

PRELIMINARY IDEAS FOR REFORM – CCBSA LAWYERS GROUP

Introduction

What is now known as the Co-operative and Community Benefit Societies Act 2014 (“CCBSA”) started life, as set out in the Law Commission Consultation document at page 11, as the Industrial and Provident Societies Act 1852. It fell within the remit of the U.K.’s department of finance (His Majesty’s Treasury) rather than the Department of Business, because of its development from community vehicles for working class people to encourage savings for health, burials etc. It permitted communities to establish community trading enterprises with relatively small financial contributions and a democratic basis.

In 1939 the legislation was amended to introduce definitions of a co-operative and community benefit society in order to discourage the fraudulent use of the society form. There had been some instances in the 1930’s in companies and societies of fraudulent promotions of shares.

New societies from that date had to satisfy tests devised by H M Treasury which gave wide discretion to the registrar. Since then, financial services legislation has developed significantly, as has legislation for companies, but legislation for societies has not. This consultation is the first since 1852 to properly review the whole of the legislation to make it proportionate and effective for today’s world.

Overall explanation The aims of these proposals are to (a) better enable citizens to establish purpose-based enterprises; (b) strengthen the role of members in enforcing a society’s purpose; (c) better address the risk of fraudulent financial promotions; and have a proportionate system of registration.

1) Basis for registration of a society

Explanation The basis for registration should be explicitly purpose-based. Citizens should be able to specify the purpose with statutory parameters preventing an unlawful purpose.

a) Purpose

A Registered Society is a **corporate body**, with a membership of individuals and/or other corporate bodies, united by a **common purpose**, defined in the Registered Society’s constitutional rules.

The common purpose of a Registered Society must be **other than the generation of profit or capital gain for distribution to members** and any profit distribution or capital gain for members must be consistent with the defined common purpose.

The common purpose of a Registered Society **may be (non-exclusively)**:

- a **collective purpose**, where the purpose is defined as mutual and/or co-operative ; **and/or**
- a **community purpose**¹, where the purpose is defined as for the **benefit of the general community, or a section** of the general community, **and/or**
- a **charitable purpose**, where the defined purpose is **for the public benefit**, which may be a charity.

Explanation The role of the registrar is to be satisfied that the requirements of the Act as to registration are complied with. Schedule 1 will specify matters required to be covered by rules generally or for specific purposes.² If there is a lawful purpose and the required conditions of the Act are set out in the Rules registration will follow. There is no requirement for an extensive registration process.

A society shall only be registered if the **Registrar is satisfied** that the requirements of the CCBS Act as to registration are complied with. **Minimum constitutional rules**, with appropriate variations relating to possible types of purpose, are set out in Schedule [1].

Ordinary membership of a Registered Society shall be **open to any applicant** for membership affirming the defined common purpose of the Registered Society, **who fulfil reasonable qualifying criteria** for membership to provide reasonable assurance that the prospective member is, in good faith, committed to the common purpose. [\[This could be in schedule 1 CCBSA\]](#)

Voting in general meetings shall be on an equitable basis, not based on shareholding. There is a presumption of one person one vote, or where appropriate voting based on volume of trade with society. In societies with multiple membership constituencies, weighting of votes between constituencies is permitted where appropriate to purpose; but one person one vote or voting based on volume of trade to apply within constituencies. [There should be a catch-all such as: some other equitable voting arrangements which the subscribers declare is in the best interests of the purpose which the members advance and which does not prioritise investor or financial interests in a way which satisfies the /Registrar that confidence in societies is at risk. \[This could also be in schedule 1 CCBSA \]³](#)

b) Unlawful purpose

¹ As with the CIC regulations 2005, certain activities might be precluded from being included in community purpose

² More detailed requirements of the conditions in s.14 CCBSA now to ensure compliance , with some to apply to all societies and others to specific purposes.

³ See s.4(4),(5) CCBSA for current special cases voting arrangements.

Restoration of the requirement removed in 1939 that a society is not to be formed for an unlawful purpose. If acting unlawfully the Registrar can intervene as with companies. Statutory declaration on registration by subscribers that society formed for a lawful purpose.⁴

2) Duties of officers

Explanation The duty of officers (not just directors - but its managers, secretary and treasurer) is to deliver the purpose, and it is primarily for the members to ensure that the directors discharge their duties.

A director of a society must act in the way they consider, in good faith, would be most likely to promote the success of the company in delivering its purpose, and in doing so have regard (amongst other matters) to—

(a) the likely consequences ...⁵

The other fiduciary duties and civil consequences to be incorporated from company law except where not appropriate for the different purposes.

Duties to apply to all persons named as officers including secretary, treasurer and managers who should be registered with the Registrar.⁶

Suggestion that there should be a duty for directors to ensure that financial promotions are fair, clear and not misleading⁷,

3) Accountability

Explanation Directors accountability to members needs to be strengthened.

Societies should report on how they fulfil their objects (Q68) Agree with Law Commission Recommendation

Provide a remuneration report to members to approve at AGM where turnover more than [£1m]

Provide details of remuneration of officers (in bands) in Annual Accounts where turnover more than [£1m]

Require details of transaction with connected persons in annual accounts where turnover more than [£1m.]

⁴ As per Companies Act 2006 section 7 (2) and s.9(2)(e)

⁵ Continue with the wording from section 172 (2) Companies Act 2006 which provides an adequate framework.

⁶ This goes further than the Law Commission and is consistent with s.41. and s.42 of the CCBSA (Security from officers and duty of officers to account) which is no longer relevant today.

⁷ A similar obligation is placed on company directors in the context of disapplication of pre-emption rights in s. 572 Companies Act 2006.

Require societies to advertise to all members board vacancies which the directors wish to fill, if society has turnover of more than [£1 million.] Directors can organise nomination committee and put forward nominations in usual way or otherwise permit members to appoint directors.

Members to have right to pass a resolution to remove a director.⁸

4) Shares

Explanation The Law Commission proposals on transferable and withdrawable shares enhance creditor protection but will need to be drafted to be proportionate for those societies which are permitting withdrawal of shares on a daily basis.

They do not address fraudulent financial promotions by officers of societies which offer certain financial instruments which are exempt (bonds) or not within financial services legislation (withdrawable shares). It is suggested this is addressed by stronger obligations on officers, transparency, and when offers are made of financial promotions of bonds and withdrawable shares explicit financial promotion requirements.

a) Share Capital

Transferable shares are already caught by FSMA

Withdrawable shares and bonds (“Community investment”) – additional requirements of withdrawable shares and bonds are offered to the public:-

Must be offered to persons who confirm they are investing for the purpose of the society and not solely for profit

Which carries no right to pre-emption

Which carries a proportionate risk warning

“Risk warning requirement (derived from FSMA 2000 COBS Mutual shares)

(1) The society is required to give the prospective member a proportionate risk warning on paper or another durable medium and obtain confirmation in writing from the prospective member that they have read it, before the prospective member has committed to buy the community investment. The risk warning may contain some or all of the following (noting that items (b) and (c) may reasonably be excluded in the case of bonds whose terms include binding interest and capital repayments):-

(2) “The investment to which this communication relates is a community investment. Community investment can be high risk and is very different to investment in deposit accounts or other savings products. In particular, you should note that:

(a) the entire amount you invest is at risk;

⁸ This should be a parallel provision to Companies Act 2006 s. 168

(b) Interest payments are not guaranteed and may be suspended or cancelled at any time, for any reason;

(c) withdrawal or repayment may be at the discretion of the society and you may have no right to require the society to buy back the community investment or sell to another person;

(d) investing more than 10% of your savings in a community investment of this type is unlikely to be in your best interests

(e) if you are in doubt about the investment you should consult an appropriately qualified adviser;

(f) the community investment is not safeguarded by the Financial Services Compensation Scheme.”

[Since the CCBSA is already a financial services Act tackling fraudulent financial promotions it is appropriate to place this condition in the Act or regulations]

b) Interest on Shares

Explanation It is for the society to determine the appropriate interest rate, with registrar intervention only in extreme cases.

Any interest rate should be no more than is needed to obtain and retain necessary funding for the society's purpose

Decisions on interest should be made by directors in accordance with their duties

The society should record in its annual accounts how it reached its decision on interest

A society can pay a lesser rate than forecast

A society can pay a higher rate to account for earlier lower payments than forecast

The directors must ensure the interest rate is reasonable

c) Dividends

A collective purpose society may pay a dividend on a member's transactions with the society in accordance with the purpose of the society.

A community purpose or charitable society is prohibited from paying a dividend on a member's transactions with the society but may provide incidental discounted benefits or services based on the volume of transactions with the society provided that such discount is no greater than [10%]⁹ of the cost of the transaction. Where a community purpose society is established for a community purpose such as housing the provision of housing for members should not be considered as a financial benefit.

⁹ Probably too low, but something specific needed

5) Protection of assets

Explanation The current “asset-lock” arrangements are opaque and inadequate protection. The risk is demutualisation and/or leakage of historic reserves. This is better addressed directly.

A Registered Society with a community or charitable purpose shall, and a Registered Society with a collective purpose **may** have constitutional rules defining the Registered Society **as non-profit distributing, and/or with provisions ensuring that all capital and assets** of the Registered Society **are to be applied only to its defined purpose.**

On a winding up, a member of a community or charitable purpose society will only be entitled to the paid up nominal value of their shares plus outstanding interest. A member of a collective purpose society may be entitled to some share of reserves but only if permitted by the rules.

Following the winding up of a society the residual assets shall be distributed to another body with the same or similar purpose specified by the members on winding up or in the absence of such designation to a charity.

All new societies to be able to include in rules a provision specifying that conversion or transfer of engagements to a company is never permitted or requires consent of all members.

All existing societies to be able to include in their rules, subject to enhanced voting threshold, a provision specifying that conversion or transfer of engagements to a company entity is never permitted or requires consent of all members.

6) Duties of the Registrar

Explanation The 1939 amendments introduced the definitions of co-operative and community benefit societies and guidance from the Registrar to what those terms meant. The guidance introduced measures of what can be regarded as principles of corporate governance. When introducing the legislation, it was hoped that the provisions would be “as effective as possible in dealing with the rogue and make it as little hampering as possible in dealing with the honest man”.

Before those amendments, the Registrar’s decision was appealable. Afterwards it was not. As an appointee of HM Treasury within the Financial Conduct Authority, it is unsurprising that the Registrar views its role through a financial services rather than a business prism.

The new Act should focus on the members policing the adherence by directors to the rules of the society rather than the Registrar’s view of corporate governance as suggested in the section on accountability above. The Registrar’s role is therefore closer to that of the Registrar of Companies.

Registration – the basis for registration is set out in the first section of this document.

A principles-based approach to the requirements of registration is required

If the approach proposed in this paper is adopted, then it solves the current problem of the status of existing societies, both pre-2014 and post-2014, that do not clearly match the definition of either co-operative or community benefit society. The Law Commission's proposal of retrospectively applying its new definitions to existing societies within an 18 month grace period is very problematic, and taking the new approach to definitions might help solve the issue in a better way (because you don't have to choose between one or the other or face de-registration).

Amendments to constitution - The Act will set out conditions when consent of the Registrar is required for regulated alterations to the rules of a society such as:-

- When voting does not fit the models defined in the Act where the Registrar can approve derogations which may reasonably be regarded as analogous to, or within the spirit of the prescribed voting requirements
- In respect of material change of purpose away from a collective purpose
- On profit or asset distribution
- Demutualisation

Appealing decisions of the Registrar – decisions of the Registrar should be appealable to a court or tribunal. The Charity Tribunal might be a suitable tribunal.

Intervention by the Registrar – the Registrar should intervene only if the society is conducting an unlawful purpose or if there are specific reasons set out in the Act for intervention

10% of the members or 100 members if less should be given the right to call general meetings rather than require the Registrar to call a general meeting.

Reporting – We agree with the proposed reporting requirements of the Law Commission in relation to an annual report by societies.

Practice of the Registrar – The registrar must adopt an approach to the discharge of its functions which is based on good regulatory practice, that is an approach having regard to –

- a) the likely impact on those who may be affected by the discharge of those functions and
- b) the outcome of consultations with, and with organisations representing societies and others with relevant experience.

In deciding whether and how to exercise its powers the Registrar must adopt an approach which is based on the principle that it should seek to prevent an unlawful purpose.

The Registrar should have a power to investigate if a reasonable person would believe the society is conducting an unlawful purpose and it was necessary to maintain confidence in societies

7. **CCBSA LAWYERS GROUP**

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