EXPLANATORY MEMORANDUM TO

THE INDUSTRIAL AND PROVIDENT SOCIETIES (INCREASE IN SHAREHOLDING LIMIT) ORDER 2014

2014 No. 210

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This Order increases from £20,000 to £100,000 the maximum interest which a member of an industrial and provident society ("an IPS") may have in the shares of the society. It also allows a society to increase the limit in its rules by resolution, so that a new limit can take effect before the society has registered an amendment to its rules.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Industrial and Provident Societies Act 1965 ("the 1965 Act") is the main statute governing the registration and operation of IPSs. Section 6 provides that a member of a society may not have or claim and interest in the withdrawable shares of the society exceeding £20,000. This does not apply to specified types of member, including other registered societies.

4.2 Credit unions may also be registered under the 1965 Act by virtue of the Credit Unions Act 1979, and are generally subject to the provisions of the 1965 Act. But section 6 does not apply to credit unions by virtue of section 31(3) of the Credit Unions Act 1979. A credit union must determine the maximum amount of a member's interest in shares in accordance with rules made by the Financial Conduct Authority and the Prudential Regulation Authority.

4.3 The original limit of £1,000 was increased to £5,000 by the Industrial and Provident Societies Act 1975, which conferred power on the Chief Registrar of Friendly Societies (with Treasury consent) to increase the limit further by order. The limit was increased to £20,000 by the Industrial and Provident Societies (Increase in Shareholding Limit) Order 1994. This Order revokes the 1994 Order and the first such order made in 1981.

4.4 Power to increase the shareholding limit was transferred to the Treasury by article 4 of Financial Services and Markets Act 2000 (Mutual Societies) Order (S.I. 2001/2617). It includes power to make provision allowing a society to increase its shareholding limit by resolution, so that a new limit can take effect before the society has registered an amendment to its rules.

4.5 These measures form part of a package of legislative reform for registered societies, which is made under various powers with a view to commencement on 6 April 2014.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain and the Channel Islands.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

> In my view the provisions of the Industrial and Provident Societies (Increase in Shareholding Limit) Order 2014 are compatible with the Convention rights.

7. Policy background

- ***What is being done and <u>why</u>***

7.1 This instrument is one measure for implementing the Government's commitment to promote mutual bodies and foster diversity in the UK economy. The objectives are to preserve and strengthen the unique features of societies registered under the 1965 Act, and to promote a diverse, healthy and successful mutuals sector which is able to offer a broad range of services to growing numbers of members.

7.2 The 1965 Act provides for the registration of IPSs, of which there are two types: co-operative societies and community benefit societies. A co-operative society is a business owned and run by and for the benefit of its members. A community benefit society must satisfy the same co-operative principles as a co-operative society and must also be operated for the benefit of the community in which it works. All IPSs embody democratic principles; in particular, members have equal voting rights regardless of the level of their financial commitment. This enables all members, who may be employees, customers or residents, to be involved in the running of the business.

7.3 Over 7,000 IPSs and credit unions were registered in Great Britain in 2013. The number has grown as the sector has continued to provide a popular and successful structure for mutually run business. IPSs cover a vast range of activities and industries. They include public service providers, football clubs, wind farms, web designers and agricultural suppliers. Some have hundreds of members and are large employers; others have just a handful of members. IPSs are found in all parts of the UK and in the Channel Islands (legislation governing registered societies is devolved in Northern Ireland).

7.4 Withdrawable Share Capital ("WSC") is share capital contributed by IPS members on the basis that it can be withdrawn on demand. WSC is an important source of capital for IPSs. The maximum amount of WSC a member can invest is currently £20,000. By preventing a single person from holding a disproportionate stake the limit guards against the financial vulnerability and possibility of undue influence that a society would otherwise face if a single member could withdraw a considerable share of total capital.

7.5 This Order will increase the WSC limit from £20,000 to £100,000. Concerns have been raised that the current limit constrains the growth and development of the IPS sector. Attention has been drawn to under-capitalisation, over-exposure to debt finance, the difficulty of financing new investment and constraints for new societies in capital intensive sectors. The Government accepts that raising the limit will facilitate greater investment by societies in industries requiring higher capital input, such as agriculture, housing and energy.

7.6 Article 3 provides that within 18 months of the date on which the Order comes into force a society may resolve to increase the limit specified in its rules to any amount up to £100,000. The rules have effect accordingly until a subsequent amendment is registered. The right to make a resolution is lost if the society's rules are amended before a resolution is made.

7.7 The increase in the statutory limit is entirely permissive. As an IPS can determine its own maximum limit up to £100,000 it can exercise its own judgment about the need to mitigate the risks of determining a higher limit for individual holdings.

- ***Consolidation***

7.8 As this Order raises the current WSC limit the possibility of consolidation does not arise.

8. Consultation outcome

8.1 The Government consulted publically on a package of measures (including this Order) proposed for the reform of IPS legislation; see *Industrial and Provident Societies: growth through co-operation* issued on 26 July 2013. The consultation period was eight weeks (until 20 September 2013). This was proportionate to the scale and subject matter of the consultation and took into account the capacity of interested parties to respond. The Treasury had regard to the specialised nature of the issues raised; the number of likely respondents; the prior involvement of some interested parties; and its on-going dialogue with industry representatives about the proposals and the timing of consultation.

8.2 The Treasury received 42 responses from a variety of sources, including mutual sector representatives, individuals, trade bodies, legal advisers and consumer groups.

8.3 22 respondents provided comments on this measure. All were in favour of increasing the WSC limit. One respondent agreed with the figure being set at around £30,000 in line with the Retail Price Index. The others called for higher limits ranging from £40,000 to

£100,000. Two suggested that there should be no legislative maximum, allowing IPSs complete freedom to determine a limit. 15 respondents took the view that a limit of between £60,000 and £100,000 would be sensible.

8.4 After careful consideration the Government has decided that a limit of £100,000 would be most appropriate. Allowing WSC limits to be raised to this level will boost the IPS sector, particularly IPSs in more capital-intensive industries, such as agriculture, energy and housing. It should also provide enough flexibility to address the needs of IPSs, which vary widely according to size and field of activity. While the higher limit will increase the scope for disproportionately large holdings, any increase will enhance risks associated with this. The Government aims to balance the risks against the benefits to be derived from allowing larger holdings, and believes that they are best managed by IPSs themselves, in setting a suitable limit via their own rules.

8.5 A full Government consultation response was published at: www.gov.uk/government/consultations/industrial-and-provident-societies-growth-through-co-operation

9. Guidance

9.1 The Treasury does not intend to issue guidance in connection with this Order.

10. Impact

10.1 The impact of the Order on business, charities and voluntary bodies run as IPSs is wholly beneficial. It will allow IPSs to raise more capital from individual members. Co-ops UK have estimated that raising the WSC limit to £100,000 could save the sector up to £2.5 million per annum through lower funding costs.

10.2 The impact on the public sector is likely to be negligible. The FCA, as registration authority for IPSs, may have some additional work to carry out, particularly in relation to registering rule changes; however, this is expected to be very limited and absorbed within the existing budget.

10.3 The Regulatory Policy Committee has confirmed that this measure qualifies for its fast-track process; therefore no impact assessment has been prepared.

11. Regulating small business

11.1 Many IPSs are small businesses. There was consensus among consultation respondents that IPSs generally are currently disadvantaged by the low WSC limit, and that the benefits of increasing it will be felt by all irrespective of their size.

12. Monitoring and review

12.1 While no specific review is planned for this instrument, it will be reviewed with regard to future policy on co-operative and community benefit societies.

13. Contact

13.1 Candice Mullineux at HM Treasury can answer queries regarding the instrument. Phone: 0207 270 1037; or email: Candice.Mullineux@hmtreasury.gsi.gov.uk