
Financial Services Authority

# The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 Statutory Instrument 2011 No. 2687

## Explanatory document for credit unions

March 2012

# Contents



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# Overview

This document explains the effect on credit unions of the changes to legislation introduced by The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 (Statutory Instrument 2011 No. 2687). It follows the structure of the Order, and gives references to the amended legislation. It sets out the law as it stands after amendment, without discussing the previous position. It does not explain credit union law generally, nor the law applying to other types of industrial and provident society.

Many of the powers in the Order may only be exercised by a credit union if its registered rules specifically provide for it to do so. A credit union will therefore need to check its registered rules to see whether it needs to register an amendment with the FSA before exercising a power.

The material in this document does not constitute guidance under sections 157 and 158 of the Financial Services and Markets Act 2000, nor does it have the status of guidance in the FSA Handbook. This also means that GEN 2.2 (Interpreting the Handbook) does not apply.

If you have any doubts about the legal position, refer to the relevant legislation (see www.legislation.gov.uk), and seek appropriate legal advice.

# 1 Introductory

Articles 1 to 2 of the Order deal with technical issues like the start date of the Order. The changes came into force on 8 January 2012.

From 8 January onwards, credit unions are able to take advantage of the new legislative provisions. However, it may be necessary to make amendments to the credit union's rules. Any amendments must be submitted to and registered by the FSA. The credit union cannot take advantage of any new rules until they have been acknowledged as registered by the FSA.

# 2 Industrial and provident societies

Articles 3 to 6 of the Order do not amend the law relating to credit unions.

# 3 Industrial and provident societies and credit unions

Articles 7 to 10 of the Order amend the law relating to credit unions as well as industrial and provident societies.

## Provision of copies of rules

*See article 7 of the Order and section 15 Industrial and Provident Societies Act 1965.*

A credit union must give a copy of its registered rules to anyone who asks for it. It may charge a fee of up to £5 for a copy. But any member who has not been given a copy of those rules before must be given a copy free of charge.

## Members under 18

*See article 8 of the Order, section 20 Industrial and Provident Societies Act 1965 and section 9 Credit Unions Act 1979.*

With effect from seven days after a credit union's first annual general meeting on or after 8 January 2012, a person under the age of 16 may become a member of a credit union (that is to say, a shareholder in the credit union), **unless its registered rules provide to the contrary**. (The idea is to give credit unions a chance to pass an amendment of rules at an annual general meeting before the change in the law takes effect, though that amendment will not be valid until registered by the FSA.)

If the registered rules do provide to the contrary, that contrary provision will continue to apply until the credit union's members pass an amendment of rules and register it with the FSA.

If a credit union's registered rules do not specify a minimum age, or they refer to the age specified by law, then an individual will be eligible for membership, however young. This means that a credit union is not allowed to treat deposits as 'juvenile deposits' (deposits by persons too young to be members) unless it has specified a minimum age for membership.

The absence of a registered rule does not confer discretion on a credit union's board to determine that a person is ineligible for membership on the basis of age. So the board cannot set a policy that only persons over the age of 12 (for example) should be admitted to membership. That is a matter for the credit union's registered rules.

Every member of a credit union must have one vote. Credit unions will need to take this into account when deciding whether to introduce a minimum age for membership. If the credit union's registered rules allow persons to be members at an age at which they cannot vote independently, those rules will need to provide how their votes should be cast, and how the other rights of membership should be exercised.

Subject to the credit union's registered rules, a member between the ages of 16 and 18 may execute all instruments and give all receipts on behalf of the credit union under its rules.

A person under the age of 16 may not be a member of the credit union's committee (board) or be a trustee, manager or treasurer of the credit union. A credit union's registered rules may specify a higher age (but not a lower one) for holding these offices.

For corporate members, the specified minimum age for membership **will apply** to an individual in his/her capacity as a partner in a partnership and an officer or member of the governing body of an unincorporated association, unless explicit provision to the contrary is made in the registered rules.

A body corporate may be a member of a credit union in its own right, but it will need an individual to exercise the rights of membership on its behalf. That individual does not have to be a member of the credit union, unless the credit union's registered rules require this. If the registered rules do not require the individual to be a member, the specified minimum age for membership will not apply to that individual.

The age of the body corporate, partnership or unincorporated association itself is irrelevant.

(See section on corporate members in Part 4.)

## Juvenile deposits

The credit union may accept deposits (juvenile deposits) from persons who are, according to the membership rules, too young to be members – so long as they would otherwise be eligible for membership. The credit union may pay interest (but not a dividend) on these deposits.

The credit union may not issue shares to such persons, and they have no right to vote.

If a credit union wishes to provide Child Trust Fund (CTF) accounts, or successor accounts prohibiting withdrawal until individuals reach a specified age, it will need to register a rule preventing such individuals from becoming members until they reach that age.

Where a credit union has specified a minimum age for members, persons below that age may have deposit accounts that may be made non-withdrawable.

This is in contrast to members who hold shares that must be withdrawable.

## Dissolution

*See article 9 and section 55 Industrial and Provident Societies Act 1965.*

Credit unions may be dissolved by an instrument of dissolution, registered by the FSA.

The instrument must be:

- signed by three-quarters of the credit union's membership; or
- approved by a special resolution of the credit union and confirmed by the FSA.

The special resolution procedure requires two general meetings of credit union members, just like a resolution for amalgamation, or transfer of engagements. The resolution must be passed by two-thirds of the members voting at a first meeting (in person, or by proxy where the rules allow this). A second meeting must be held not less than 14 days and not more than one month later. At the second meeting, a simple majority of those voting is required to confirm the resolution.

A copy of the resolution must be:

- signed by the chairman of the meeting at which the resolution is confirmed;
- countersigned by the secretary of the credit union; and
- sent to the FSA within 14 days.

The resolution needs confirming by the FSA. If a resolution is sent to the FSA, it is deemed to have been confirmed unless the FSA notifies the credit union to the contrary in writing within 21 days.

The FSA must register the resolution at the same time as the instrument of dissolution.

## Publication of interim accounts

*See article 10 and section 3A Friendly and Industrial and Provident Societies Act 1968*

The credit union may publish interim revenue accounts and balance sheets that have not been audited, provided they are:

- published together with the latest audited revenue account and balance sheet; and
- they are marked in clearly legible characters and in a prominent position with the words 'unaudited revenue account' or, as the case may be, 'unaudited balance sheet'.

# 4 Credit unions

Articles 12 to 21 of the Order amend the law relating to credit unions.

## Common bonds

*See articles 12 to 14 and sections 1, 1A and 1B Credit Unions Act 1979.*

A credit union's registered rules must restrict membership to persons who fall within one or more of the following common bonds:

- following a particular occupation;
- being employed by a particular employer;
- residing or being employed in a particular locality;
- being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union; and
- any other bond for the time being approved by the FSA.

### Membership qualification for individuals

A credit union must base the membership qualification in its registered rules on the common bonds listed above. It cannot invent a common bond that is not on the list, and base its membership qualification on that.

The membership qualification in the rules must be specific: the particular occupation, employer or locality must be identified. So, for example, a particular occupation might be identified as 'carpenter', a particular employer as 'ABC Ltd' and a particular locality as the 'London Borough of Tower Hamlets'.

The qualification may be based on than one common bond on the list. So, for example, it could allow all the following people to join:

- a 'carpenter';
- an 'employee of ABC Ltd'; or

- a ‘resident of the London Borough of Tower Hamlets’ (subject to the ‘further requirements where the common bond relates to locality’ – below).

The qualification might allow the credit union to admit people:

- following different occupations: for example, a ‘carpenter’ or a ‘bricklayer’;
- employed by different employers: for example, an ‘employee of ABC Ltd’ or an ‘employee of XYZ Ltd’; and
- residing in different localities: for example, a ‘resident of the London Borough of Tower Hamlets’ or a ‘resident of the London Borough of Hackney’ (subject to the ‘further requirements where the common bond relates to locality’).

When a credit union uses one of the listed common bonds, it may choose to add a further qualification to it, in the sense of narrowing its scope, rather than widening it. So, a credit union could adopt a common bond of following a particular occupation, like being a ‘carpenter’, and add a further restriction to it, like having to be ‘a resident of London’. To join the credit union a person would have to satisfy both requirements, not one or the other. He or she would have to be both a carpenter **and** a resident of London. A carpenter resident in London could join, but not one living elsewhere in the country. London residents in general would not be able to join – only London residents who were carpenters. Additional qualifications like this can only be used to narrow the scope of the listed common bonds – not to widen them by adding an alternative qualification that is not among the listed common bonds.

It should be relatively clear from the membership qualification criteria in a credit union’s registered rules whether or not a person qualifies for membership, without the need for difficult judgements, or the exercise of broad discretion.

The legislation does not define the terms used in the listed common bonds, but the following information may help credit unions in framing their rules on membership qualifications.

## Following a particular occupation

A credit union’s membership qualification will need to identify the particular occupation involved.

The most reliable interpretation of ‘particular occupation’ is that it equates to an occupation at the ‘unit group’ level of the **Office of National Statistics’ Standard Occupational Classification**.

Best practice would be to use the terminology of the ‘unit group’ level in identifying particular occupations. However, where a credit union intends to cover all the occupations within a wider group, like the ‘minor group’, it may be more practical for the credit union’s membership rule to refer to the name of that group, rather than listing all the individual occupations within that group.

So, for example, the rule might restrict membership to persons following occupations in the ‘construction and building trades’ (‘minor group’ 531), rather

than listing all the occupations making up that group – steel erectors, bricklayers, masons, roofers, etc ('unit groups' 5311 to 5319).

## Being employed by a particular employer

A credit union's membership qualification will need to identify the 'particular employer' involved. Where a credit union intends to cover more than one particular employer, best practice would be to list each one. However, where a credit union intends to cover all the employers in a named group, it may be more practical for the credit union's membership rule to refer to the name of that group, rather than listing all the individual employers within that group.

While it is ultimately for the committee of management of a credit union to determine the meaning of being employed, we take the view that employment will generally indicate a situation where an employer has the right to instruct an individual about what to do.

Employment need not be full-time, nor even part-time in any formal sense, as in some circumstances it may include regular but casual employment. Payment does not need to be a requisite element. So unpaid volunteer workers could, in relevant circumstances, become members of a credit union with an employment common bond.

## Residing or being employed in a particular locality

A credit union's membership qualification will need to identify the 'particular locality' (or 'particular localities') involved. This is generally done by incorporating a map in the registered rules.

Our working definition is that a 'locality' extends up to a natural geographical or administrative area, comparable in size (but not limited to) the principal tier of local government in Great Britain, that is unitary authorities or county councils. The justification for this is that the common provision of 'local' public services is currently made at this level. 'Locality' may therefore extend to the area covered by such local authorities, and so may cover such areas as single cities, London boroughs or counties. Our presumption is that a larger area would not fall within the definition of 'locality', but a smaller one, like the area of a particular village or parish, would do so.

A credit union's membership qualification may cover more than one 'locality', but any use of a 'locality' common bond brings into play the further requirements relating to 'locality'.

Credit unions choosing this common bond generally adopt a membership qualification allowing both residents and employees in the locality to join, but they are not bound to do so. Instead, their membership qualification could provide that only residents of the locality may join, or that only employees in the locality may join.

### Being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union

Where this common bond type is used, the credit union's membership qualification should identify the 'bona fide organisation' (or 'bona fide organisations') or spell out precisely the way (or ways) in which persons eligible for membership of the credit union are associated.

An organisation is not bona fide if it exists only to provide a basis for the credit union's membership qualification, for example 'a club', open to all and sundry, that has no real independent existence.

It must be clear how the people 'otherwise associated' are distinguished from ordinary members of the public. They must be associated by something other than the desire to be members of a credit union. Examples are regular attendance at a place of worship, or receiving a pension from the same employer. People associating in this way form a pre-existing 'society' that is capable of being registered as a credit union.

### Any other bond for the time being approved by the FSA

The additional common bonds already approved by the FSA are rendered inadequate by the Order, because they do not provide for the way in which the qualification for corporates must relate to the qualification for individuals. A credit union with a membership rule based on one of these bonds is not obliged to amend it, unless it intends to change who is eligible (allowing corporates to join, for example). If it makes a change, it should use the listed common bonds for its new membership qualification, rather than the bond approved before.

The need to approve additional common bond types is likely to be limited in future, given the scope of 'otherwise associated' and the ability to combine common bond types. Any additional common bond type approved by the FSA would have to be of general application, and not just for the purpose of a single credit union's membership rule.

### Family members

If the credit union's registered rules provide for this explicitly, a 'relative' who lives in the same 'household' as a member will be eligible for membership in his or her own right.

This includes the 'relatives' of persons who are members through being:

- a partner acting for a partnership; or
- an officer or member of the governing body acting for an unincorporated association.

Only individuals are eligible as family members, not corporates (see below).

The term 'relative' is defined in the legislation to mean:

- a spouse or civil partner (including a former and reputed spouse or civil partner);
- any lineal ancestor, lineal descendant, brother, sister, aunt, uncle, nephew, niece or first cousin of his, or of his spouse or civil partner; and
- the spouse or civil partner of any of the relatives above.

Illegitimate children and step-children are treated as legitimate for the purpose of establishing these relationships.

The term 'relative' also includes people who live together and call themselves 'partners' or 'spouses'.

To be eligible for membership, a relative must live in the same 'household' as the member. It is not sufficient merely to live under the same roof. There needs to be an element of shared living.

If a credit union's rules do not provide explicitly for 'family' members, they cannot be admitted.

## Membership qualification for corporates

A credit union may only admit corporate members if the membership qualification in its registered rules provides specifically for this.

The legislation envisages three types of corporate member:

- a body corporate;
- a partner acting for a partnership; and
- an officer or member of the governing body acting for an unincorporated association.

A body corporate is capable of being a member of a credit union in its own right if it satisfies the credit union's membership criteria for corporates. Shares and loans will be held in the name of the body corporate, rather than in the name of an individual. Nevertheless, the body corporate will need an individual to act on its behalf in exercising the rights of membership. Under the law, that individual does not have to be a member of the credit union. If the credit union wants to impose a requirement that only an individual who is a member may act as a representative of a body corporate, it should provide for this in its registered rules. A credit union will have to make sure that the individual is properly authorised by the body corporate to act. A credit union's registered rules and policies may need to take account of this. Where there is a change of individual acting for a body corporate, there is no change of membership, and no change of shareholder or borrower. Share and loan accounts will continue to be held in the name of the body corporate. This is different from the position for the other types of corporate member.

An individual representative of a body corporate may also be elected to office. Where an elected individual is the representative of a body corporate, the credit union rules should provide for how such officers should be replaced.

Some partnerships may be bodies corporate (like 'Limited Liability Partnerships' or 'LLPs') and therefore eligible for membership in their own name. If not, they will need a partner to act for them. Unincorporated associations will need an officer or member of the governing body to act for them.

Only a partner can act for a partnership in this way, and only an officer or member of the governing body can act for an unincorporated association. The 'governing body' of an unincorporated association will generally be its Board (of Directors) or (Main) Committee.

The registered rules and policies of a credit union that intends to admit corporate members will need to take account of the position of partners and officers or members of the governing body.

A credit union will also have to check that the partner, officer or member of the governing body has the necessary relationship and appropriate authorisation, to act in that capacity on behalf of the organisation.

The eligibility of the corporate for membership of the credit union is determined entirely by whether the partnership or unincorporated association meets the membership qualification for corporates in the credit union's registered rules – not by whether the partner or officer or member of the governing body meets the qualification for individuals. But the partner, officer or member of the governing body needs to be old enough to be a member under the credit union's rules.

So, to use the example of an application for membership by a partner acting for a partnership where the common bond is based on residence in a particular locality:

- the application may be accepted if the partnership itself satisfies the credit union's membership qualification for corporates – even if the partner is a non-resident; and
- conversely, the application must be rejected if the partnership does not itself satisfy the credit union's membership qualification – even if the partner is a resident.

An individual acting for a corporate may separately become a member of a credit union in a personal capacity, provided that he or she satisfies the credit union's membership qualification. So a partner who is a resident may join the credit union in his or her own right, as well as acting for the partnership.

The fact that a corporate is a member of a credit union does not confer eligibility on those who work for (or have any other relationship with) that body. Those people must satisfy the credit union's membership qualification in their own right. For example, where the corporate member is an employer, its employees may only join if the credit union's membership rule includes the specific qualification of being employed by that employer, unless they are eligible in their own right, as residents perhaps. The same applies to the employees of partnerships and unincorporated associations.

Where a corporate member is a partner (acting for a partnership) or an officer or member of the governing body (acting for an unincorporated association) a change in the partner, officer or member of the governing body means a change of membership in the credit union. One membership ceases and a new one begins. That is because a partnership or unincorporated association cannot be a member of a credit union in its own right.

Deferred shares are transferable (though not withdrawable) so they may be transferred from one member to another – for example, from one officer of an unincorporated association to another.

Other shares (non-deferred shares) are not transferable, so they may not be transferred from one member to another. But they are withdrawable, so they may be withdrawn by the existing member and the proceeds reinvested by a new member. So, for example, the officer who currently holds the shares on behalf of the unincorporated association will need to withdraw them and a second officer will need to invest the proceeds on behalf of the unincorporated association.

An outstanding loan will need to be repaid and a new one granted (though not necessarily on the same terms). For example, the officer of the unincorporated association who received the original loan will need to repay it and a new loan will need to be granted to a second officer of the unincorporated association.

This is different from the position for bodies corporate. A credit union's registered rules, policies and procedures will need to reflect this difference.

The liability of members of unincorporated associations and partners and the risks of lending to clubs and partnerships are discussed in Annex 2 of the **Second Report of the House of Commons Select Committee** on the Order (HC 506, 29 March 2010).

The membership qualification in the credit union's rules must set out the eligibility criteria for corporate members, making it as clear as possible which bodies are eligible for membership (just as in the case of individual members).

These criteria must:

- relate to the body (the corporate body, partnership or unincorporated association) – and not to the individual partner or officer or member of the governing body acting for the partnership or unincorporated association; and
- conform to the requirements of the legislation for each common bond type (see below).

Corporates are only eligible for membership under the common bond types available for individuals, which means that a credit union may not adopt a particular common bond type for corporates unless it is adopting that same type for individuals. So, a credit union may not admit corporates under a common bond of 'residing or being employed in a particular locality' unless it is intending to admit individual residents or employees under that bond.

### Following a particular occupation

To be eligible, the corporate must:

- employ or otherwise engage persons who follow that occupation; or
- relate to that occupation in some other way.

### Being employed by a particular employer

To be eligible, the corporate must:

- itself be the employer;
- provide services to that employer; or
- or be otherwise related to that employer.

### Residing or being employed in a particular locality

To be eligible, the corporate must:

- have a place of business in the locality; or
- have some other significant connection with that locality.

### Being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union

To be eligible, the corporate must:

- belong to the bona fide organisation; or
- be associated in the same way as the individuals.

(The bona fide organisation itself may be regarded as eligible for membership of the credit union under the 'otherwise associated' element of the common bond.)

### Any other bond for the time being approved by the FSA

- To be eligible, the corporate must:
- relate to the members of the credit union in the way specified in the FSA's approval of that common bond type.

It must be possible to use the wording of the credit union's membership qualification to judge whether or not a corporate member is eligible for membership. So, for example, in the case of a common bond based on occupation, it is not enough for the membership qualification to state that corporate members must relate to the occupation 'in some other way'. Instead, the membership qualification must state what that other relationship is.

## Credit unions as corporate members

It is possible for a credit union to frame its membership qualification in a way that permits other credit unions to join.

## Statutory declaration

We may accept a statutory declaration (to be signed by three members and the secretary of the society) as sufficient evidence that the common bond requirements have been met, though we are not bound to do so. We will generally accept a statutory declaration if the wording of the credit union's membership rule directly follows the wording of a common bond (or bonds) in the Credit Unions Act 1979. We will not generally check a membership rule before the submission of a formal application. It is the responsibility of the credit union to devise a compliant rule and decide whether to support it by a statutory declaration.

## Further requirements where common bond relates to locality

Further requirements apply where a credit union's membership qualification is based on a common bond 'involving a connection with a locality'. This is the case with the bond of 'residing or being employed in a particular locality' (and one of the 'other bonds for the time being approved by the FSA').

Unless there are 'extraordinary circumstances', **both** of the following conditions apply:

- the number of potential members must not exceed two million; and
- it must be reasonably practicable for every potential member:
  - to participate in votes;
  - serve on the credit union's committee; and
  - have access to all the credit union's services.

  (This means that a credit union cannot adopt a membership qualification covering more people than it intends, or is able, to service.)

The Treasury may make an order extending the further requirements to other common bond types. It could do that if the number of potential members under the other types ever approaches 2 million.

## Number of potential members

The number of potential members means the number of persons (individuals and corporates) who *could* join the credit union. It does not mean the number of persons who *actually* join, or the number of persons who are *likely* to join.

The number of potential members is the sum of persons in the following categories (A+B+C+D):

A. individuals who qualify (are eligible) for membership under the qualification in the credit union's registered rules (whether or not they actually join);

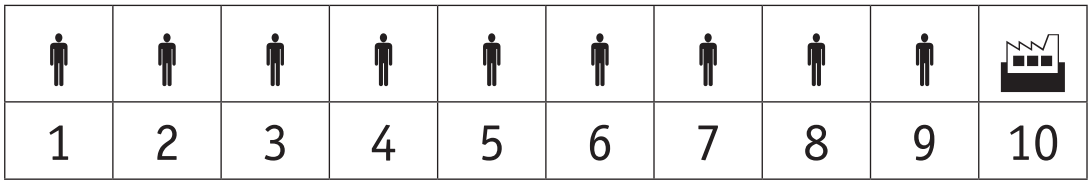
B. individuals who are non-qualifying members (those who retain membership, but no longer qualify under the rules);

C. corporates that qualify (are eligible) for membership under the qualification in the credit union's registered rules (whether or not they actually join) – *subject to cap*; and

D. corporates that are non-qualifying members (those who retain membership, but no longer qualify under the rules).

There is a cap on the number of corporates in category C. The law limits the actual number of corporate members in a credit union, so some corporates in category C may qualify for membership, but be unable to join in practice. They are not potential members.

The law says that the number of corporates in a credit union must not be more than 10% – one-tenth – of the total membership. This may be illustrated in the following way:




= Individual member = Corporate member

If each of the symbols represents one member, then the total number of members is ten. One of these members (one-tenth of the total) could be a corporate, but the other 9 members (nine-tenths of the total) would have to be individuals. If each of the symbols represents 10 members, then the total number of members is 100. Ten of these members could be corporates, but the other 90 would have to be individuals.

The illustration shows how the limit on the number of corporates relates to the number of individuals (as well as to the total number of members). The number of corporates cannot be more than one-ninth of the number of individuals. If there are 9 individuals, there can be 1 corporate. If there are 90 individuals, there can be 10 corporates.

It is more straightforward to calculate the cap directly from the number of individuals. These are the steps:

- **Step one:** add A and B (giving the number of individuals who could join).
- **Step two:** divide by 9 (giving the maximum number of corporates who could join).
- **Step three:** subtract D (giving the number of places still available for corporates – since some corporates may already be members under category D).

This calculation may be expressed in the formula: Cap C = [(A+B)/9]-D.

When calculating the potential membership (A+B+C+D) use the category C cap in the following circumstances:

- the number of qualifying corporates is greater than the cap; or
- the number of qualifying corporates is unknown.

When the number of qualifying corporates is less than the cap, use that number (not the cap).

The following persons do not need to be added separately:

- the (actual) number of qualifying members (members who remain eligible under the credit union's membership qualification); and
- the (estimated) number of persons who may become non-qualifying members in the future.

Even in a common bond based purely on residence in a particular locality, the number of persons eligible does not necessarily equate to the number of persons resident, because some residents may be too young to be members. If the common bond is based on residence or employment, then non-resident employees will also need to be included.

## Combining locality with other common bonds

If any one of the common bonds adopted by a credit union involves a connection with a locality the further conditions apply to the business of the credit union as a whole. This means that 2 million is the overall limit on the potential membership of the credit union, and the credit union must be able to service all those persons (not just those who are eligible under the locality common bond).

## Statutory declaration

We may accept a statutory declaration (to be signed by three members and the secretary of the society) as sufficient evidence that the conditions relating to locality are met, although we are not bound to do so. If the credit union does not make a statutory declaration, it will either need to provide other evidence that it meets the conditions, or make a case that there are extraordinary circumstances justifying registration, despite the fact that the conditions are not met.

## Extraordinary circumstances

The legislation does not define 'extraordinary circumstances'. Clearly, they will have to be very unusual, perhaps to allow an emergency transfer of engagements, but we cannot reasonably anticipate or prescribe what these might be. The concept suggests that we exercise discretion, which cannot be fettered by setting out a fixed view in advance.

### Existing membership qualifications

The further requirements apply to existing credit unions, as well as to new ones. Existing credit unions will need to establish whether the membership qualification in their registered rules is based on a common bond involving a connection with a locality. If it is, they will need to consider whether **both** conditions are satisfied. If either of the conditions is not satisfied, they will need to consider whether there are extraordinary circumstances to justify this. If they conclude that such circumstances exist, they should explain them to the FSA. In the absence of such circumstances, they will need to apply to the FSA to register a revised membership qualification that satisfies both conditions.

Registering an amendment to the membership qualification may mean some of the existing members of the credit union become non-qualifying. However, they will be able to retain membership and exercise full membership rights, provided that the proportion of non-qualifying members does not exceed any limit specified in the credit union's registered rules.

Any new members admitted by the credit union will have to fulfil the revised qualification. Where a residential qualification is reduced in size, new members may not be admitted from the discarded area (whether or not they are relatives of, and live in the same household as, an existing member).

A credit union will need to analyse the effect on its business of any amendment to the membership qualification in its rules. The quality of that analysis has no bearing in law on the registrability of the amendment, but it may have a bearing on the continuing authorisation of the credit union. We may review the analysis and, if we find that analysis defective, or consider that registration may have adverse consequences for the credit union, we may ask the credit union whether it wants to proceed with registration.

The wording of the amended membership rule registered by the FSA must be same as that passed by the members in general meeting. We will **not** register the following:

- a rule, passed by the members, saying that the credit union's board may decide the common bond; and
- common bond wording drafted by the board, but not passed by the members – even if the members have passed a resolution giving permission for the board to draft the wording.

## Corporate members

*See article 15, sections 5, 5A, and 11 Credit Unions Act 1979*

There are three types of corporate member. The first type is the body corporate. Such a body may only be admitted to membership if the credit union's registered rules provide for this. The membership qualification in those rules will need to set out the eligibility criteria for bodies corporate and the other two types of corporate member

(a partner acting for a partnership, and an officer or member of the governing body acting for an unincorporated association).

Even so, the legislation limits the extent to which corporate members may participate in the business of the credit union. A credit union should not admit corporate members if it does not have the systems and controls to enable it to comply with these limits.

A credit union may wish to establish internal limits that are lower than the statutory limits, for example, to avoid having to repay existing deposits, or to terminate the membership of existing corporate members, when there is a fall in the number of individual members, or their shareholdings.

## Number

The number of corporate members must not exceed 10% of the total number of members.

(The number of corporate members will also count towards the total number of members.)

A credit union's registered rules must provide for terminating the membership of corporate members where that is necessary to comply with the limit. Such termination might become necessary if there were a fall in the number of members, and the percentage of corporate members increased as a result.

Holding a share of any kind confers membership. So a corporate that holds deferred shares with the sole intention of contributing to a credit union's regulatory capital is nonetheless a member with a right to vote, and must be included in the above calculation.

This provision limits the voting strength of corporate members, on the basis that each member is allowed only one vote (whatever the size and nature of a member's shareholding).

## Shareholding

There is no limit on the number of deferred shares that may be allotted, but the number of non-deferred shares allotted to corporate members must not exceed 25% of the total of non-deferred shares allotted to all members.

(The number of non-deferred shares allotted to corporate members will also count towards the total of non-deferred shares allotted to all members).

The shareholding limit is based on the number of shares allotted, not the amount paid on shares. Shares in a credit union are of £1 denomination, and cannot be allotted until paid for in full. So, the number of shares allotted to a member will be the round number of pounds paid in by the member (and will not include the extra pence paid towards the next share). The difference between the number of shares allotted and the amount paid for shares is only likely to be significant to the outcome of the calculation when a credit union is around the limit.

The total of non-deferred shares allotted to all members is set by the most recent year-end balance sheet submitted to the FSA. So, for example, if that balance sheet indicated 100,000 such shares had been allotted to **all** members (including corporate members), then the limit on the number of such shares that could be allotted to corporate members would remain at 25,000 until the next balance sheet was submitted. If that balance sheet showed a rise in the total of non-deferred shares, then more shares could then be allotted to corporates. If there were a fall, then some corporate shares would need to be repaid. (A credit union's registered rules must make provision for doing this.)

The total **number** of non-deferred shares allotted to all members is unlikely to appear as an explicit figure in a credit union's balance sheet, but will need to be derived from/reconciled with the total **amount paid** towards such shares – which will be shown on that balance sheet.

This provision limits the financial stake of corporate members, except for deferred shares, which contribute to capital (because they are non-withdrawable, and are repayable only in limited circumstances).

## Loans

A credit union may only make a loan to a corporate member if its registered rules provide explicitly for this. It is not sufficient for the rules merely to provide for them to be admitted to membership and hold shares.

A credit union cannot make a loan to a corporate member that holds only deferred shares. (See the section on 'deferred shares').

The credit union cannot make a loan to a corporate member if that would cause the aggregate of the outstanding balances on such loans to exceed 10% of the aggregate of the outstanding balances on all loans to members.

The calculation is concerned solely with loans to members, so loans to non-members are not included. If a credit union admits another credit union as a corporate member under its common bond, and makes a loan to it, that loan will count towards both parts of the calculation (the aggregate of loans to corporate members and the aggregate of loans to all members).

It is the amount outstanding on each loan that needs to be included in the calculation: so, the total amount still remaining to be repaid by the member, rather than the amount of the loan originally granted. In working out the outstanding balance, any repayments of the capital from the original loan will have to be deducted. Where interest charges have been added but have not been paid, they will have to be included in the outstanding balance. Shareholdings are irrelevant to this calculation. It is concerned with the outstanding balance on the loan, not the member's net liability, or the credit union's exposure to the member. The member's shareholding does not reduce the outstanding balance of the loan, even if those shares are held as security, or they are 'attached' or if they may be subject to the exercise of a lien by the credit union.

Granting a loan might constitute a breach of the requirement, but, for example, a credit union would not be in breach of the requirement merely because a non-corporate member paid off a large loan, causing the percentage of corporate loans to rise above 10%. But it would be in breach if it then made a loan to a corporate member.

This provision limits a credit union's exposure on loans to corporate members, as compared with the lending to all members.

### Registered rules

A credit union's registered rules will need to provide for terminating the membership of corporate members and repaying their shares where necessary to comply with the limits.

## Non-qualifying members

*See article 16 and section 5 Credit Unions Act 1979.*

A non-qualifying member is a person who was eligible for membership when he or she joined the credit union, but subsequently ceased to qualify.

For example, where a credit union's membership qualification is based on residing in a particular locality, an individual would cease to qualify when ceasing to reside there, and a corporate when ceasing to have a place of business there (or some other significant connection).

Where the corporate member is a partner acting for a partnership, then the corporate member would also cease to qualify if the partner ceased to be a partner in the partnership. Similarly, where the corporate member is an officer or member of the governing body acting for an unincorporated association, the corporate member would cease to qualify if the officer or member ceased to hold office in the unincorporated association.

A credit union's registered rules may:

- restrict the entitlement of non-qualifying members to purchase shares and receive loans; and/or
- place a limit on the number of non-qualifying members.

In the absence of such provisions:

- non-qualifying members retain the full rights of membership; and
- there is no limit on the number of non-qualifying members (theoretically meaning that all members could eventually be non-qualifying).

## Deferred shares

*See article 17 and sections 7 and 31A Credit Unions Act 1979.*

Credit unions have the power to issue deferred shares satisfying all the requirements set out below. They do not have power to issue deferred shares that do not meet all these requirements.

Deferred shareholders have very limited access to their funds, and rank behind all creditors (including other shareholders, and subordinated lenders). Deferred shareholdings therefore contribute to the reserves of the credit union.

### Eligibility

A credit union may only issue deferred shares to members, whether individuals or corporates.

### Voting

Deferred shares carry the right to vote, but there is only one vote per member in a credit union. A member may hold other types of share, but does not acquire an additional vote by so doing.

### Dividend and interest

Like other shares in a credit union, deferred shares must be either dividend-bearing or interest-bearing. Where deferred shares are dividend-bearing, the dividend rate must be the same as the dividend rate on other types of share, unless the credit union is entitled under FSA rules to pay different dividends on different types of share. Where deferred shares are interest-bearing, the interest rate may differ from the interest rate on other types of share. A credit union may only issue interest-bearing shares if it meets the necessary criteria.

### Loans

A member of a credit union who holds deferred shares may not borrow on the strength of that shareholding. If a deferred shareholder also holds another type of share, he or she may borrow on the strength of the non-deferred shares. The deferred shareholding does not count towards making a loan a secured loan, and cannot be used to guarantee the repayment of another member's loan.

### Equivalent transfer to reserves

If a member subscribes for deferred shares in full, the credit union must transfer an equivalent amount to its reserves.

Because a credit union's shares are of £1 denomination, the obligation to transfer to reserves applies only to whole pounds. So, for example, if a member has subscribed £17.50 to deferred shares, the credit union should have transferred £17 to its reserves. If the member pays in a further £0.75, taking his or her deferred shareholding to

£18.25, the credit union will need to transfer a further £1 to reserves, bringing the total amount transferred up to £18.

## Withdrawal and repayment

Deferred shares are not withdrawable (unlike the other shares in a credit union).

They are repayable only in the limited circumstances set out in the issue documents.

They are not repayable on the death of an individual or the winding-up of a corporate (but may be transferred for value to another person eligible for membership).

## Transfer of shares

Deferred shares are transferable.

A credit union may issue a certificate of ownership of deferred shares, containing the two prominent statements that must appear in the issue documents.

The holder of the deferred shares may transfer the shares to another person, provided that the person is already a member of the credit union (or is accepted as a new member).

The payment for those shares need not be the nominal value of those shares. Any payment is retained by the person making the transfer, and the new shareholder has a claim against the credit union for the nominal value of the shares as set out in the issue document.

## Issue documents

The rights and obligations of the credit union and member who holds deferred shares must be set out in an issue document or documents.

Every applicant for deferred shares must be given all of the issue documents.

## Prominent statements

One of the issue documents must contain a prominent statement that the shares are deferred shares for the purposes of the Credit Unions Act 1979.

Every issue document must contain a prominent statement whether or not the shares are covered by the Financial Services Compensation Scheme

Under current FSA rules, deferred shares are not covered by the Financial Services Compensation Scheme.

The purpose is to make clear to members who hold these shares that they will not receive compensation for them if the credit union fails.

## Required term

One of the issue documents must contain a term prohibiting repayment, except in Case A or B.

**Case A. Creditors have been paid.**

This applies where the credit union is being wound up or dissolved, and all the creditors have been paid in full. 'Creditors' include members who hold other types of share in the credit union. All their shareholdings must have been repaid in full, and they must have received any interest or dividend, before the deferred shareholders can be repaid. 'Creditors' also include holders of subordinated debt, so they too need to be repaid, albeit after unsecured creditors and the holders of other types of share. (If the amount remaining after doing this is insufficient to repay the deferred shareholders in full, they will be repaid proportionately to their shareholding.)

**Case B. With the FSA's consent.**

The credit union needs to have applied to the FSA for the necessary consent and to have had it granted. The application must not be the result of a provision in any of the issue documents:

- requiring the credit union to apply;
- granting the credit union any benefit for applying; or
- imposing a sanction for not applying.

The purpose is to ensure that repayment only takes place when it is entirely in the interests of the credit union's members.

### Documents of title

Any document giving evidence of title to the shares (ownership) must contain the two prominent statements required in the issue documents.

## Attachment of shares

*See article 18 and sections 7 and 11 Credit Unions Act 1979.*

Shares are said to be 'attached' when they cannot be withdrawn because the member has an outstanding loan in excess of his/her shareholding.

The fact that shares are attached does not convert an unsecured loan into a secured loan. A loan may only be secured on shares if the member:

- applies to have the loan treated as secured;
- has shares equal to or greater than the loan; and
- is not allowed to withdraw those shares in any circumstances.

The credit union's loan documentation should make the position clear.

## Attachment under loan agreements made before 8 January 2012

Where the member has an outstanding loan, shares are automatically attached by virtue of the law in force at the time. Shares up to the amount of the outstanding loan may only be withdrawn at the discretion of the committee – exercised on a case-by-case basis, or through a comprehensive laid-down policy. (For example, if a member has a £1,000 loan, and £1,500 shares, then the member may freely withdraw £500, but the remaining £1,000 may only be withdrawn at the discretion of the committee).

No outstanding loan that was made to a member before 8 January 2012 will be affected by the provisions outlined below, but any subsequent loan to that member will be subject to those provisions.

## Attachment under loan agreements made from 8 January 2012

Credit unions will need to devise policies covering the terms appearing in loan agreements for unsecured loans.

Every such agreement must include a term identifying which of the member's shares are unattached (and so withdrawable) and which are attached (and so non-withdrawable) for the duration of the loan.

Shares are unattached (and withdrawable) unless the agreement makes it quite clear that they cannot be withdrawn for the duration of the loan.

All shares held in excess of the outstanding balance of a loan are unattached (and withdrawable) unless the loan is secured by those shares.

So, for example, if a member has shares of £3,000 and an outstanding loan balance of £1,000, then £2,000 in shares is unattached (and withdrawable). The loan agreement must dictate that the remaining £1,000 in shares is attached (and non-withdrawable) for the duration of the loan, or they will be treated as unattached (and withdrawable).

The loan agreement might identify attached (non-withdrawable) shares in different ways, for example, the shares:

- in particular accounts;
- below a specific amount; or
- below a specific proportion (of member's shareholding, or outstanding loan).

The loan agreement will need to make clear the position for shares already held by the credit union at the date the agreement is made, and those that are received after that date.

The credit union will need systems capable of identifying at all times whether particular shares are non-withdrawable or withdrawable.

The term in a loan agreement identifying which shares are unattached (withdrawable) and which are attached (non-withdrawable) for the duration of the loan may be varied in accordance with contract law.

## Interest-bearing shares

*See article 19 and section 7A Credit Unions Act 1979.*

Shares issued by a credit union must be either dividend-bearing or interest-beating. No share can be both.

Dividend-bearing shares give a member the right to participate in the distribution of a credit union's profits. The credit union discharges its liabilities, satisfies its requirement for capital, and pays a dividend to members out of the remaining profits. The dividend rate must be the same for all types of share in the credit union, unless the credit union is entitled under FSA rules to pay different dividends on different accounts.

Interest-bearing shares give the member the right to a contractual rate of interest, whatever the profits of a credit union – but no dividend may be paid on those shares. A credit union may pay a different interest rate on different types of share.

A credit union may not issue interest-bearing shares unless:

- the registered rules of the credit union provide explicitly for this;
- it has submitted to the FSA an audited balance sheet for its most recent year-end, showing that it holds reserves of at least £50,000 or 5% of total assets (whichever is the higher); and
- it has submitted a report from its auditor that it satisfies the conditions specified by the FSA.

The term 'reserves' does not include:

- provisions for bad and doubtful debt; and
- subordinated debt (loans repayable to a third party).

It includes retained earnings from past years and amounts transferred to reserves in respect of deferred shares that have been subscribed for in full.

### Auditor's report on conditions

Both initial and annual reports should be made on the **appropriate form**.

The form sets out the conditions specified by the FSA

#### *Initial report*

Before the credit union may issue interest-bearing shares, it must submit a report from its auditor that the credit union satisfies the conditions specified by the FSA.

This report:

- is distinct from the auditor's report on the annual accounts (under the Friendly and Industrial and Provident Societies Act 1968);
- does not have to be submitted at the same time as the report on the annual accounts; and

- is made by the same auditor, unless the credit union has appointed a new auditor in the interim.

### *Annual report*

Once it has started issuing interest-bearing shares, the credit union must submit an annual report from its auditor that it satisfies the conditions specified by the FSA. This is in addition to the auditor's report on the annual accounts (under the Friendly and Industrial and Provident Societies Act 1968).

The FSA has specified that the auditor's annual report on conditions must be submitted by the same date as the credit union's annual supervisory report (CY).

### Conversion of interest-bearing shares

If any of the following apply for two consecutive years, the credit union must stop issuing interest-bearing shares, and convert existing ones into dividend-bearing shares.

The audited annual accounts:

- show that the credit union does not hold the qualifying level of reserves; or
- have not been submitted on time.

The annual report on conditions:

- does not state that the conditions have been satisfied; or
- has not been submitted on time.

### Conversion rules

If the credit union issues interest-bearing shares, its rules will also need to provide for their conversion into non-interest bearing shares if the requirements of the legislation are no longer being met (including where the conditions specified by the FSA are no longer being satisfied).

## Fee for ancillary services

*See article 20 and section 9A Credit Unions Act 1979.*

The credit union has power to provide members with services that are ancillary to taking a deposit or making a loan. These include:

- making or receiving payment (via standing order, direct debit or otherwise);
- issuing and administering means of payment (via cheque-books and debit cards);
- money transmission services; and
- giving advice on the above.

Members who joined the credit union on or after 8 January 2012 may be charged an appropriate fee for providing these services. Members who joined before that date may only be charged the cost of providing these services.

## Dividends

*See article 21, section 14 and paragraph 14 of Schedule 1 Credit Unions Act 1979.*

There is no limit on the annual dividend rate payable on shares, unless one is specified in the credit union's registered rules, or the credit union is terminating, in which case the dividend is limited to 8% (or whatever rate is specified by the Treasury order).

This provision is intended to prevent a credit union from circumventing the requirement that any surplus remaining on termination must be transferred to another credit union or used for charitable purposes.

# 5 Consequential, transitional and supplementary provisions

*See articles 22 to 29 of the Order.*

Most of these provisions relate to changes outlined, and have already been explained, or are no longer relevant.

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