England and Wales, to imprisonment for a term not exceeding twelve months or a fine of an amount not exceeding the statutory maximum, or both; and
- (c) on summary conviction in Scotland, to imprisonment for a term not exceeding six months or a fine of an amount not exceeding the statutory maximum, or both.

^(a) 1911 c.6.
^(b) 1995 c.39.

SCHEDULE 3

Regulation 29

Modifications of Industrial and Provident Societies Act 1965

Modifications

1. Subsection (3) of section 2 of the 1965 Act (a) (registration of society) shall, for the purpose of the registration of a society that has included in its rules a restriction on use, have effect as if—

- (a) after “the Authority”, in the first place where it occurs, there were inserted “, following consultation with the enforcement authority within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004”; and
- (b) after “this Act”, there were inserted “section 1 of the Co-operative and Community Benefit Societies Act 2003 or the provisions of the Community Benefit (Restriction on Use of Assets) Regulations 2004.”.

2. Section 10 of the 1965 Act (amendment of registered rules) shall, for the purpose of an amendment made to the rules of a prescribed community benefit society in accordance with regulation 4(1), have effect as if—

- (a) in subsection (1), after “the Authority” there were inserted “and the enforcement authority within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004”;
- (b) in subsection (3)—
 - (i) after “the Authority”, in the first place where it occurs, there were inserted “, following consultation with the enforcement authority within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004”; and
 - (ii) after “this Act”, there were inserted “section 1 of the Co-operative and Community Benefit Societies Act 2003 or the provisions of the Community Benefit (Restriction on Use of Assets) Regulations 2004.”.

3. Section 23 of the 1965 Act (nomination to property in society) shall, where the registered society of which a person is a member is a prescribed community benefit society that has a restriction on use, have effect as if—

- (a) in subsection (1), for the words “Subject to subsections (2) and (3)” there were substituted “Subject to subsections (2), (2A) and (3)”;
- (b) after subsection (2), there were inserted—

“(2A) A member of a registered society that is a prescribed community benefit society that has adopted a restriction on use (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004), may only make a nomination under subsection (1) in relation to assets of that society which are not prescribed assets (within the meaning of those Regulations).”;
- (c) after subsection (4), there were inserted—

“(4A) Where a prescribed community benefit society (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004) adopts a restriction on use in accordance with those Regulations, that adoption shall operate as a revocation of any nomination made by a member of that society under subsection (1) that relates to prescribed assets (within the meaning of those Regulations).”.

4. Section 25 of the 1965 Act (provision for intestacy) shall, where the registered society of which a person is a member is a prescribed community benefit society that has a restriction on use, have effect as if the words “his property”, wherever occurring, did not include any property that is a prescribed asset.

5. Section 26 of the 1965 Act (payments in respect of mentally incapable persons) shall, where the registered society of which a person is a member is a prescribed community benefit society that has adopted a restriction on use, have effect as if, for the words “any shares, loans and deposits” there were substituted “, other than any prescribed assets (within the meaning of the Community Benefit (Restriction on Use of Assets) Regulations 2004), any shares, loans and deposits”.

6. Section 50 of the 1965 Act (amalgamation of societies) shall, where one or more of the registered societies referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if—

(a) at the beginning of subsection (1), there were inserted “Subject to subsection (1A)”;

(b) after subsection (1), there were inserted—

“(1A) No registered society that—

(a) is a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004); and

(b) has a restriction on use within the meaning of those Regulations,

shall amalgamate with a registered society that is not a prescribed community benefit society that has a restriction on use.”.

7. Section 51 of the 1965 Act (transfer of engagements between societies) shall, where the registered society referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if—

(a) at the beginning of subsection (1), there were inserted “Subject to subsection (1A),”;

(b) after subsection (1), there were inserted—

“(1A) No registered society that—

(a) is a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004); and

(a) has a restriction on use within the meaning of those Regulations,

shall transfer its engagements in accordance with subsection (1) where the effect of that transfer would be that the whole or any part of the society’s prescribed assets (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) would be transferred to a registered society that does not have a restriction on use.”.

8. Section 52 of the 1965 Act (conversion into, amalgamation with, or transfer of engagements to company) shall, where the registered society referred to in that section is a prescribed community benefit society that has a restriction on use, have effect as if, in subsection (1), for “, a company under the Companies Acts” there were substituted—

“—

(a) a community interest company (within the meaning of section [23(1)] of the Companies (Audit, Investigations and Community Enterprise) [Act 2004]”;

(b) a company under the Companies Acts that is a registered social landlord (within the meaning of the Housing Act 1996); or

(c) a company under the Companies Acts that is a charity (within the meaning of section 5A(7)).”.

9. Section 59 of the 1965 Act (restriction on dissolution or cancellation of registration of society) shall, where a prescribed community benefit society has a restriction on use, have effect

as if, for the words “that all property vested in the society has been duly conveyed or transferred by the society to the persons entitled” there were substituted—

“that—

(a) all prescribed assets of the society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) have been transferred to one or more of—

(i) a prescribed community benefit society (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) whose assets are subject to a restriction on use (within the meaning of those Regulations) and which will apply that restriction to any assets so transferred;

(ii) a community interest company (within the meaning of the Companies (Audit, Investigations and Community Enterprise) [Act 2004];

(iii) a registered social landlord (within the meaning of the Housing Act 1996) which has an unalterable restriction on the use of its assets which is equivalent to a restriction on use (within the meaning of the Community Benefit Societies (Restriction on Use of Assets) Regulations 2004) and which will apply that restriction to any prescribed assets so transferred; or

(iv) a charity (within the meaning of section 5A(7) of the 1965 Act)

(v) a body established in a member state other than the United Kingdom, that is equivalent to any of those persons; and

(b) all other property vested in the society has been duly conveyed or transferred by the society to the persons entitled.”.

EXPLANATORY NOTE

(This note is not part of the Regulations)