BUILDING SOCIETIES (FUNDING) AND MUTUAL SOCIETIES (TRANSFERS) BILL

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Building Societies (Funding) and Mutual Societies (Transfers) Bill, as brought from the Commons on 30th April. They have been provided by HM Treasury with the consent of Lord Naseby, the Peer in charge of the Bill, in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by Parliament.

2. These notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a clause or part of a clause does not seem to require any explanation or comment, none is given.

TERRITORIAL EXTENT AND APPLICATION

3. The Bill extends to the whole of the United Kingdom.

4. The Bill applies in Wales as it does elsewhere. It does not have any particular effect on the National Assembly for Wales.

SUMMARY AND BACKGROUND

5. The purposes of the Bill are to liberalise the wholesale funding limits on building societies, to place building society members on a par with creditors on a winding up, and to make it easier for mutual societies transfer their business to subsidiaries of other mutual societies.

6. The Bill was introduced by Sir John Butterfill MP as a Private Member's Bill on 13th December 2006. Amendments tabled by the Government were made in Committee on 25th April.

7. The Bill has three aims. First, to increase the proportion of wholesale funding building societies may use. At present, building societies must raise at least 50 per cent of

their funds from shares held by individual members of the society. The Bill will allow the Treasury to change that requirement, so that societies may raise up to 75 per cent of their funding from wholesale sources. This is intended to give societies access to cheaper funding and create a more level playing field with banks. However, the retention of at least 25 per cent individual member funding will mean that this source of funding will remain significant.

8. Second, to alter the position on the distribution of assets on dissolution or winding up of a building society, to give shareholding members of the society equality with creditors. At present, creditors have priority over members in a winding up. A change to the funding limit would increase the risk to members in an insolvency, as any available funds would first be used to satisfy a larger pool of (wholesale) creditors. This second change is intended to reduce that risk, by improving the position of building society members in an insolvency.

9. Third, to 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. A subsidiary for these purposes is a company controlled by another mutual society. The Bill will allow the Treasury to modify the statutory provisions which apply to such transfers, to make them less onerous. This is intended to make it easier for mutual societies to acquire other mutuals, and to develop group structures. The changes will ensure that certain safeguards, such as members' rights and safeguards against demutualization, remain in place.

10. The changes to the relevant legislation to give full effect to the policy will be made by the Treasury in secondary legislation. This approach will allow the Treasury to consult mutual societies and other interested parties before making any substantive changes to the legislation.

COMMENTARY ON CLAUSES

Clause 1: Funding limit for building societies

11. Subsection (1) amends section 7 of the Building Societies Act 1986 ("the 1986 Act") to make it possible for the Treasury to change the funding limit for building societies.

12. New subsection (6A) enables the Treasury to make an order providing that the limit on non-member funding in section 7(1) has effect as if the current limit of 50% were a greater amount, up to a maximum of 75%, specified in the order. The order may also prohibit societies from applying the increased percentage unless they have passed a resolution of the kind specified in the order.

13. New subsection (6B) provides that an order under subsection (6A) is of no effect unless there is also an order in place under new section 90B, giving members equality with creditors in dissolution and winding up. This aims to protect the position of members: if no order were made under s.90B, an increase in wholesale (non-member) funding would put

them at greater risk in the event of an insolvency, as funds would be used to satisfy a larger pool of creditors first.

14. New subsection (6C) provides that an order under subsection (6A) may not be amended or revoked if the effect is to reduce the percentage specified in the order. The purpose is to ensure that the funding limit, once increased, cannot be reduced. If the Treasury were able to raise the funding limit and later reduce it, that could deter building societies from taking advantage of the raised funding limit. There would be no certainty that they could continue to use that amount of wholesale funding in the future.

15. New subsection (8A) requires an order under subsection (6A) to be approved in draft by affirmative resolution in each House of Parliament before it is made.

16. Subsection (2) amends section 5 of the 1986 Act, which requires the purpose or principal purpose of a building society to be that of making loans secured on residential property which are funded substantially by its members.

17. New subsection (11) gives the Treasury a power to amend section 5(1)(a) of the 1986 Act so as to alter the extent to which loans are required to be funded by the society's members. This will ensure that the requirement in section 5 is consistent with the revised funding limit, as that will allow societies to have less member funding.

18. New subsections (12) and (13) give the Treasury a power to make consequential, saving, supplementary or transitional provision. This includes provision amending specified provisions of the Act, concerning the functions of the Financial Services Authority, amalgamations and societies' memoranda. This will ensure that those sections are consistent with section 5 as amended.

19. New subsection (14) requires an order made under the section to be approved in draft by affirmative resolution in each House of Parliament before it is made.

Clause 2: Power to alter priorities on dissolution and winding up

20. This clause inserts new section 90B into the 1986 Act. Subsection (1) gives the Treasury the power to make an order to ensure that, on the winding up or dissolution by consent of a society, any assets available to satisfy the society's liabilities to creditors or to shareholders are applied in satisfying those liabilities pari passu (equally). The order may make amendments of the 1986 Act, as well as consequential, supplementary, transitional and saving provision (subsection (5)).

21. Subsection (2) provides that liabilities to creditors do not include liabilities in respect of subordinated deposits, preferential debts, and any other category of liability specified by the Treasury. Subsection (3) makes a similar provision in respect of deferred shares. The

purpose is to ensure that only ordinary shareholding members are given equality with the general pool of unsecured creditors.

22. Subsection (6) requires an order under new section 90B to be approved in draft by affirmative resolution in each House of Parliament before it is made.

Clause 3: Transfers to subsidiaries of other mutuals

23. Subsection (1) gives the Treasury the power to modify provisions in the legislation identified in subsection (10), to facilitate, or in consequence of, a transfer of business from a mutual society to the subsidiary of another mutual society. "Modifications" include omissions, alterations and additions (subsection (8)). A mutual society is a building society, a friendly society (within the meaning of the Friendly Societies Act 1992) or an industrial and provident society (subsection (9)). A subsidiary of a mutual society is a company in which the society holds or controls a majority of the voting rights and in relation to which the society can appoint or remove a majority of the board of directors (subsection (11)).

24. Subsection (2) specifies that the order may make provision concerning certain rights, including membership rights, in the mutual society controlling the subsidiary. This will enable the Treasury to require that members of the transferring mutual society, and new customers of the subsidiary, are given equivalent rights to those they would have enjoyed as members of the transferring mutual.

25. Subsection (3) provides that the order may confer functions on the Financial Services Authority. Those functions might for example include a power to direct that, in certain circumstances, restrictions on transfers of shares in the new subsidiary, or transfers of its business, will not apply. The Authority has a similar power under s.101(4) of the Building Societies Act 1986.

26. Subsections (6) and (7) provide that an order which modifies the primary legislation identified in subsection (10), or which modifies subsection (11), must be approved in draft by affirmative resolution of each House of Parliament before it is made. An order which does not modify those provisions will be subject to annulment by a resolution of either House. This allows an order which modifies subordinate legislation only to be made under the negative resolution procedure.

27. Subsection (11) specifies what a subsidiary of a mutual society is, and allows the Treasury to amend this to make the degree of control required by the mutual society over the subsidiary more or less onerous.

Clause 4: transfers to subsidiaries: distribution of funds

28. This clause has effect only if an order made under clause 3 so provides (subsection (1)), and applies only to transfers to which the order applies (subsection (2)).

29. Subsection (3) provides that a distribution of funds which exceeds limits prescribed by the Treasury must be approved by the transfer resolution of the mutual society making the transfer, and by a resolution of the holding mutual of a kind specified by the Treasury. A distribution which does not exceed the prescribed limit must only be approved by the transfer resolution or by the resolution of the holding mutual.

30. A distribution of funds is a distribution of part of the funds of the transferring society, or of the holding mutual, in consideration of the transfer, among the members of the transferor, the holding mutual or both of them (subsection (2)). The transfer resolution is the resolution specified in subsection (5) which approves the transfer. The holding mutual is the mutual society of which the transferee is a subsidiary (subsection (2)).

31. Subsection (4) requires the Treasury to authorise such distributions and to prescribe limits. If an order made under clause 3 gives effect to clause 4, it will be necessary for the Treasury to authorise distributions and prescribe limits for subsection (3) of clause 4 to work.

32. The clause is similar to the provisions on distributions of funds on mergers of building societies in s.96(4) to (6) of the Building Societies Act 1986. It will create a less onerous procedure for distributions of funds in transfers to subsidiaries of other mutuals, in particular for distributions in transfers of building societies, which are currently limited to shareholding members of two or more years' standing under s.100(9) of the 1986 Act.

33. Subsection (7) provides that subsections (4) to (7) of clause 3 apply to an order made under clause 4. This means that an order which only makes provision under subsections (3) and (4) of clause 4 and does not modify primary legislation will be subject to the negative resolution procedure. However, the clause 4 powers may be exercised at the same time as the clause 3 powers in an affirmative resolution order.

Clause 5: short title, commencement and extent

34. Subsection (2) provides for the Bill to be commenced by one or more Treasury orders. Subsection (3) provides that the Act extends to the whole of the United Kingdom. However, as the Industrial and Provident Societies Act 1965 does not extend to Northern Ireland, any modifications to that Act under clause 3 will not extend there.

FINANCIAL EFFECTS AND PUBLIC SERVICE MANPOWER

35. It is unlikely that the Bill will have any impact on public expenditure or on public service manpower. Where the FSA acts as registrar with responsibility for approving transfers within the mutuals sector it is able to recover its costs from the participants under existing legislation.

REGULATORY IMPACT ASSESSMENT

36. The Treasury's view is that the contents of the Bill are consistent with Government policy and would help to further strengthen the sector, so the Bill has Government support. A full Regulatory Impact Assessment on the options for implementing the Bill and the attendant costs and benefits will be published on the Treasury website at www.hm-treasury.gov.uk after Royal Assent.

COMMENCEMENT DATES

37. The Government intends to commence the Bill two months after Royal Assent.

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