

# **The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007: a consultation**

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September 2008



HM TREASURY





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**The Building Societies  
(Funding) and Mutual Societies  
(Transfers) Act 2007:  
a consultation**

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## **HM Treasury contacts**

This document can be found in full on our website at:

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If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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# CONTENTS

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	<b>Page</b>
Executive Summary	<b>3</b>
Foreword	<b>5</b>
By The Economic Secretary to the Treasury	
Chapter 1	<b>7</b>
Introduction	
Chapter 2	<b>11</b>
Funding limits	
Chapter 3	<b>13</b>
Rights of building society members on insolvency	
Chapter 4	<b>17</b>
Transfer of engagements	
Annex A	<b>27</b>
Summary of questions	
Annex B	<b>29</b>
Transfer provisions	



# EXECUTIVE SUMMARY

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This consultation seeks stakeholders' views on the implementation of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 ("The Act").

This Act received Royal Assent on 23 October 2007. It gives the Treasury the powers to:

- Amend building society law to enable building societies to borrow a greater proportion (up to 75 per cent) of their funding from the wholesale markets (section 1);
- Amend building society law so that, in the event of a building society insolvency, members' shares would rank equally with liabilities to creditors (section 2); and
- Make it easier for a mutual society to transfer its business to the subsidiary of another mutual society (sections 3 and 4).

The Government supports the principle of extending the wholesale funding limit for building societies as a way of increasing flexibility. However, it is not aware that the current limit is causing a constraint to business and believes that certain safeguards need to be in place before considering implementation. It considers the change to building society members' priority in an insolvency (Section 2 of the Act) to be one essential safeguard.

The Government intends that the Treasury should use its powers under the Act to simplify transfers of the business of a mutual to a subsidiary of another mutual. In doing so, it intends to introduce safeguards to protect the position of members of the transferred mutual, and seeks views on the preferred way of doing this.

This consultation will be open from 1 September 2008 to 27 October 2008.

This document can also be accessed via the Treasury website at [www.hm-treasury.gov.uk/consultations](http://www.hm-treasury.gov.uk/consultations). Paper copies are also available from the HM Treasury Correspondence and Enquiry Unit by email to [ceu.enquiries@hm-treasury.gov.uk](mailto:ceu.enquiries@hm-treasury.gov.uk) or by telephone on +44 (0) 20 7270 4558.



# FOREWORD BY THE ECONOMIC SECRETARY TO THE TREASURY

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Building societies in the United Kingdom, together with other mutual societies, play a valuable role in the economy and wider society. Mutual societies in the UK have a combined membership of over 30 million and total assets in excess of £400 billion. Almost half the UK population belongs to a mutual.

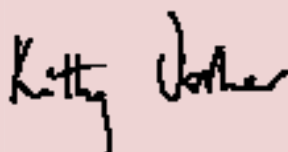
The Government wants the mutuals sector to be able to expand, unconstrained by the limitations of an out-of-date legal framework. It believes that mutuality should offer an alternative model to other legal forms such as proprietary companies, enhancing competition in the modern global economy.

In the current economic climate it is all the more important that mutuals can grow and thrive, to provide for greater diversity and choice and better serve their members in local communities. The Government has recently consulted on a Legislative Reform Order to update the legislative framework for credit unions and industrial & provident societies, and in the past year we have also implemented European legislation to strengthen and enhance the audit, accounting and corporate governance standards for building societies and friendly societies.

The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 allows the Treasury to make some important reforms for building societies. It also has implications for industrial & provident societies and friendly societies. The Act will, in time, enable building societies to have greater flexibility in their funding strategies, enhance their members' rights in the unlikely event of an insolvency and facilitate cross-fertilisation within the mutuals sector by making it easier for mutuals to transfer their business to a subsidiary of another mutual. Together the measures will enhance the sector's effectiveness and efficiency.

I am grateful to Sir John Butterfill MP, Vice Chairman of the All Party Parliamentary Group on Building Societies and Financial Mutuals for putting forward these proposals in a Private Members' Bill and for his collaborative engagement with the Treasury.

I hope that as many of you as possible will respond to this consultation to ensure that we have views from a very wide range of stakeholders.



Kitty Ussher

Economic Secretary to the Treasury



# INTRODUCTION

**1.1** The Building Societies (Funding) and Mutual Societies (Transfers) Act (the Act) is part of a wider package of measures aimed at enhancing the efficiency of the mutuals sector. The Act received Royal Assent on 23 October 2007. It allows the Treasury to:

- change building society law to enable building societies to borrow a greater proportion (up to 75%) of their funding from the wholesale markets;
- change building society law so that, in the event of a building society insolvency, members' shares would rank equally with liabilities to creditors;
- make it easier for a mutual society (building society, friendly society or industrial and provident society) to transfer its business to a subsidiary of another mutual society.

**1.2** This consultation is a fulfilment of the assurance provided to both Houses during the passage of the Building Societies (Funding) and Mutual Societies (Transfers) Bill that there would be a public consultation and further public debate before implementing the Act. It seeks views on the Government's proposals for implementing the Act, which will be implemented through a series of Orders, each of which will be subject to the affirmative resolution procedure.

**Mutuals in the UK** **1.3** Mutual societies are, broadly speaking, societies registered under the Building Societies, Friendly Societies and Industrial & Provident Societies Acts. They are:

- Owned/controlled by their members;
- Run democratically on the basis of one member one vote;
- Set up to meet the mutual needs of their members;
- Not set up to make profits for external shareholders or primarily provide a return on capital;
- Share any surplus or profits (the dividend) with their members.

**EEA Mutuals** **1.4** The original Bill was amended in Committee in the House of Lords to bring European Economic Area (EEA) mutuals within the scope of the Act. This ensures that it will be implemented in a way, which is consistent with EC law, and also brings some mutual insurers within scope. An EEA mutual for the purposes of this consultation is a European Cooperative Society, a cooperative society established in any EEA state, or any other type of body specified by the Treasury. This is discussed further in Chapter 4.

**EC Cross Border Mergers Directive** **1.5** A recent EC Directive on Cross Border Mergers (Directive 2005/56/EC) seeks to establish a legal framework to enable cross border mergers between companies within the EEA where no legal framework presently exists. Although the Directive applies only to limited companies, following consultation<sup>1</sup>, and developments in European case law, the Treasury considered what arrangements should be put in place to facilitate cross-border mergers involving UK mutuals. The Government's view is that implementing section 3 of the Act could make it easier for UK mutuals to engage in cross-border

<sup>1</sup> Consultation on EC Directive 2005/56 was from 5<sup>th</sup> March 2007 to 1<sup>st</sup> June 2007.

transfers involving mutuals in other Member States. The Government believes that it would be extremely difficult to legislate further in this area, given the different definitions and legislative regimes for mutuals across member states. The Government does not therefore intend to take any further action, beyond implementing section 3, to facilitate cross-border mergers involving UK mutuals.

**Devolution 1.6** Building society and friendly society law is reserved to Westminster under the devolution legislation of Scotland, Wales and Northern Ireland.

**1.7** Matters relating to IPSs are reserved to Westminster under the devolution arrangements for Scotland and Wales. IPSs in Northern Ireland are a devolved matter; the relevant enactment is the Industrial & Provident Societies Act (Northern Ireland) 1969. The Industrial and Provident Societies Act 1965 Act extends to the Channel Islands and the provisions of the Act can therefore be extended to the Channel Islands. The Government will consult the Islands authorities as to whether implementation of section 3 of the Act should extend to the Channel Islands.

**Policy responsibility 1.8** The Treasury is responsible for policy relating to the mutual sector in general, including building societies and friendly societies in the UK and industrial and provident societies in Great Britain.

## CONSULTATION

**1.9** This consultation document follows the format recommended by the Better Regulation Executive (BRE). The criteria are applicable to all UK public consultations under the BRE Code of Practice on Consultation.

### The Six Consultation Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for the written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for the responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out an Impact Assessment if appropriate.

**1.10** If you feel that this consultation does not fulfil these criteria please contact the Treasury's designated Consultation Co-ordinator:

Angela Carden  
 HM Treasury  
 1 Horse Guards Road  
 London, SW1A 2HQ

E-mail: [angela.carden@hm-treasury.gsi.gov.uk](mailto:angela.carden@hm-treasury.gsi.gov.uk)

**1.11** A partial Impact Assessment (IA) for the specific provisions of the Act is not included at this stage of the consultation. The Government welcomes assessments of costs and benefits for individual societies and the sector as a whole and will publish an Impact Assessment at a future date.

## **DISCLOSURE AND FREEDOM OF INFORMATION**

**1.12** It is possible that requests for information contained in consultation responses may be made in accordance with access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004). If you do not want your response to be disclosed in response to such requests for information, you should identify the information you wish to be withheld and explain why confidentiality is necessary. Your request will only be acceded to if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not of itself be regarded as binding on the Department.

## **RESPONDING TO THE CONSULTATION DOCUMENT**

**1.13** Comments on the proposals in this consultation document should be sent by 27 October 2008 to:

Sammy Amissah  
Savings and Investments Team  
HM Treasury, 1 Horse Guards Road  
London SW1A 2HQ

Tel: +44 (0) 20 7270 5291

Fax: +44 (0) 20 7270 4694

E-mail: sammy.amissah@hm-treasury.x.gsi.gov.uk

**1.14** An electronic version of this consultation document and the response form can be downloaded from the HM Treasury public website at:

<http://www.hm-treasury.gov.uk>

## **Next steps**

**1.15** The Government will publish draft implementing Orders, having considered the responses to this consultation. The Orders will be subject to debate in both Houses of Parliament under the affirmative resolution procedure.

**1.16** If any of the proposals change as a result of consultation, the Government will consult further, although this may be limited to an informal discussion of aspects of the revised proposals with key stakeholders before the Orders are laid before Parliament.



# 2

## FUNDING LIMITS

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**2.1** Under current legislation, building societies must raise at least 50 per cent of their funds from shares held by individual members of the society. Most building societies raise the remainder from the wholesale markets.

**2.2** Under section 1 of the Act the Treasury may raise the limit on non-member funding in section 7 of the Building Societies Act 1986 from its current 50 per cent to any percentage up to 75. The Treasury may raise the limit more than once, but cannot reduce it. Subject to the safeguards discussed below, any building society would be able to increase its wholesale funding up to the revised limit.

**2.3** There has been an upward trend in building societies' funding from the wholesale markets in recent years, as the table below shows, but the proportion remains well within 50 per cent. Furthermore, the Government is not aware of any building society, which currently would want to make use of a limit higher than 50 per cent.

Year	Percent
1999*	22.8
2000*	23.7
2001	20.9
2002	21.2
2003	27.4
2004	28.3
2005	27.0
2006	29.0
2007	31.2

\* 1999 and 2000 include Bradford & Bingley

**2.4** The Government supports the principle that building societies should have greater flexibility over their funding strategies. It believes this will enable the sector to compete on a more level playing field with banks, and is consistent with our overall aim of enabling mutuals to grow and flourish. Accordingly, the Government intends that the Treasury should, at some point, use its power under section 1.

**2.5** However, the Government also believes that the Treasury should be satisfied that there are adequate safeguards in place before this section of the Act is implemented.

**2.6** One important safeguard is the implementation of section 2 of the Act (dealt with in the following chapter), which will rank liabilities to shareholding members and liabilities to creditors equally in the event of a building society insolvency. At present members rank behind creditors. If there were more wholesale creditors, as is the probable impact of implementing section 1, then it is less likely that the funds available

in an insolvency would be able to satisfy all creditors, so members would be in a worse position than they are at present.

**Prudential regulation** **2.7** An increase in the funding limit has the potential to alter significantly the business model used by a society. While flexibility is the intention, it carries risks. A further safeguard will therefore be the FSA's regulation of building societies wanting to take advantage of the higher funding limit, including, for example, imposing stricter liquidity and disclosure requirements.

**2.8** The Government will keep the timing of implementation under review, consulting with the FSA and the industry. It will consult on the issues of what figure the limit should be raised to, and whether societies should be required to seek approval of their members before applying the revised limit, once it judges an increase in limit is both needed by the industry and prudent.

**Funding limit**

I. Are there safeguards in addition to those identified above, which should be in place before Section I is implemented?

# 3

## RIGHTS OF BUILDING SOCIETY MEMBERS ON INSOLVENCY

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**3.1** Building society insolvency is extremely rare. The last collapse the Government is aware of was the Liberator Permanent Benefit in 1892, caused by the financial activities of its founder. It is generally accepted that *in extremis* a failing building society will be taken over by another society.

**3.2** Section 2 of the Act gives the Treasury the power to alter the ranking of shareholders and creditors, which currently apply in the event of a building society insolvency. A proposal to implement this provision of the Act was included in the Government's consultation "Financial stability and depositor protection: strengthening the framework<sup>2</sup>". Respondents were unanimous that the Government should do so.

**3.3** Investors in a building society can generally be divided into two main categories: depositors and shareholding members (or shareholders). Depositors are not members of the society and therefore do not have a say in the running of the society. Shareholding members on the other hand have the right to receive certain information such as the summary financial statements, to be notified of the annual general meeting and any special general meeting, and to vote on resolutions at meetings. Their investment takes the form of shares issued by the society. With some limited exceptions, such as current account customers, most individual investors in building societies are shareholding members.

**3.4** Depositors enjoy a greater level of security than shareholders as, in the unlikely event of an insolvency they, along with other creditors, will receive some or all of their money back before any distribution to shareholders.

**3.5** The current position also puts shareholders at a disadvantage when compared with bank depositors in the event of insolvency, as the latter already rank alongside creditors.

### CHANGING THE PRIORITY ON WINDING UP

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**3.6** Section 2 of the Act inserts a new section 90B into the Building Societies Act 1986. This gives the Treasury the power to amend the 1986 Act for the purpose of ensuring that, on the winding up or dissolution by consent of a building society, any assets available for satisfying the society's liabilities to creditors or to shareholders are applied equally. The power may be used in relation to voluntary winding up, compulsory winding up or dissolution by consent.

### Voluntary & compulsory winding up

**3.7** The legislation on voluntary and compulsory winding up which applies to companies also applies to building societies in this situation, with certain modifications<sup>3</sup>. A voluntary winding up is instigated by a special resolution of the society, passed by three quarters of those voting. The society must notify the FSA that it has voted to wind up.

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<sup>2</sup> From 30 January to 23 April 2008

<sup>3</sup> S.90 and Schedule 15, Building Societies Act 1986

**3.8** In a compulsory winding up the court can wind up a building society on various grounds<sup>4</sup> on presentation of a petition by one of the persons listed in s.89(2) of the Building Societies Act 1986 (BSA 1986). This list includes the FSA.

**3.9** Under present building societies law, the distribution of assets in a winding up is in the following order:

1. Payment of the costs of winding up, including the liquidator's remuneration;
2. Payment of preferential debts (which include employees' remuneration, contributions to occupational pension schemes, and various other liabilities);
3. Payment of other debts and liabilities to creditors;
4. In accordance with the rules of the society.

**3.10** Assets which are secured by a fixed charge (for example a mortgage on a property owned by the building society) fall outside the winding up.

**3.11** The Government intends that the Treasury should use its power under the Act to change this order so that the third item becomes "payment of other debts and liabilities to creditors **and shareholders**".

### **Distribution of any surplus**

**3.12** Currently building societies are required to make provision in their rules about how, on a winding up, any assets should be distributed among members once creditors have been repaid in full. A consequence of changing the order of asset distribution to shareholders is that their shares will rank equally with liabilities to creditors, so liabilities in respect of shares (and interest on shares) will no longer be within the scope of societies' rules on distribution of surplus.

**3.13** The Act does not confer any power for the Treasury to determine what should happen to any surplus in a winding up, so this must remain the prerogative of societies. However, the Government considers that there will need to be a consequential amendment to Schedule 2, paragraph 3(4) of the 1986 Act, which at present requires societies' rules to cover the entitlement of members to participate in the distribution of any surplus assets after payments to creditors (not including shareholders) on the winding up of the society. The Treasury proposes to allow a transitional period in which building societies may make any necessary amendments to their rules.

### **Dissolution by consent**

**3.14** Dissolution by consent is a way of closing a building society, and distributing its assets, without going through the full winding up procedure. A society may be dissolved by instrument of dissolution to which three-quarters of the members, holding not less than two thirds of the shares in the society, consent by signing the instrument.

**3.15** A significant difference between a dissolution and a voluntary winding up is that **statute does not prescribe the order of payment for a distribution of assets in a dissolution by consent, as it does for a winding up**. It is up to the members of the society how the assets should be distributed in these circumstances.

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<sup>4</sup> Set out in sections 37(1) and 89(1) of the BSA 1986

**3.16** The Treasury's power in section 2 may be used in relation to dissolutions by consent. However, the Government does not consider it necessary to do so. Rather, it believes that there is sufficient safeguard for members in the dissolution process itself, which requires both a large majority of members to agree, and active participation in the decision through signature of the dissolution instrument.

### Transitional Provisions

**3.17** The Act also gives the Treasury a power to make transitional provisions. These could be used to preserve the priority of wholesale creditors in respect of liabilities entered into before the implementing Order comes into force. The rationale for this is that some creditors will have entered into arrangements with the society on the understanding that, in the event of an insolvency, they would enjoy priority over shareholders, and will have priced loans or other instruments accordingly.

**3.18** The Government proposes that wholesale creditors should continue to enjoy priority over shareholders in respect of loans or other time-limited instruments entered into before the changes come into force, until the term expires.

**3.19** Deposits not held in the form of shares, and other liabilities, take a number of forms, including, for example:

- individuals' current accounts;
- client or trustee deposit accounts;
- transferable instruments;
- debt securities.

The Government is interested in views as to which (if any) other creditors should continue to enjoy priority over shareholders for the duration of any contract in place. As a general principle, the Government believes that instruments should only be included where the position of the lender in the event of insolvency is likely to have been a material factor in the decision to lend, or to have affected the price of the product.

#### Rights of building society members on insolvency

2. Is a transitional period needed to allow building societies to change their rules in respect of distribution of surplus? If so, how long should it be?
3. Do you agree that the 'dissolution by consent' process gives sufficient protection to members, and that the Treasury should not use the power granted by section 2 in relation to dissolutions by consent?
4. Do you agree that all wholesale loans and other time-limited instruments entered into before the commencement of the Order should continue to have priority over all shares for the duration of the contract? Should any instruments be excluded? Are there other instruments for which the lender should be put in the same position?



# 4

## TRANSFER OF ENGAGEMENTS

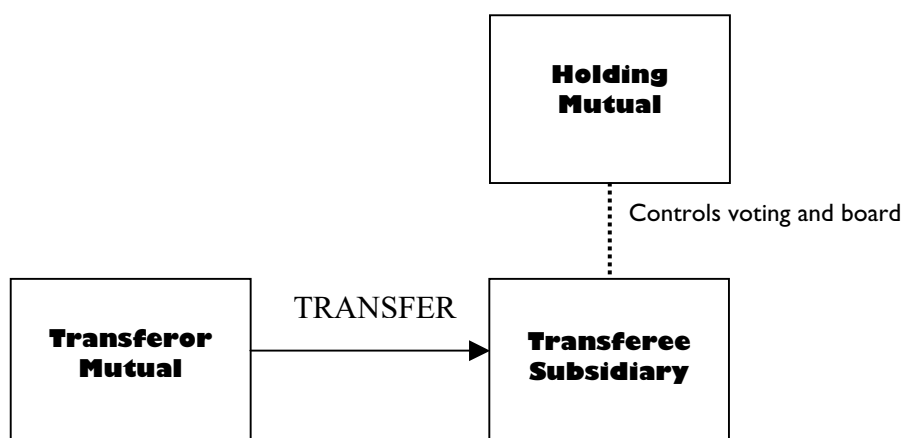
**4.1** This chapter sets out the Government's proposals for implementing sections 3 and 4 of the Act. The policy intention is to make it easier for a UK mutual society (building society, friendly society or industrial & provident society) to transfer its business to a subsidiary of another UK mutual society or of an EEA mutual society, while maintaining safeguards in relation to members' rights and the principles of mutuality. This will enable flexible group structures to develop in the mutuals sector, and will more easily allow a mutual to take over the business of a different type of mutual.

**4.2** Under current law, it is straightforward for a mutual to transfer its engagements to another mutual of the same kind. There are also provisions governing transfer of engagements (or business) of a mutual to a company, as follows:

- Sections 97 to 102D of the Buildings Societies Act 1986, paragraph 30 of Schedule 2 to that Act and Schedule 17 to that Act;
- Sections 86 and 88 of and Schedule 15 to the Friendly Societies Act 1992;
- Section 52 of the Industrial and Provident Societies Act 1965.

**4.3** Summaries of a number of the provisions contained in the above primary legislation are set out in Annex B.

**4.4** What is not generally possible within existing legislation is to transfer the engagements of one type of mutual to a different type<sup>5</sup>. This option was examined during the passage of the Building Societies (Funding) and Mutual Societies (Transfers) Bill, but the nature of existing legislation made it impossible. So what the Act does is to give the Treasury a power to modify the legislation governing transfer of engagements to a subsidiary company, provided the company is controlled by another UK mutual or a mutual society in the European Economic Area (EEA), that is, the holding mutual controls a majority of the voting rights in the company and has the right to appoint a majority of the company's board of directors.



<sup>5</sup> There is one exception: a transfer from a friendly society to an industrial and provident society (Friendly Societies Act 1992 s.86 (1)(b)).

**4.5** It is the Government's intention that the Treasury should use this power: further detail on proposed implementation is set out below.

## Scope

**4.6** The transferring mutual can be a building society, friendly society or industrial and provident society. The holding mutual can be any of these, or it can be an EEA mutual. This gives rise to two issues, on which the Government would welcome views.

**4.7** For friendly societies, the provisions for transferring engagements to a company are already the same as those concerning transfers to any other body. So either:

(a) the implementing order would not make any changes to the transfer provisions for friendly societies where the transfer is to a subsidiary of another mutual, or

(b) the order would make similar changes for friendly societies to those proposed where the transferring mutual is a building society or an industrial and provident society (see sections below on safeguarding members' rights and restrictions on further transfers).

**4.8** Arguably, implementing the Act for transfers from friendly societies would impose additional burdens without making the transfer any easier than it is at present. However, there could be reasons for giving members of the transferring friendly society the same rights as if the transferring mutual were a building society or industrial and provident society.

**4.9** There is also the question of whether the implementing provisions in the Act should apply where the transferring mutual and the holding mutual are of the same type – for example, where a building society transfers to a company, which is a subsidiary of another building society. This would afford additional flexibility in corporate structures, but transfers of business from one mutual to another of the same type are already straightforward under existing law. The transition of the business of the transferring mutual to a company could be regarded as an 'unnecessary' demutualisation, with the protection of members' rights being much more complicated than under a straight transfer.

## Safeguarding members' rights

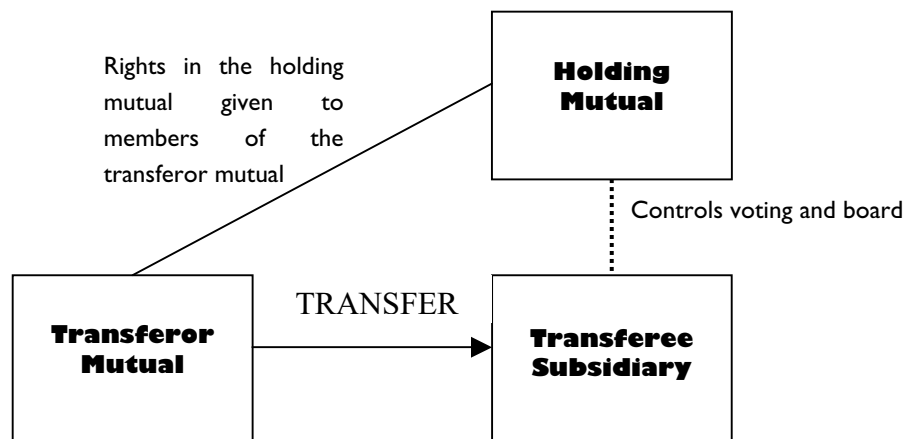
**4.10** An Order under section 3 may confer rights in the holding mutual on members of the transferring mutual, or on persons who subsequently become customers of the subsidiary company<sup>6</sup>. This section discusses the following two options.

### Option 1 – granting rights in the holding mutual

**4.11** The Government supports the principle that giving members of the transferring mutual automatic rights in the holding mutual would be an effective means of preserving the spirit of mutuality in the newly formed corporate structure. Such rights might include automatic membership of the holding mutual, voting rights, and equal rights with existing members of the holding company to a share of the benefits of a future demutualisation.

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<sup>6</sup> See section 3(2)



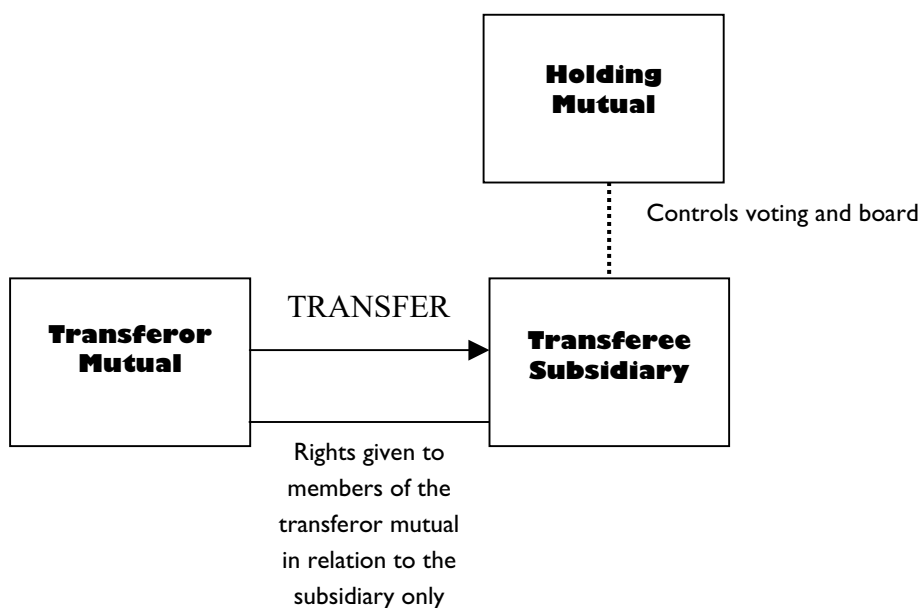
**4.12** However, the Government considers that there are practical and legal difficulties with this approach, which could only be overcome by creating a separate class of non-customer membership in the holding mutual.

**4.13** In any mutual, membership is based on a contract between the mutual and the member – for a building society that is an individual taking out a mortgage or making a deposit; for a friendly society it is paying a subscription or receiving a service from the society.

**4.14** As an illustration of the difficulties, where the holding mutual is a friendly society, non-customer membership may contravene section 5(2) of the Friendly Societies Act 1992, which stipulates that the activities of the society are to be carried on for the benefit of its members. In addition, friendly societies' rules may prevent persons who do not receive services from the society, or pay a subscription, from becoming members and enjoying voting and other rights.

**4.15** There is also a question of fairness as between members of the holding mutual and transferring mutual. For example, members of the transferring mutual could receive a bonus as a result of the transfer in addition to their new rights as members of the holding mutual. If the holding mutual were later to demutualise then the members of the transferring mutual could also benefit from this.

## Option 2 – granting rights in the subsidiary company



**4.16** As an alternative, members of the transferring mutual could be given rights in the subsidiary company. The Government considers that stringent conditions would be needed to protect the interests of members of the transferring mutual, including:

- The subsidiary must be created as a specially formed company.
- The voting rights given to members of the transferring mutual should enable them together to veto matters, which would normally require approval by a special resolution of the company.
- Members of the transferring mutual should have other rights including the right to participate in any proceeds from a future sale of the subsidiary's business; and to appoint a minority of the board of directors.

**4.17** This option leaves two main issues to be addressed:

1. Whether the subsidiary should be a company limited by shares or a company limited by guarantee.
2. Whether new customers of the subsidiary should also become members of the subsidiary.

**4.18** If the subsidiary is a public company limited by shares, the shares not owned by the holding mutual could be offered to members of the original mutual on preferential terms before they are offered to the public. If new customers wanted shares in the subsidiary they would have to buy them on the market.

**4.19** If the subsidiary is a company limited by guarantee, all customers of the subsidiary could automatically become members of it – whether members of the original mutual or new customers of the subsidiary after the transfer.

**4.20** In summary, the Government believes that there are distinct advantages to protecting members' rights through the subsidiary route. This avoids the practical problems associated with assigning rights in the holding mutual. With the conditions outlined above, former members of the transferring mutual would still have a stake in

the business, be able to veto significant decisions and benefit from any future sale of the business.

**4.21** It would also mean that only members of the holding mutual would benefit from a demutualisation of the holding mutual and only members of the subsidiary (including the holding mutual as a shareholder) would benefit from a sale or transfer of the subsidiary.

**4.22** The Government considers that a company limited by guarantee is the better way of maintaining the spirit of mutuality, and that new customers should become members as of right.

### Restrictions on further transfers of the subsidiary

**4.23** The intention of the Act was that, post-transfer, the subsidiary company should remain in the ownership of the holding mutual for a certain period.

**4.24** The Government proposes to achieve this by modifying the “requisite protective provisions”<sup>7</sup> in the BSA 1986. These provide that, where a building society transfers to a specially formed company, the company’s articles must ensure that for a period of 5 years, there can be no transfer of shares which would have the effect of one person, or a group of persons in agreement, holding more than 15 per cent of the shares in the company. The 5-year rule ceases to apply if the company takes over the business of, or is taken over by, another person authorised under the Financial Services and Markets Act 2000, or if 75 per cent of the members of the company vote to disapply it, or if the FSA directs.

**4.25** For industrial and provident societies and for friendly societies, similar provisions would apply to ensure that, in a transfer under the Act, the subsidiary would remain in the ownership of the holding mutual for at least 5 years.

## THE TRANSFER PROCESS

**4.26** There are a number of issues to be resolved in relation to the transfer process, for example, authorisation, information to be provided to members of the transferring mutual, and any distribution of funds (or bonus) to members of the transferring mutual.

**Transfer Resolutions** **4.27** The purpose of the Act is to make transfers of engagements easier. The law currently makes different provisions on transfer resolutions, depending on whether the transfer is to a company or another mutual. A summary of the current provisions is set out at Annex B. With the exception of friendly societies, under the law as it stands it is easier to transfer from one mutual society to another mutual of the same type, than from a mutual society to a company.

**4.28** The Government proposes that the resolutions to approve transfers from one mutual to the subsidiary of another mutual would be the same as for transfers between mutuals of the same type. So where the transfer is from a building society to the subsidiary of another mutual society, the transfer will have to be approved as if it were a transfer from one building society to another.

**4.29** The principle behind this is that it should be easier to transfer engagements to a company, which is a subsidiary of another mutual, as the transferred business will

<sup>7</sup> BSA section.97 (4)(a) and section 101

remain within a mutual group. The safeguards described above – on members’ rights and restricting further transfers – will ensure this.

**4.30** Where the transferring mutual is a building society, this would mean that the transfer would have to be approved by a shareholding members’ resolution (more than 75 per cent of shareholding members of the society) and a borrowing members’ resolution (more than 50 per cent of borrowing members). But unlike a transfer to a commercial company, which is not owned by another mutual, there would be no requirement for a minimum turnout on the shareholding members’ resolution. This would make it easier for the society to obtain the necessary transfer resolutions.

### Transfer Information

**4.31** The current law governing transfers of mutuals also specifies what information must be provided to members. Again, there are different provisions for the information required for transfer to a company and to an equivalent mutual. A summary of the current provisions concerning the information and statements required for transfers of engagements by building societies and friendly societies is set out at Annex B. At present there are no requirements for industrial and provident societies to provide such information.

**4.32** As with resolutions, the Government proposes that, in a transfer to a subsidiary of another mutual, transfer information is standardised to the minimum, that is, the information which would be required for a transfer to a mutual of the same type.

### Distribution of funds

**4.33** Section 4 of the Act deals with distribution of funds, that is, payment of bonuses to members of the societies participating in the transfer, whether to members of the transferring or holding mutual or both. The provisions on distributions of funds contained in the Act are modelled on the relevant provisions of the BS Act 1986, and the Government proposes to implement section 4 on this basis for building societies. There remains the question of the limit above which a resolution of members of both transferring and holding mutual is required, which needs to be specified in the Order. The Government proposes this limit should be the same as the equivalent limit for transfers between building societies.<sup>8</sup>

**4.34** Industrial & provident societies and friendly societies legislation does not make any provision about distribution of funds. The Government does not propose to add complexity by introducing provisions about distributions of funds in relation to industrial and provident societies and friendly societies. The correct comparison is with transfers between mutuals of the same type, so where an industrial and provident society transfers its business to the subsidiary of another mutual, the procedure should be as close as possible to the procedure for a transfer of one industrial and provident society to another. It would be inappropriate to make all transfer procedures similar to the building societies procedure, which is more complex due to the nature and business of building societies and the number of high profile demutualisations of building societies in recent years.

## EUROPEAN ECONOMIC AREA MUTUAL SOCIETIES

### European Mutuals

**4.35** EEA mutual societies also fall within the scope of the Act<sup>9</sup>. The holding mutual can be an EEA mutual or a building society, friendly society or industrial and provident society. The transferring mutual can only be a building society, friendly society or

<sup>8</sup>The limit is set out in the Building Societies (Mergers) Regulations 1987, S.I. 1987/2005.

<sup>9</sup> Section. 3(10)

industrial and provident society, as the Act only gives the Treasury the power to modify the legislation relating to these societies.

**4.36** An EEA mutual society is defined<sup>10</sup> in the Act as:

- (a) a body which is a European Cooperative Society for the purposes of Council Regulation (EC) No 1435/2003 (Statute for a European Cooperative Society);
- (b) a body which is established as a cooperative under the law of an EEA state as mentioned in that Regulation;
- (c) a body which is a cooperative or mutual undertaking of such description as the Treasury specify by order and which is established or operates in accordance with the laws of an EEA state or any of the Channel Islands or the Isle of Man.

**4.37** The first and the second category of EEA mutual are fixed in the Act. However, section 3(12)(c) gives the Treasury the power to extend the scope of the definition of EEA mutual. There are three options:

### Option 1

**4.38** Do nothing. By not legislating, the definition of EEA mutual for the purposes of the Act would be confined to (a) and (b) above. The advantage of this would be that there would be no risk of entities that are not genuine mutuals acquiring UK mutuals under the simplified transfer process.

### Option 2

**4.39** Legislate by specifying particular types of body, for example, “building societies established in the Republic of Ireland”.

**4.40** The advantage of this option is that it would give clarity that particular types of body could be holding mutuals.

**4.41** The disadvantage is that it would not be possible to specify all types of mutual bodies in all EEA states, so some mutuals would be excluded.

**4.42** Later Orders under section 3(12) could add further types of mutual bodies if necessary.

### Option 3

**4.43** Legislate by setting out criteria, which a body must satisfy, to qualify as a “co-operative or mutual undertaking”.

**4.44** The advantage is that this could possibly capture all types of EEA mutual without needing to list them.

**4.45** The disadvantage is that it would be very difficult to specify criteria, which were not too wide (risking admitting bodies which were not genuine mutuals) or too narrow (and excluding genuine mutuals). Given the practical difficulties and risks, the

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<sup>10</sup> Section. 3(12)

Government is minded not to legislate at this stage and to retain the current scope of the definition of EEA mutual as set out in the Act.

### **Cross-Border Mergers Directive**

**4.46** The EC Cross-Border Mergers Directive (2005/56/EC) seeks to establish a legal framework enabling cross-border mergers between companies within the European Economic Area (EEA) where no legal framework presently exists.

**4.47** Cross-border mergers involving UK mutuals are treated differently from domestic mergers. If a particular form of a mutual (for example a building society) wanted to merge with another building society in the UK a simplified procedure applies, whereas if they wanted to merge with a building society in the EEA they would have to first demutualise. Direct cross-border mergers between UK mutuals and mutuals in other EEA States would be more complex and difficult to achieve than mergers between companies because unlike companies there are no clear like-for-like mutual forms in the EEA States.

**4.48** Some EEA mutuals may be able to benefit from the Act. It would, for example, be possible for a UK building society or industrial and provident society to transfer to the subsidiary of an EEA mutual under the simplified transfer process outlined above, provided the safeguards are satisfied.

**4.49** At this stage the Government is not planning any additional step toward application of the principles of the Cross-Border Mergers Directive to mutuals, given the insuperable difficulties of legislating for direct cross border mergers between different forms of mutuals in different Member States.

### Transfer of engagements

#### Scope

5. Are there reasons for implementing the Act in relation to transfers from friendly societies?
6. Should the Act be implemented in relation to transfers where the transferring mutual and the holding mutual are of the same type?

#### Members' rights

7. What are your views on option 1 (granting rights in the holding mutual)? How could the difficulties described be overcome?
8. What are your views on option 2 (granting rights in the subsidiary company)? Would this model work and would a holding mutual view this as sufficiently attractive to wish to take a transfer? Would it give sufficient protection to members' rights?
9. Would a company limited by guarantee or a company limited by shares be more appropriate for option 2?
10. Should new customers of the subsidiary be entitled to membership of the holding mutual (in option 1) or the subsidiary (in option 2)?
11. Do you agree that it is appropriate to prevent further transfers of the subsidiary for a 5-year period? If not, please give reasons.

#### Transfer process

12. Do you agree that the transfer resolutions for a transfer under the Act should, for each type of transferring mutual, be the same as the resolutions for transfers between mutuals of that type?
13. Do you agree that transfer information for transfers under the Act should be the minimum? What if any additional information should be provided?
14. Do you agree that section 4 (distribution of funds) should be implemented as described for building societies, and not implemented for friendly societies or industrial and provident societies?
15. Do you agree that the Treasury should not legislate to extend the scope of EEA mutuals? If not, please say why, what you would like to see as the scope, and how the problems of definition could be overcome.



## SUMMARY OF QUESTIONS

### **Funding limit**

1. Are there safeguards in addition to those identified above, which should be in place before Section 1 is implemented?

### **Rights of building society members on insolvency**

2. Is a transitional period needed to allow building societies to change their rules in respect of distribution of surplus? If so, how long should it be?
3. Do you agree that the 'dissolution by consent' process gives sufficient protection to members, and that the Treasury should not use the power granted by section 2 in relation to dissolutions by consent?
4. Do you agree that all wholesale loans and other time-limited instruments entered into before the commencement of the Order should continue to have priority over all shares for the duration of the contract? Should any instruments be excluded? Are there other instruments for which the lender should be put in the same position?

### **Transfer of engagements**

#### Scope

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6. Should the Act be implemented in relation to transfers where the transferring mutual and the holding mutual are of the same type?

#### Members' rights

7. What are your views on option 1 (granting rights in the holding mutual)? How could the difficulties described be overcome?
8. What are your views on option 2 (granting rights in the subsidiary company)? Would this model work and would a holding mutual view this as sufficiently attractive to wish to take a transfer? Would it give sufficient protection to members' rights?
9. Would a company limited by guarantee or a company limited by shares be more appropriate for option 2?
10. Should new customers of the subsidiary be entitled to membership of the holding mutual (in option 1) or the subsidiary (in option 2)?
11. Do you agree that it is appropriate to prevent further transfers of the subsidiary for a 5-year period? If not, please give reasons.

Transfer process

12. Do you agree that the transfer resolutions for a transfer under the Act should, for each type of transferring mutual, be the same as the resolutions for transfers between mutuals of that type?
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15. Do you agree that the Treasury should not legislate to extend the scope of EEA mutuals? If not, please say why, what you would like to see as the scope, and how the problems of definition could be overcome.

# B

## TRANSFER PROVISIONS

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### BUILDING SOCIETIES

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**Requisite transfer resolutions** **B.1** The current situation for building societies is that where a transfer to a company is taking place the building society must approve the transfer and its terms in the following manner (known as the requisite transfer resolutions)<sup>11</sup>:

- A **borrowing members' resolution** – this must be passed by a majority of more than 50 per cent of the borrowing members voting.
- A **requisite shareholders' resolution**, which must be passed:
  - As a shareholding members' resolution (75 per cent majority of those voting); and
  - At least 50 per cent of those qualified to vote on such a resolution must have voted (or members holding 90 per cent of the value, where the transfer is to an existing company).

**B.2** If the transfer is simply from one building society to another it is dealt with slightly differently<sup>12</sup>. It still requires a borrowing members' resolution and a shareholding members' resolution; however, there is no requirement for a 50 per cent voter turnout or a 90 per cent by value turnout. If only some of the society's engagements are to be transferred, the transfer must also be approved by a resolution of those members affected.

**Transfer Information** **B.3** In the case of a merger between two building societies, the societies must each send a statement to their members setting out a limited number of matters<sup>13</sup>. In the case of a transfer from a building society to a commercial company, the building society must send members either a transfer statement or a transfer summary. The matters, which must be included in, transfer statements and summaries are set out in Regulations<sup>14</sup>; these list matters which are always required as well as additional matters when dealing with:

- A transfer to an existing company
- A transfer to a specially formed company
- A case where shares or related rights are to be offered in connection with a transfer.

**B.4** The principle behind this is that members need appropriate information so that their vote in any transfer is suitably informed.

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<sup>11</sup> Building Societies Act 1986, s.97 (4)(c)

<sup>12</sup> See Building Societies Act 1986 s.94.

<sup>13</sup> The financial position of the societies concerned; the interest of the directors of the society in the merger; any compensation or other payment to be made to the directors or officers of the societies concerned; any payments to be made to members of the societies concerned; any changes to be made to terms governing mortgages in connection with the merger; and any other matters which the FSA requires in the particular case

<sup>14</sup> Building Societies (Transfer of Business) Regulations 1998 (S.I. 1998/212)

**Distribution of funds** **B.5** In a transfer from one building society to another, the terms of the transfer may include provision for part of the funds of one or more of the participating societies to be distributed in consideration of the transfer among any of the members of the participating societies.<sup>15</sup>

**B.6** If the distribution does not exceed limits prescribed by the Treasury, it must be approved by each of the transfer resolutions of the society making the distribution.

**B.7** If the distribution exceeds the prescribed limits, it must be approved by each of the transfer resolutions of all societies involved in the transfer.

**B.8** The limits are set out in the Building Societies (Mergers) Regulations 1987<sup>16</sup>.

**B.9** In a transfer of business to a commercial company, only the following distributions are permitted:

- a distribution of funds to shareholding members who were not able to vote on the transfer;
- where the transfer is to an existing company, a distribution of funds to members who held shares for at least two years before the transfer.

**B.10** Where the transfer is to a specially formed company, shareholding members of the society of at least two years' standing may be offered a right to subscribe to shares in priority to other subscribers, but no distribution of funds may be made.

**B.11** Any distribution must be approved by the transfer resolutions (see above).

## **INDUSTRIAL & PROVIDENT SOCIETIES**

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**B.12** There are a number of differences between the procedure for converting into, amalgamating with or transferring engagements to a company under s.52 of the Industrial and Provident Societies Act 1965 and amalgamating with or transferring engagements to another society under s.50 or s.51.

**B.13** At present the requirements for a transfer to another I&P society are less onerous than for a transfer to a company.

**B.14** A resolution to transfer to a company must be approved by at least three quarters of those voting (Industrial & Provident Societies Act 1965 s.52(3)(b)) with at least half the members entitled to do vote doing so (s.50(3)(c)). In contrast, the resolution for transfer to another I&P society must be approved by at least two thirds (s.50(2)(a)). There is no voter turnout requirement.

**B.15** The legislation in relation to I&P societies is in any event less prescriptive than for building societies.

- There is no requirement for I&P societies to prepare transfer statements or summaries.
- The 1965 Act is silent on the issue of bonuses payable to members on a transfer.

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<sup>15</sup> Building Societies Act 1986 s.96(4).

<sup>16</sup> S.I. 1987/2005.

## FRIENDLY SOCIETIES

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**Transfer resolutions** **B.16** To transfer its engagements to a company, another friendly society or any other body, a friendly society must resolve to transfer the engagements by special resolution (section 86(2)(b) Friendly Societies Act 1992). A special resolution requires a majority of three quarters of the members voting. If only some of the society's engagements are to be transferred, the transfer must also be approved by a resolution of those members affected.

**Transfer information** **B.17** A friendly society which desires to transfer its engagements to any other persons must send a statement concerning specified matters to every member entitled to vote on the transfer resolution (see Friendly Societies Act 1992, Schedule 15).

**B.18** The statement must cover various matters including:

- the financial position of the society and every other society or person participating in the transfer;
- any interest of the members of the committee of management of the society in the transfer;
- any compensation to be paid to officers of every society or other person participating in the transfer;
- any other matter required by the Financial Services Authority.

**Distribution of funds** **B.19** The 1992 Act is silent on the issue of distributions of funds on transfers, so there are no statutory limits.









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