

Chapter 6: The Asset Lock - Contents

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6.1. Restrictions on the transfer of assets (the Asset Lock)

The Asset Lock is a fundamental feature of CICs. It is important that you understand the concept before setting up a CIC as it has permanent long-term consequences.

“Asset Lock” is a general term used to cover all the provisions designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.

6.1.1. A transfer of assets must satisfy certain requirements

This means that, subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must satisfy one of the following requirements:

- ❖ It is made for full consideration (i.e. at market value), so that the CIC retains the value of the assets transferred;
- ❖ It is made to another asset-locked body (a CIC or charity, a permitted industrial and provident society or non-UK based equivalent) which is specified in the CIC’s articles of association;
- ❖ It is made to another asset locked body with the consent of the Regulator; or
- ❖ It is otherwise made for the benefit of the community.

Provision to this effect, as prescribed in the Regulations, must be included in a CIC’s articles of association. CICs are permitted to adopt asset lock rules that impose more stringent requirements, provided they also include these basic provisions.

6.1.2. What is a ‘specified’ asset-locked body

An asset-locked body means a community interest company, a charity, a permitted industrial and provident society or a body established outside the United Kingdom that is the equivalent to those persons.

It is important to consider whether you want to specify an asset-locked body as a possible recipient of your CIC’s assets (for less than full consideration) in the CIC’s articles.

Such a nomination may prove particularly important in the event of the CIC being wound up or dissolved when it is not insolvent, as, in the absence of a nomination, the Regulator will have to decide the destination of any remaining assets.

In addition, the Regulator will have to approve any transfers (for less than full consideration) to asset-locked bodies which are not nominated in the CIC’s articles of association.

6.1.3. Restrictions on the return assets to members

With only very limited exceptions such as the payment of dividends and the return of paid up capital on liquidation, a CIC's assets cannot be returned to its members unless they are themselves asset locked bodies. See Chapter 6.3 with regard to the payment of dividends and the cap on dividends which is an important feature of the Asset Lock that applies to dividends paid to non-asset locked bodies.

6.1.4. Assets can be used as collateral

Normal trading conditions apply. A CIC is a limited company with all the usual duties and obligations of a company. The Asset Lock should not be seen as a bar to the CIC using its assets for normal trading, or other business activities, and meeting its financial obligations.

For example, a CIC may take on a commercial venture with the purpose of generating profits to support its community benefit objects. If the venture fails and makes losses the CIC must still meet its contractual obligations in regard to the venture even if this means depleting its assets or selling some of them to meet its debts.

6.1.5. Interpretation of transfer of assets

The transfer of assets at less than market value must be given a wide interpretation and it should always be remembered that cash is often an organisation's main asset. Payments for services etc must represent full market value. This means, for example, that payments to staff and directors must not be disproportionately high in relation to their abilities and the services they perform. Similarly management, or other service charges (particularly if provided by associates who are not asset locked bodies), must represent value for money.

6.1.6. The community interest test and the asset lock

There is a clear inter-relationship between the asset lock and the Community Interest Test in that the test may not be seen to be met if a reasonable person might consider that the activities of the CIC are being carried on for the benefit of the company's directors, employees or service providers rather than for the benefit of the community.

6.1.7. A CIC providing a service at less than the market rate

There is no reason why a CIC should not be run to provide a service (to other CICs, charities etc), which is delivered at less than the going open market rate providing it covers its outgoings and does not infringe other legal considerations, such as, wrongful trading or unfair competition.

6.2. Dividends and the Dividend Cap Overview

The ability of a CIC to pay dividends to shareholders depends on the constitution of the specific CIC.

6.2.1. CIC CLG without a share capital

A CIC which is a company limited by guarantee without share capital has no shareholders and so cannot pay dividends (see chapter 3).

6.2.2. CIC CLS or CLG, with a share capital, adopting Schedule 2

A company limited by shares, or limited by guarantee, with a share capital, adopting the provisions in Schedule 2 in its articles of association may only pay dividends to specified asset-locked bodies, or other asset-locked bodies with the consent of the Regulator (see Chapters 3, 5 and www.cicregulator.gov.uk/memArt.shtml).

In these circumstances, the amount of dividend is not subject to the Dividend Cap, but is subject to the same constraints that apply to an ordinary company, for example, the rules as to distributable profits. This is a detailed subject beyond the scope of these notes upon which professional advice should be obtained.

6.2.3. CIC CLS or CLG, with a share capital, adopting Schedule 3

A company limited by shares (including a guarantee company) with articles of association adopting the provisions in Schedule 3 may pay dividends to shareholders who are not asset locked bodies, including private investors. However, the payment of a dividend to a private financial investor is subject to a dividend cap. The dividend cap does not apply to dividends paid to certain asset-locked bodies (see below).

Any dividend paid is subject to the Companies Act 2006, the company's articles of association and the Community Interest Company Regulations 2005 'the Regulations' (see Chapter 5 or www.cicregulator.gov.uk/memArt.shtml for the articles of association, or <http://www.opsi.gov.uk/si/si2005/20051788.htm> for the regulations)

6.2.4. Restrictions on the payment of dividends

If an asset-locked body holds shares, then there is no additional constraint on the payment of dividends, provided that:

- ❖ The Regulator has consented to the payment; or
- ❖ The asset-locked body concerned is named, as a possible recipient of the company's assets in its articles of association.

The dividend will be subject to the dividend cap if shares:

- ❖ Are not held by an asset-locked body, or
- ❖ Are held by an asset-locked body not specified in the articles of association, as

a possible recipient of the CIC's assets holds them, and the Regulator has not consented to the payment of the dividend.

Unlike most companies CICs may only declare a dividend by ordinary, or special resolution, of the members. This means that the directors cannot declare a dividend without consulting the members and gaining their support.

Annex G contains a flow chart of the steps typically taken for a CIC to pay a dividend.

6.3. The Dividend Cap

The Dividend Cap strikes a balance between encouraging people to invest in CICs and the principle that the assets and profits of a CIC should be devoted to the benefit of the community. This helps to ensure that the dividends are not disproportionate to the amount invested and the profits made by the company.

6.3.1. The three elements to the dividend cap

The Cap has three elements:

- ❖ The maximum dividend per share limits the amount of dividend that can be paid on any given share. The limit for shares in issue between 1 July 2005 and 5 April 2010 is 5% above the Bank of England base lending rate of the paid-up value of a share. The limit for shares issued on or after 6 April 2010 is 20% of the paid-up value of a share.
- ❖ The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- ❖ The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is 5 years.

6.3.2. Amount of first and subsequent caps

The Regulations set the first caps and these rates may be varied from time to time by the Regulator after consultation and with the approval of the Secretary of State.

Shares in issue between	Maximum Share Dividend Cap:
1 July 2005 to 5 April 2010 (set by the Regulations)	Five percentage points higher than the Bank of England's base lending rate of the paid up value of share
6 April 2010 and onwards (set by the Regulator)	Twenty percent of the paid-up value of a share in a relevant company
	Aggregate Dividend Cap
1 July 2005 and onwards	35% of distributable profits

The Bank of England's base lending rate (also referred to as the Repo Rate) is available from its [website](#), which also gives details of what the rate has been in the past.

It should be noted that these caps set maximums. They should not be taken as in any sense suggesting that those who invest in community interest companies are entitled to a particular rate of return on their investment. The caps should also not be seen as limiting companies' discretion as to whether or not to pay dividends at all, or whether to pay a dividend in any given year. Finally, there is no reason why a company should not restrict distributions to lower amounts than would be permitted under the caps in its articles, or share prospectus, or offer documents. If the company has, for example, issued fixed rate preference shares, the dividend on those shares will be subject to the caps but if the caps allow a higher rate this does not entitle the shareholders to receive that higher rate.

6.3.3. Maximum share dividend explained

The maximum dividend per share is fixed by reference to the "share dividend cap" in force at the time that the share was issued, or, if the share was already in existence on the date the company became a CIC, the cap applicable on that date.

The share dividend cap is expressed as a percentage of the paid up value of the share (the rate). The paid up value of the share is so much of the share's nominal value as has been paid up and any premium paid on that share to the company. Thus if the company issued £1 shares fully paid at a premium of £2.50 a share the paid up value of those shares would be £3.50. This should not be confused with market value; if, for instance, the same share were purchased from an existing shareholder for £5 the paid up value would still remain at £3.50

The rate for a particular share is fixed for the life of that share and will not change if the rate generally is changed. It can, however, fluctuate if the Bank of England base lending rate changes and it is referenced to that rate.

In respect of shares issued between 1 July 2005 and 5 April 2010 if, for example, the agreement is made when the Bank of England Base Rate at the time is 3%, the cap will be 8%. If the Bank of England Base Rate subsequently rises to 5%, the rate for that debt will rise to 10%.

Where the rate is subject to this kind of fluctuation, the rate applicable to any dividend payment is that in force on the first day of the financial year in which the dividend is declared. This may not be the same as the rate when the dividend is actually declared. For example, if the financial year begins on 1 April 2009 when the rate is 7%, but the dividend is paid in October 2009 when the rate is 7.25% because the Bank of England has put its Base Rate up by 0.25% in the meantime.

If more than one dividend is declared in a financial year the total of all such dividends must not exceed the maximum dividend per share. For example, if the share dividend cap is 7% on the first day of the financial year the maximum amount of dividend that may be declared over the course of that financial year on

a fully paid up £1 share is 7p. This may be paid either as a single dividend of 7p, or for example, an interim dividend of 3p and a subsequent final dividend of 4p.

6.3.4. Maximum aggregate dividend explained

This element of the Cap is calculated by reference to the aggregate dividend cap in force at the first day of the financial year for which the dividend is declared and is a proportion of the company's distributable profits for that year. Unlike the maximum dividend per share therefore, where the amount payable is fixed for the life of the particular share, the amount of the maximum aggregate dividend will vary from year to year in line with the distributable profits available.

For example if the cap is fixed at 25% and the distributable profits for the year are £2,000, the maximum aggregate dividend for all the company's shares would $£2,000 \times 25\% = £500$.

However, for any particular share the dividend must not exceed the maximum dividend per share. So, for example, if a company issued 5000 fully paid shares, each with a value of £1, but the maximum dividend per share is 9%, the company will not be able to pay a dividend per share of more than $£1 \times 9\% = 9p$ per share. If 5000 shares are issued $5000 \times 9\% = £450$ in total, £50 short of the maximum aggregate dividend.

6.3.5. Carrying forward unused dividend capacity explained

The unused dividend capacity is the amount that could have been paid on shares in a financial year but was not paid. For example if a company had £30,000 £1 shares fully paid and the dividend cap for the shares was 10% the maximum aggregate dividend would be 10p per share, i.e. a total of £3,000 (providing the maximum aggregate dividend was at least £3,000). If the company only declared a dividend of 6p a share the unused capacity would be 4p a share or £1,200.

This unused capacity can be carried forward to subsequent financial years so that in year 2 the company could declare a dividend of up to 14p per share providing the maximum aggregate dividend was at least £4,200. The carrying forward of unused dividend capacity therefore allows a company to pay a larger dividend per share than it otherwise would be able to pay, but does not allow it to pay a larger aggregate dividend than the maximum aggregate dividend for the relevant year.

The ability to carry forward unused dividend capacity is limited to four years i.e. if the unused capacity arising in year 1 is not used by year 5 it ceases to be available for distribution.

6.3.6. Further examples

Please see [Annex G](#) for further worked examples of all three elements. These calculations can involve complicated accountancy questions (particularly for example what constitutes distributable profits) and professional advice should be sought if you are in doubt about your intended dividend payments.

6.4. Performance related interest cap

Subject to its articles CICs have the same borrowing powers as any other company and generally will be able to borrow and pay normal commercial rates of interest to lenders. This Chapter is not concerned with normal lending of this type but with the somewhat rare circumstances where the interest payable on debts or debentures is linked to the performance of the CIC. Such debt is regarded as similar to equity shares (it is sometimes referred to as “debt with equity characteristics”) and the ability to pay uncapped interest on such debt would circumvent the Dividend Cap.

The Act and Regulations therefore provide that payment of such performance related interest should be subject to a cap. The cap is expressed in terms of a percentage rate on the average amount outstanding on any given loan, or debenture (debt). It will be the rate in force at the date the agreement for payment of the interest was made, or, for existing debt, the date the company became a CIC. The rate for a particular debt is fixed for the life of that debt and will not change if the rate generally is changed. If referenced to the Bank of England rate it can, however, fluctuate if the Bank of England rate changes (Bank of England base lending rate plus a fixed percentage).

6.4.1. Amount of first cap

The Regulations set the first caps and these rates may be varied from time to time by the Regulator after consultation and with the approval of the Secretary of State.

Agreements made between	Interest Cap:
1 July 2005 to 5 April 2010 (set by the Regulations)	Four percentage points higher than the Bank of England's base lending rate of the average amount of a community interest company's debt, or sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations 2005)

6 April 2010 and onwards (set by the Regulator)	10 percent of the average amount of a community interest company's debt, or sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations 2005)
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If, for example, the agreement was made sometime between the 1 July 2005 and 5 April 2010 and the Bank of England Base Rate on the first day of the financial year in which the interest is due is 3%, the cap will be 7%. If the relevant Bank of England Base Rate in a subsequent year rises to 5%, the rate for that debt will rise to 9%.

The rate applicable to any interest payment is that in force on the first day of the financial year in which the interest is due and the amount is calculated on the average amount of the debt, as defined in the Regulations, in the 12 months ending on the day before the payment is due.

If, for example, the company borrowed £100,000, the interest was agreed at 10% of the company turnover, the debt remained at £100,000 all year and the turnover was £130,000 the lender would be entitled under the agreement to £10,000 interest. If, however, the interest cap was 8% the interest payment would be restricted to £8,000.

It should be noted that if the contractual rate is lower than the interest cap rate this does not entitle the lender to receiver the higher cap rate.

6.5. Redemption and repurchase of shares and reduction of capital

A company with a share capital may, subject to its constitution and compliance with company law, redeem shares, purchase its own shares or reduce its share capital. **If your CIC is considering doing any of these things, you should seek professional advice.** This is a complex area of law for any company, and a general treatment of the requirements of the Companies Act 2006, in relation to these operations, is beyond the scope of this guidance. This chapter concentrates on the additional rules that apply to CICs in this area.

In many circumstances, redemption and repurchase of shares, or reduction of share capital, is in effect is a distribution of assets to members particularly where the member receives a premium over the paid up value of the shares. CICs are subject to additional rules in relation to such operations because if they were able, for example, to reduce their share capital without restriction, this could undermine the asset lock. Sections 30(1) & (2) of the Companies (Audit, Investigations and Community Enterprise) Act 2005 and regulations 24 and 25 of the Community Interest Company Regulations 2005, therefore contain a number of provisions to prevent this.

6.5.1. Redemption and purchase of shares

Regulation 24 prevents a community interest company from distributing its assets through the redemption or purchase of its own shares unless the payments are set at, or below, the paid up value of the shares. This supplements the asset lock provisions in the articles of association of a community interest company.

A company must have the necessary powers to issue redeemable shares, or to purchase its own shares, in its articles. Additionally, the articles of association must comply with the Companies Act 2006 and the Community Interest Company Regulations 2005 with regard to such distributions.

The amount paid must not exceed the paid up value of the shares, that is, the amount of the nominal value paid up together with any premium paid to the company. Please note that s. 686 and section 691 provides that redeemable shares must be fully paid on redemption.

The Companies Act 2006 contains detailed rules (which are different for public and private companies) as to the funds that may be used for the redemption.

When the shares have been redeemed they are cancelled and the issued share capital is reduced by their nominal value.

6.5.2. Reduction of capital

Regulation 25 prevents a company from distributing its assets by reducing its share capital, unless it does so:

- ❖ By reducing part of the value of shares that is not paid up, or
- ❖ By paying out more than the paid up value of the shares.

The company must have the necessary powers to reduce its capital in its articles. Additionally, the articles must comply with the Companies Act 2006 and the Community Interest Company Regulations 2005 with regard to such distributions.

6.5.2.1. Distribution of assets to members by way of reduction of capital

A CIC may not distribute assets to members by way of reduction of capital unless:

- ❖ The reduction is made by extinguishing or reducing the liability of any of the members on any of the company's shares in respect of share capital not paid up; or
- ❖ The amount to be paid by the company to members in paying off paid up share capital does not exceed the paid up value of their respective shares.