Title: **Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011**	**Impact Assessment (IA)**
Lead department or agency: HM Treasury	**IA No:**
Other departments or agencies: Financial Services Authority	**Date:** 29/06/2011
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Secondary legislation
	Contact for enquiries: public.enquiries@hm-treasury.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Much of the current legislation for Industrial and Provident Societies (IPSs) and credit unions originates in the 19th century. It is holding back the development of the sector by imposing unnecessary burdens by modern standards. The aim of the Legislative Reform Order (LRO) is to remove these burdens, and contribute to the delivery of the Coalition commitment to foster diversity in financial services, promote mutuals and create a more competitive banking industry. Parliament has completed the first stage scrutiny process and the LRO has been amended to reflect the recommendations made by Committees. The sector has been involved in extensive consultation to develop the LRO, has already begun making the necessary administrative changes, and is keen for it to be implemented quickly.

What are the policy objectives and the intended effects?

The measures in the LRO are designed to:
i) broaden membership criteria and enable growth in the sector;
ii) allow bodies corporate (including small businesses) to access credit union services and so improve their access to a broader range of financial services;
iii) enable credit unions to expand the services they offer to allow them to compete more readily with other financial services providers; and
iv) remove unnecessary and outdated administrative burdens to reduce costs for credit unions and IPSs.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

An LRO is by very definition deregulatory. All the 14 measures this LRO contains are deregulatory, and have been developed following extensive consultation with the sector.

There are three overall options for the LRO:
Option a) No Intervention. This will fail to remove unnecessary burdens and restrictions that are holding back the development of the sector and will not achieve the Government's objectives.
Option b) Partial implementation. Each of these measures in the LRO has its own rationale, is the result of public consultations in 2007 and 2008, and reflects the priorities of the sector for deregulation. Only implementing some of the measures would leave unnecessary burdens on the sector.
Option c) Full implementation. This is the preferred option.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 7/2016 **What is the basis for this review?** PIR. **If applicable, set sunset clause date:** N/A	
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off For final proposal stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister: M Hoban Date: 15/7/11

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Summary: Analysis and Evidence

Policy Option 1

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £39m	High: £60m	**Best Estimate: £45m**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	10	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	£2.7m		£0	**£2.7m**

Description and scale of key monetised costs by 'main affected groups'

- Credit unions: administrative costs of amending documentation and processes, and staff training to take advantage of new opportunities created by measures (£2.1m one-off).
- IPSs: administrative costs of amending documentation and processes (£0.6m one-off).

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£0	10	£4.9m	£42m
High	£0		£7.3m	£63m
Best Estimate	£0		£5.5m	£47m

Description and scale of key monetised benefits by 'main affected groups'

- Credit unions: greater profitability from removal of barriers to growth (£1m - £22m NPV, depending on level of growth in the sector and offsetting lower profits for other financial services firms).
- IPSs: removal of unnecessary costs imposed by outdated regulation (£33m NPV), greater profitability from removal of barriers to capital growth (£7m NPV).

Other key non-monetised benefits by 'main affected groups'

- Consumers and small businesses: greater access to finance and affordable credit, less use of high cost credit or unregulated financial services.
- UK economy: increased competition and diversity of business models in the financial services sector.
- Financial Services Compensation Scheme: reduced costs from fewer credit union failures.
- FSA and dormant IPSs: savings from dissolution of dormant societies.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5%

Estimates of costs and benefits are based on figures supplied by the credit union and IPS industry. If the industry changes substantially in the coming years, the costs and benefits could also change.

Direct impact on business (Equivalent Annual) £m): | **In scope of OIOO?** | **Measure qualifies as**

Costs: £0.3m	**Benefits: £5.5m**	**Net: £5.2m benefit**	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			Great Britain		
From what date will the policy be implemented?			2 months after LRO made		
Which organisation(s) will enforce the policy?			FSA, Courts		
What is the annual change in enforcement cost (£m)?			None		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	
Does the proposal have an impact on competition?			Yes - positive impact		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** N/A	**Benefits:** N/A	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro** N/A	< 20 N/A	**Small** N/A	**Medium** N/A	**Large** N/A
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	Annex 1
Small firms Small Firms Impact Test guidance	Yes	Annex 1
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

Evidence Base (for summary sheets) – Notes

References

No.	Legislation or publication	
1	Consultation Document	http:// www.hm-treasury.gov.uk/consult_credit_union.htm
2	Response to Consultation	http:// www.hm-treasury.gov.uk/consult_credit_union.htm
3	Explanatory Document	http://www.hm-treasury.gov.uk/consult_credit_union.htm
4	Draft LRO	http://www.hm-treasury.gov.uk/consult_credit_union.htm

Evidence Base

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	£2.7m	£0	£0	£0	£0	£0	£0	£0	£0	£0
Annual recurring cost	£0	£0	£0	£0	£0	£0	£0	£0	£0	£0
Total annual costs	£2.7m	£0	£0	£0	£0	£0	£0	£0	£0	£0
Transition benefits	£0	£0	£0	£0	£0	£0	£0	£0	£0	£0
Annual recurring benefits	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m
Total annual benefits	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m	£5.5m

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

1. Background

The Legislative Reform Order (LRO) will modernise the legislative framework under which credit unions and Industrial and Provident Societies operate and remove unnecessary burdens on these organisations. The changes proposed by the LRO are far reaching in their potential to modernise and encourage growth in both sectors.

The Government carried out a consultation on the "Review of GB cooperative and credit union legislation" from 21 June to 12 September 2007. This was followed by a further consultation in July 2008 "Proposals for a Legislative Reform Order for credit unions and industrial and provident societies in Great Britain". Respondents identified some 30 policy and legislative issues which they wanted the Government to address. The responses were published 19 April 2009.

The Treasury has held subsequent discussions with key stakeholders including the Financial Services Authority and the Department for Business, Innovation and Skills. The Treasury has also consulted with the main trade representative bodies for IPSs and credit unions.

As a result of this consultation with the sector, 14 legislative measures have been developed for inclusion in the LRO. These are set out in separate sections for credit unions and Industrial and Provident Societies below, although all measures have the same deregulatory aim of removing restrictions and enabling growth. Each measure is presented separately, with its objective and rationale set out before outlining costs and benefits to the organisations affected by the measure.

A separate section considers the broader economic impact of the measures on consumers and the financial services sector.

Further legislative reforms, which were outside the scope of a Legislative Reform Order, were enacted in the Cooperative and Community Benefits Societies and Credit Unions Act 2010. These will be commenced once the LRO has been made.

2. Measures affecting Industrial and Provident Societies

2.1 Summary of Measures

There are six measures affecting Industrial and Provident Societies (IPSs). The table overleaf indicates the objective of each measure, the overall economic rationale for the measure (i.e. the benefit to society), the business rationale (i.e. the benefit to business), and any other options that were considered during consultation.

No.	Proposal	Objective	Economic Rationale	Business Rationale	Other options considered
A1	**Lower the minimum age for becoming an officer of an IPS or becoming a member of an IPS.** Abolish the current minimum age of 16 for becoming a member of an IPS and reduce from 18 to 16 the minimum age for becoming an officer.	Remove unnecessary restrictions to bring IPSs into line with companies which are not subject to such age restrictions.	Facilitate greater competition in overall financial services. Improve younger people's access to financial services	Allow greater engagement with the younger generation to create a sustainable membership.	
A2	**Abolish limits on share capital** For transferable share capital, members will no longer be subject to the current £20,000 investment limit.	Enable IPSs to expand through more capital investment.	Facilitate greater competition in overall financial services.	Increase access to capital to allow societies to grow.	
A3	**Raise cap on fees for a copy of the society's rules** A society can currently charge a maximum of 10p for a copy of their rules. This measure raises the cap from 10p to £5 for non-members and makes it free for current members.	Enable IPSs to bring fees into line with modern costs for printing and postage. Increase levels of corporate governance, transparency and member participation by facilitating member access to society rules.	Remove unnecessary regulation, while promoting good corporate governance by making sure members are entitled to society rules for free.	Release IPSs from burden of unnecessary costs imposed by outdated rules.	The original proposal was to increase the fee cap from 10p to £1 for non-members. On consultation with the sector it was apparent that £1 would not provide sufficient flexibility to meet modern costs of printing and postage.

No.	Proposal	Objective	Economic Rationale	Business Rationale	Other options considered
A4	**Facilitate the easier dissolution of dormant societies** The threshold number of votes for dissolution will be lowered from 75% to 66%, and the requirement that 50% of the membership must vote will be removed, to make it easier for dormant societies that have lost touch with their members to dissolve.	Facilitate the dissolution of dormant societies by providing an alternative, more pragmatic method of resolution.	Save unnecessary cost of societies continuing to operate and meet regulatory requirements despite dormancy.	Save unnecessary cost of societies continuing to operate and meet regulatory requirements despite dormancy.	
A5	**Flexibility on year-ends** Currently a society's financial year-end must fall between the 31 Aug and 31 Jan, irrespective of whether this coincides with the trading year for societies. This measure allows societies to choose their own year-ends.	Remove unnecessary burden and expense for IPSs by bringing their rules into line with those for companies	Remove unnecessary and burdensome regulation	Make year-end reporting less arduous for IPSs by allowing it to be aligned with the trading year, as is already the case for companies.	
A6	**Remove requirement on societies to have interim accounts audited**	Remove unnecessary burden and expense for IPSs by bringing their rules into line with those for companies	Remove unnecessary and burdensome regulation	Allow societies wishing to publish interim reports to do so without incurring large auditing fees.	

2.2 Costs to IPSs of measures

The sector consists of approximately 11,000 IPSs, which vary enormously in their size and economic significance. IPSs take many forms, for example, agricultural co-operatives, sports supporters clubs, or co-operative retailers. Almost all are small businesses, apart from some of the larger co-operatives. With the exception of measure A6, which only affects larger societies that produce interim reports, the proposals will make improvements and reduce burdens for the whole sector.

Each of these proposals will require IPSs to make small amendments to their rules, either on their websites or in hard copy. The sector expects that there will be a small administration cost for making these amendments. While each of the measures individually would impose this cost, the sector does not expect the costs of making all the various multiple rule amendments at once to be more than making only some or just one of the amendments. This is because there are clear synergies between the changes, and the costs incurred from making them are largely fixed given the small scale of the amendments required. The cost of the changes has been estimated by the sector as an average of £50 per society, which equates to £550,000 for the sector as a whole.

Measure A3 – amending the fees for society rules – has the potential to impose additional costs on the sector beyond these administrative costs. However, the sector expects this to be cost/benefit neutral in monetary terms. Currently, IPS rules are available on request for members and non-members of any IPS for 10p. While the exact number varies from society to society, evidence from the sector is that the average frequency of requests is low. In the majority of cases a copy of the rules is sent electronically at negligible cost to the society, and a minority of rules are sent out in hard copy. There is no data collected by societies or the sector as a whole on what proportion of the requests comes from members and non-members. Under the new proposals, the cost of receiving a new copy of the rules will be removed entirely for members of the society, and a charge can be levied of up to £5 for non-members. On consultation with the sector, it is expected that each society will individually set the charge to non-members at a level which covers the cost to that society of issuing all hard copies out (to members and non-members). This will offset the lost income the society would receive from the 10p they currently charge for all requests.

The table below summarises these costs and the expected take-up for each measure.

Measure	Costs imposed	Expected take up	Costs per firm
All measures	Administrative cost of changing documentation to reflect the rule changes.	All IPSs are expected to make rule changes as a result of these measures.	Average £50 estimated by the sector for making the full package of rule changes for all measures, equal to **£550,000 one-off** cost for the sector.
A1 Lower age requirements	None beyond the administrative cost of making the rule change.	All IPSs are expected to take up this measure.	Zero.
A2 Abolish limits on share capital	None beyond the administrative cost of making the rule change.	A small number of investors in larger IPSs, representing about 0.5% of overall membership, will take advantage of this.	Zero.
A3 Fees for society rules	Cost of foregone income from charging 10p for rules for members – netted off from benefits from ability to charge more for non-member requests.	All IPSs are expected to take up this measure.	Zero in net terms, as described above.
A4 Dormant society dissolution	None beyond the administrative cost of making the rule change.	300 dormant IPSs are expected to dissolve as a result.	Zero.
A5 Year end change	None beyond the administrative cost of making the rule change. IPSs will still conduct the same year-end process, but at a date of their choosing.	All IPSs are expected to take up this measure.	Zero.
A6 Interim accounts	None beyond the administrative cost of making the rule change. Removing the requirement to audit interim accounts will only present a financial benefit.	30 large IPSs are expected to take up this measure.	Zero.
TOTAL		**One-off transitional cost: £550,000**	

	Annual cost: £0

2.3 Benefits to IPSs and FSA of measures

All six proposals offer societies benefits, either through removing unnecessary regulatory burdens and simplifying processes by aligning the legislation with that for companies, or through abolishing outdated limitations which impose direct costs on the sector or constrain growth.

Many of these benefits take the form of additional flexibility for processes such as year ends (A5) or appointing IPS officers (A6). The sector is eagerly anticipating this flexibility, but the scale of monetised benefits will be small and it would not be proportionate to attempt to quantify it exactly.

Measure A2 (Abolish limits on transferable capital) offers benefits to any society wishing to receive more investment above the current individual threshold of £20,000 of transferable share capital. Based on evidence from the industry a number of large societies have identified investors representing 0.5% of overall IPS membership who already wish to invest more than the £20,000 limit. Further investment may take place in future. The removal of the limit will therefore enable these societies to use more capital to grow the business. Based only on those investors already planning to invest more, the sector has estimated an investment uplift of 7.5%, calculated from case studies of a number of IPSs across the sector. The share capital level across the sector is currently £235m, and so as a result the capital base is expected to grow to £252m (£235m x 7.5%). This increased capital will return greater profit to the sector. Using the Return on Capital ratio the sector is currently operating with (5% on average, according to Coops UK and consultants), the benefit the sector will receive in the form of increased profits is £850,000 annually (5% return on the £17m increase in capital is £850,000).

Measure A4 (Dormant society dissolution) offers benefits to the FSA and to dormant societies. 300 societies are projected to dissolve in the first year as a result of this measure. The FSA will benefit financially from not having to perform the registrar function for societies no longer in operation. Dormant societies will save the costs of sending year end statements (either electronically or in hard copy) on an annual basis to the FSA. Given the small number of societies involved, and the fact that the annual returns are simply pro forma returns for a dormant society produced at negligible cost, it would not be proportionate to attempt to monetise the exact savings to the FSA and societies, but both groups are looking forward to this change.

Measure A6 (Interim accounts) will allow the larger societies that publish interim accounts to save the cost of having these audited. According to the main industry body, 30 IPSs currently have interim reports audited, costing £3,855,000 annually. The industry expects removing the obligation to conduct an audit will lead to all societies ceasing to audit interim accounts, bringing them into line with companies. These societies would therefore save their current audit costs in full.

Measure	Detail	Total Benefits Received
A1 Lowering age requirements	No monetised benefit – more flexibility on officer nominations, and potential for a small increase in membership.	Small benefits from flexibility and additional membership, but not proportionate to monetise given limited scale.
A2 Modify rules on share capital	Benefits of raising additional capital.	As discussed above, the expected uplift of 7.5% in share capital will boost annual return on capital from £17m to £17.85m – an estimated benefit of **£850,000 annually**.
A3 Fees for society rules	Benefit from being able to charge non-members for rules.	Zero in net terms, as discussed in the section on costs above.
A4 Dormant society dissolution	Benefit to dormant societies and FSA of no longer having, respectively, to prepare and monitor annual returns.	Small savings for societies and FSA, but not proportionate to monetise given small number of societies involved and negligible costs of existing requirements.
A5 Year end change	IPSs will be able to conduct year-end processes at a date of their choosing, which will simplify the accounting process by better aligning it with the trading year.	Small benefits from flexibility to use simpler year end processes, but not proportionate to monetise given limited scale.
A6 Interim accounts	Benefits to societies saving costs of having to get interim reports audited if published.	Saving of current audit costs of **£3,855,000 annually**.
TOTAL		**One-off transitional benefits: £0m** **Annual benefits: £4,705,000**

Combining these benefits with the estimate of costs above gives an estimate of the net present value of the measures for IPSs over ten years, based on a discount rate of 3.5%. This is summarised in the table below.

	Transitional	**Annual**
Costs	£550,000	£0
Benefits	£0	£4,705,000
Net present value (10 years)	£40m	

The table shows that the measures will bring significant net benefits to the sector.

3. Measures affecting Credit Unions

3.1 Summary of measures

There are eight measures affecting credit unions. The table overleaf indicates the objective of each measure, the overall economic rationale for the measure (i.e. the benefit to society), the business rationale (i.e. the benefit to business), and any other options that were considered during consultation.

No.	Proposal	Objective	Economic rationale	Business rationale	Other options considered
B1 and B2	**Broaden membership criteria** Replace requirement for members of a credit union to share a 'common bond' with a broader 'field of membership' test, subject to a cap of 2 million members.	Allow credit unions to expand their membership.	Increases consumer access to credit unions, reducing recourse to extremely high cost or unregulated credit. Facilitates greater competition in overall financial services.	Larger credit unions are more profitable and financially viable.	The Government consulted on a more limited expansion of membership criteria, and a cap of 1 million members. The criteria and cap were broadened in response to respondents' views and ambitions for growth in the sector.
B3	**Abolish limit on non-qualifying members** Abolish current limit of 10% on the proportion of members of a credit union who can continue to be members even if their circumstances change and they cease to meet the membership criteria.	Remove a barrier to labour mobility, since the current limit forces some credit union members who change location or job to find a new financial services provider.	Labour immobility can reduce overall economic output and the welfare of those individuals who are unable to move to more productive work.	Allows credit unions to retain customers who move or change jobs.	
B4	**Allow corporate, association and partnership membership** Allow businesses and charities to join credit unions, as well as individuals, subject to a cap of businesses and charities constituting at most 10% of a credit union's total assets.	Allow credit unions to expand their membership, while retaining credit unions' close focus on individual members.	Increases access to financial services for small business and charities, some of which struggle to open accounts with mainstream providers. Facilitates greater competition in overall financial services.	Larger credit unions are more profitable and financially viable.	The Government consulted on a limit of 10% of total membership for corporate members, but revised this to 10% of total assets in response to consultation respondents' concerns about crowding out individual members.
B5	**Allow interest on deposits** Allow credit unions to pay interest on deposits, as well as the existing discretionary dividend.	Remove competitive disadvantage that credit unions face compared to other financial services providers.	Facilitates greater competition in overall financial services.	Removes competitive disadvantage.	

No.	Proposal	Objective	Economic rationale	Business rationale	Other options considered
B6	**Abolish limit on dividends** Abolish the current 8% limit on annual dividend payments	Allow credit unions to determine their own level of an appropriate dividend.	Remove unnecessary burdensome regulation.	Greater flexibility to manage finances and attract additional members.	
B7	**Relax restrictions on share withdrawals** Remove requirement that members of a credit union with a loan from the credit union cannot withdraw their shares, and instead allow credit unions to decide on a loan-by-loan basis.	Allow credit unions discretion to decide on the appropriate balance between flexibility for their members and protecting their share capital.	Remove unnecessary burdensome regulation.	Greater flexibility to manage finances and attract additional members.	The Government consulted on requiring credit unions to make a one-off decision in their rules about whether to allow share withdrawals by members with a loan. Following consultation, this was revised to give unions flexibility to decide on each case individually. This approach is more complex, but respondents preferred the flexibility.
B8	**Allow credit unions to charge the market rate for ancillary services** Remove requirement that charges for ancillary services are limited to the cost of those services to the union.	Remove a key barrier to credit unions offering a broader range of services to their members.	Increase range of services offered by credit unions, facilitating greater competition in financial services.	Remove barrier to expansion through provision of additional services.	

3.2 Monetised costs of the measures to credit unions

According to the largest credit union industry body, there are 465 credit unions in England, Scotland and Wales. Based on scaling up figures from this industry body, which represents 286 credit unions, the population of credit unions that will be affected by these measures can be broken down into small, medium and large credit unions as in the table below. These categories are based on the number of members of the credit union. Looking at the number of employees, all credit unions qualify as small businesses (less than 20 employees).

Size of credit union	Number of credit unions	Number of members
Small (up to 500 members)	125	40,000
Medium (500 – 3000 members)	250	320,000
Large (3000+ members)	90	550,000
Total	**465**	**910,000**

The costs of these measures have been assessed by asking the credit union industry bodies to survey their members. The larger of the two bodies conducted a formal survey drawing responses from 30% of its members, broken down into small, medium and large credit unions. The other industry body conducted a more informal survey.

The surveys found that the main costs of implementation for all the measures related to one-off administrative costs. These involved changing documentation and processes to take advantage of the new opportunities offered by these measures, and staff training to better equip credit unions to manage the growth in the sector that these measures will facilitate.

The costs of measures B1–5 only fall on credit unions that take the opportunity to change their membership or other practices in response to the LRO. The surveys therefore assessed what proportion of credit unions of each size category would take up these opportunities. Measures B6–8 apply to all credit unions. The table overleaf summarises the take-up rates and costs by credit union size for each measure, based on consideration of both surveys.

		Take up rate			Costs per firm		
Measure	**Costs involved**	**Small**	**Medium**	**Large**	**Small**	**Medium**	**Large**
B1 and B2: Broader membership criteria	Staff training, and revising documentation and processes for new members	63%	78%	88%	£700	£1500	£6000
B3: Remove limit on non-qualifying members	Revising documentation on membership rules	50%	50%	52%	£500	£750	£1000
B4: Allow corporate membership	Staff training, and revising documentation and processes for new corporate members	62%	76%	92%	£700	£1500	£2000
B5: Allow interest on deposits	Revising processes for payment of dividends and interest	12%	47%	64%	£500	£2000	£2000
B6:Abolish limit on dividends	N/A – relaxes restrictions on an existing activity	100%	100%	100%	£0	£0	£0
B7: Relax restrictions on share withdrawals	Revising policies for new loans	100%	100%	100%	£200	£500	£1000
B8: Charge for ancillary services	Revising documentation on charges for services	100%	100%	100%	£500	£750	£1000

The surveys from which these costs have been derived considered the cost of each measure in isolation. However, the Government intends to implement the measures as a combined package, as requested by the sector. The costs of implementation will therefore be less than the sum of the costs of individual measures, as there are significant synergies between some of the measures. For example, measures B1–4 relate to expanding membership, for which the documentation changes and staff training will be partly overlapping. To be conservative, the impact assessment does not attempt to quantify these synergies, and instead assumes that as a worst case scenario credit unions will bear all these separate costs in full with no synergies.

Not all credit unions planning to implement new measures expect to do so immediately. Of those planning to implement new measures, roughly 40% intended to do so straight away, a further 40% within 2 years, and the remaining 20% within 5 years. However, there was great variation between individual measures and credit union sizes. Given the small scale of the measures it would not be proportionate to model the full variation in implementation times. Instead, this impact assessment assumes the worst case scenario – that all the implementation costs fall immediately and in full on all firms intending to make changes, whether now or in the future.

Based on the number of credit unions of each size, the costs of each measure, and the take-up rate for each measure, the overall one-off costs of implementation are estimated to be as in the following table.

	Total one-off costs by size of credit union to nearest £10k (no. of credit unions of each size x costs of each measure x take-up rate)			
Measure	**Small**	**Medium**	**Large**	**Total**
B1 and B2: Broader membership criteria	£60,000	£290,000	£480,000	**£830,000**
B3: Remove limit on non-qualifying members	£30,000	£60,000	£20,000	**£110,000**
B4: Allow corporate membership	£50,000	£280,000	£170,000	**£500,000**
B5: Allow interest on deposits	£10,000	£230,000	£120,000	**£360,000**
B6:Abolish limit on dividends	£0	£0	£0	**£0**
B7: Relax restrictions on share withdrawals	£30,000	£120,000	£90,000	**£240,000**
B8: Charge for ancillary services	£20,000	£80,000	£50,000	**£150,000**
Total	**£200,000**	**£1,060,000**	**£930,000**	**£2,190,000**

The industry surveys did not expect the measures to impose any significant ongoing annual costs, since they amend processes and procedures that already exist rather than impose any new requirements. Some credit unions may decide to develop new processes as a result of the removal of restrictions, for example new bespoke processes and marketing for admitting small businesses as members. However, these processes are simply made possible by the new regulations rather than being imposed, and will only be pursued by firms that expect a net benefit from the new process. The costs and benefits of these second order changes are not considered here.

3.3 Monetised benefits of the measures to credit unions

The measures are expected to bring direct benefits to the credit unions affected, by removing barriers to competition and growth. This is expected to allow the sector to attract a large number of new members and conduct additional business. The LRO has been in development for a number of years in close collaboration with the sector. They are expecting its introduction imminently, and have already begun making preparations to take advantage of the opportunities it offers. The industry surveys of credit unions estimated that many small credit unions expect the LRO will allow them to implement plans for rapid expansion of around 50% in their membership, while some large unions expect to double in size.

The measures contribute in different ways to these plans for growth. Measures B1 & B2 will allow credit unions to attract more individual members, while B4 will allow them to enrol corporate members for the first time. As the take-up figures show, a large majority of credit unions are planning to seize the opportunities created by these measures, and the industry has indicated this is where credit unions expect most of their membership growth to come from. However, the other measures will also make a contribution, although not to the same extent. Greater retention of members (B3), the ability to compete with banks by offering interest on deposits (B5) or ancillary services (B8), and the ability to attract greater investment through higher dividends (B6) or more flexible terms (B7) are all eagerly anticipated by the sector as valuable tools to increase membership.

There are obvious interactions and synergies between the individual measures, which the sector expects to be implemented as a package, and so it is not possible to reliably quantify the contribution of individual measures to the sector's expectations for membership growth. Instead, this impact assessment considers the impact on overall membership growth.

An expansion in membership of 50% or more, as predicted by the sector, will increase revenues proportionately. Some of these revenues may be offset by higher costs, for example due to increased administration or advertising, or lower margins, for example due to increased competition. The impact assessment therefore considers three conservative scenarios for profit growth far below the expected increase in membership and revenues – 5%, 10% and 20% profit growth.

Based on the latest available figures of profits of £16m for the credit union sector[1], and distributing this based on the number of members in unions of different sizes, the following table summarises the benefit to credit unions of different sizes from potential growth in profits. The benefits are presented as the present value of an additional x% of profits over the next 10 years. These estimates conservatively assume profit growth is a one-off event and is not compounded year-on-year, i.e. that profits in each year are x% higher than they are now, rather than that profits rise by x% each year.

		Benefits from profit growth (present value over 10 years)		
Credit union size	**Estimated current annual profits**	**5% profit growth**	**10% profit growth**	**20% profit growth**
Small	£0.7m	£0.3m	£0.6m	£1.2m
Medium	£5.7m	£2.4m	£4.9m	£9.8m
Large	£9.7m	£4.2m	£8.4m	£16.7m
Total	£16.1m	£6.9m	£13.9m	£27.7m

Combining the expected benefits with the estimate of costs above gives an estimate of the net present value of the measures for credit unions over ten years. This is summarised in the table below.

	Net present value for credit unions of measures (£m)		
Credit union size	**Low**	**Best estimate**	**High**
Small	£0.1m	£0.4m	£1.0m
Medium	£1.4m	£3.8m	£8.7m
Large	£3.2m	£7.4m	£15.8m
Total	**£4.7m**	**£11.7m**	**£25.5m**

The table shows that in all modelled scenarios the measures will bring significant net benefits to the credit union sector.

Some of the growth in profits for credit unions could in theory come from customers switching away from other financial services providers such as bank and building societies. To the extent this is the case, some of the increased profits for credit unions could be offset by reduced profits for other financial services providers. This would reduce the benefits that accrue to society as a whole.

However, credit unions by their very nature are designed to serve customers who struggle to access mainstream financial services. According to research from 2006[2], 69% of credit union customers did not feel they could obtain a loan from a bank or building society, 72% could not borrow on a credit card and 78% had no overdraft. On the savings side, 31% had no savings outside their credit union account, and 17% had no bank account at all.

These figures suggest the expansion in credit union membership is likely to be heavily concentrated among customers who cannot access their desired financial services products from mainstream providers. Small businesses and charities currently unable to access either credit unions or mainstream banking are expected to be major beneficiaries. This means that profit growth in the credit union sector will come largely from expanding access to financial services to sections of society that currently have limited access, rather than transferring the provision of existing financial services from the current providers to credit unions.

However, to incorporate the possibility that some new business is a transfer from other providers, this Impact Assessment allows a range of scenarios for the expected profit growth for credit unions to be offset by lower profits for other financial services providers. In the high NPV estimate, 80% of profits are not offset elsewhere, reflecting the statistics above that 70-80% of credit union customers do not have access to alternative financial services. In the low estimate, only 20% of profits are not offset, and in the central estimate 50% are not offset. This means that in calculating the NPV for society as a whole, this

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1 Based on latest published FSA regulatory returns - http://www.fsa.gov.uk/smallfirms/your_firm_type/credit/library/index.shtml.

2 *Membership Counts: Who uses credit unions?*, Personal Finance Research Centre, University of Bristol http://www.abcul.org/filegrab/documents/bae1ccb24f444b253e6ebe796469f8de/membership-counts.pdf

impact assessment uses high/medium/low benefits of £1.4m/£6.9m/£22.1m, rather than the full benefits from higher profits for credit unions in the table above.

4 Wider economic impacts of the measures

The measures may have impacts that extend beyond credit unions and Industrial and Provident Societies. The key wider economic impacts on society of these measures are expected to be:

- **Increased access to affordable finance for consumers and small businesses** who struggle to secure finance from mainstream lenders such as banks. This will reduce the number of consumers or small businesses resorting to extremely high cost credit, such as payday lending or unregulated credit. This will save them money and reduce the risk of default and the negative consequences that follow from it, such as court proceedings or seizure of property.

- **Greater competition in financial services**. Credit unions offer a different model of finance to mainstream lenders, and these measures will allow them greater freedom to expand their membership, placing competitive pressure on other lenders. Less competitive mainstream lenders may face reduced profitability as a result, but the overall effect of competition will be beneficial for consumers and society.

- **Reduced risk of credit union failure**. The changes to the rules on membership will make it easier for credit unions to merge, which will help small, struggling credit unions avoid failure. The costs of credit union failure fall on the broader financial services industry, since credit union depositors are insured by the Financial Services Compensation Scheme, which is funded by a levy on the industry.

Access to affordable finance and greater competition may bring considerable benefits to those consumers and small businesses affected, but the nature of these benefits is not directly or exclusively monetary and quantifying them would involve a complex assessment of consumer harms and benefits in the financial sector. The savings from fewer credit union failures are also difficult to estimate, since they will depend on forecasts of future failure rates and the number of failures that could be avoided through mergers[3].

The measures proposed here are relatively small and relate to organisations that constitute only a small proportion of the overall financial services sector. Credit unions' total assets of £600m represent less than 0.1% of the £1 trillion in deposits from individuals held by banks and building societies[4]. It is therefore not proportionate to attempt to monetise the impacts of greater competition and access to finance, but they are noted as important non-monetised benefits.

5 Alternative options considered

The 14 measures above have been developed following extensive consultation with the industry. Some of the alternative options considered in relation to individual measures have been discussed above. The Government has also considered three overall options for the LRO:

[3] As a benchmark, the Financial Services Compensation Scheme spent £3.7m between 2004 and 2010 on failed credit unions.

[4] Source: Bank of England, http://www.bankofengland.co.uk/statistics/bankstats/current/index.htm.

Option a - No Implementation

Given the de-regulatory nature of the LRO, the Government commitment to promote mutuals such as credit unions and IPSs and the fact considerable work has been invested in the LRO from authorities and the sector to date, this option is not recommended. No benefits would be realised by this option.

Option b - Partial implementation

This is not the preferred option, as each existing proposal serves a purpose and has been subject to comprehensive consultation with the sector. The deregulatory nature of the LRO means leaving any proposals out of the legislation would mean leaving unnecessary, outdated burdens on business.

Option c - Full implementation

This is the Government's preferred option. The LRO has been the result of extensive consultation with the sector, with specific proposals added and existing proposals amended according to what can help the sector grow and carry out its business in the best possible way. Each measure serves a specific purpose, either carrying a significant quantifiable benefit for all credit unions or Industrial and Provident Societies or a benefit of greater flexibility for businesses in particular circumstances.

6 Risks and uncertainties

Estimates of costs and benefits are based on figures supplied by the credit union and IPS industry. Should the industry change significantly in the coming years, for example due to a large shift in consumer preferences or competition from other industries, the costs and benefits could change.

Annexes

Annex 1: Specific Impact Tests

Small Firms Impact Test

All credit unions are small firms, and the vast majority of IPSs are small firms. The impact assessment for these proposals is therefore broadly the same as the specific impact on small firms. The assessment shows significant overall benefits for the sector.

There are some proposals which will only impact the larger IPSs such as proposal A6: removing the necessity to audit interim reports. Given that only larger IPSs produce interim reports, this is not relevant for the smaller societies.

Competition Impact Test

These measures are not expected to impose any barriers to competition in the financial services sector. On the contrary, they remove existing barriers to competition created by outdated regulation. No adverse impact on competition is expected.

Annex 2: Post Implementation Review (PIR) Plan

Basis of the review: Within 5 years of the Order coming into force the Treasury will review the legislation; one particular proposal (B8 set out in Article 20) will be reviewed in 2 years from the LRO coming into force.
Review objective: To ensure that the legislation continues to provide the deregulatory benefits for the sector and continues to be relevant for the mutuals sector, while considering any inconsistencies or hindrances brought about.
Review approach and rationale: Treasury officials will seek the views of the mutuals sector during the regular meetings held between stakeholders and the Treasury's mutuals team.
Baseline: Levels of credit union and Industrial and Provident Society membership and turnover as measured at the end of 2011 by the industry bodies Co-ops UK and Association of British Credit Unions Limited (ABCUL).
Success criteria: If the Treasury and the mutual sector consider that the implementing legislation has satisfactorily delivered deregulatory benefits for the mutual sector, with reference to evidence of growth in the sector and of administrative savings from greater flexibility.
Monitoring information arrangements: The LRO's measures will be discussed regularly during stakeholder meetings held between the mutual sector and the Treasury's mutuals team. Information about the financial performance of the sector is collected regularly by the FSA, Co-ops UK and ABCUL.
Reasons for not planning a review: N/A