

These notes refer to the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (c.26) which received Royal Assent on 23rd October 2007

BUILDING SOCIETIES (FUNDING) AND MUTUAL SOCIETIES (TRANSFERS) ACT 2007

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Building Societies (Funding) and Mutual Societies (Transfers) Act, which received Royal Assent on 23rd October 2007. They have been prepared by HM Treasury in order to assist the reader of the Act. They do not form part of the Act and have not been endorsed by Parliament.
2. These notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So where a section or part of a section does not seem to require any explanation or comment, none is given.

TERRITORIAL EXTENT AND APPLICATION

3. The Act extends to the whole of the United Kingdom. It may be extended by Order in Council to any of the Channel Islands or the Isle of Man.
4. The Act 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 Act 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 Act 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 Act allows 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.

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7. 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.

8. Third, to make it easier for a building society, friendly society or industrial and provident society to transfer its business to a subsidiary of another such society or of an EEA (European Economic Area) mutual society. A subsidiary for these purposes is a company or other body corporate controlled by another mutual society. The Act allows 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.

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

COMMENTARY ON SECTIONS

Section 1: Funding limit for building societies

10. 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.

11. 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.

12. 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.

13. 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.

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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.

14. 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.

15. 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.

16. 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.

17. 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.

18. 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.

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

19. This section 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). This power may be exercised independently of the section 1 power. An order under this section may make amendments of the 1986 Act, as well as consequential, supplementary, transitional and saving provision (subsection (5)).

20. 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.

21. 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.

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Section 3: Transfers to subsidiaries of other mutuals

22. Subsection (1) gives the Treasury the power to modify provisions in the legislation identified in subsection (11), to facilitate, or in consequence of, a transfer of business from a mutual society to the subsidiary of another mutual society.

23. The legislation which may be modified under this section specifies the procedures for transfers of business of building societies, friendly societies and industrial and provident societies (subsection (11)). So any modifications will only affect transfers made by one of those types of society.

24. A transfer under the modified procedures may be made to a subsidiary of a building society, friendly society or industrial and provident society, or to a subsidiary of an EEA mutual society (subsections (1) and (10)). An EEA mutual society is a European Cooperative Society, a cooperative under the law of an EEA (European Economic Area) state, or a cooperative or mutual undertaking of such description as the Treasury specify by order (subsection (12)).

25. A subsidiary of a mutual society is a relevant 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 (13)). A relevant company is a UK company or a body incorporated in another EEA state (subsection (14)).

26. The inclusion of EEA mutual societies in section 3 ensures that any changes made under the Act to the legislation specified in subsection (11) apply where the transfer is to a subsidiary of an EEA mutual as well as where the transfer is to a subsidiary of a UK building society, friendly society or industrial and provident society. Mutual insurers, and other UK mutual undertakings, could come within the scope of “EEA mutual society”.

27. 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.

28. 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.

29. Subsections (6) and (7) provide that an order which modifies the primary legislation identified in subsection (11), or which modifies subsection (13), 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

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by a resolution of either House. This allows an order which modifies subordinate legislation only to be made under the negative resolution procedure. An order specifying a new kind of EEA mutual may also be made under the negative resolution procedure.

30. Subsection (8) ensures that any order made under section 3 which may have effects peculiar to a particular mutual will not be dealt with under the hybrid instrument procedure in the House of Lords. As EEA mutual societies are included in subsection (10), it is possible that an order under section 3 could require an EEA mutual society acquiring a UK mutual society to give transferring members full membership rights in the EEA mutual. If the EEA mutual has a unique legal form, for example if it is established by a private Act of Parliament, that might raise a question of hybridity. This provision ensures that the hybrid instrument procedure will not apply, should such a situation arise.

31. Subsection (15) enables the Financial Services Authority to charge fees in respect of any functions conferred on it under the Act. It extends the FSA's existing powers to charge fees under the Financial Services and Markets Act 2000. The inclusion in section 3 of EEA mutual societies will require certain safeguards to be in place, equivalent to those applicable to domestic mutuals, regarding membership rights in the holding mutual and further demutualization. The FSA, which in most cases must approve transfers of UK mutual societies' business, will have to be satisfied that these safeguards are in place. If additional functions are conferred on the FSA in the order implementing the Act, it may need to charge fees in connection with those functions.

Section 4: transfers to subsidiaries: distribution of funds

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

33. 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.

34. 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)).

35. Subsection (4) requires the Treasury to authorise such distributions and to

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

36. Section 4 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. An order implementing this section 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.

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

Section 5: Channel Islands and Isle of Man

38. This section allows any provisions of the Act to be extended, with or without modifications, to any of the Channel Islands or to the Isle of Man. Some of the mutuals legislation which may be modified under the Act (see section 3(11)) either extends to the Islands or may be so extended.

Section 6: short title, commencement and extent

39. Subsection (2) provides for the Act 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 made under section 3 will not extend there.

FINANCIAL EFFECTS AND PUBLIC SERVICE MANPOWER

40. It is unlikely that the Act will have any impact on public expenditure or on public service manpower. Section 3, subsection (15) allows the Financial Services Authority to charge fees in relation to the exercise of functions conferred on it under the Act. If additional functions are conferred on the FSA, and it exercises its power to charge fees, this could result in costs for some businesses wishing to take advantage of the new procedures. However, any such fees would be paid directly to the FSA and would not exceed the FSA's costs in the transaction in question.

REGULATORY IMPACT ASSESSMENT

41. A Regulatory Impact Assessment on the options for implementing the Act and

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the attendant costs and benefits will be published on the Treasury website at www.hm-treasury.gov.uk.

COMMENCEMENT DATES

42. The Government intends to commence the Act two months after Royal Assent.

HANSARD REFERENCES

43. The following table sets out the dates and Hansard references for each stage of this Act's passage through parliament.

Stage	Date	Hansard Reference
<i>House of Lords</i>		
Introduction	30th April 2007	Vol. 691. Col.873
Second Reading	14th June 2007	Vol. 692 Cols. 1857 - 1866
Committee	10th July 2007	Vol. 693 Cols. 1355 - 1362
Report	24th July 2007	Vol.694 Col. 693
Third Reading	12th October 2007	Vol. 695 Cols 457 - 460
<i>House of Commons</i>		
Introduction	13th December 2006	Vol. 454 Cols. 888- 889
Second Reading	23rd March 2007	Vol.458 Cols. 1059- 1100
Committee	25th April 2007	Hansard Public Bill Committee
Report and Third Reading	27th April 2007	Vol. 459 Cols. 1146 - 1158
Commons Consideration of Lords Amendments	19th October 2007	Vol. 464 Cols. 1069 - 1103

ROYAL ASSENT – 23 October 2007 House of Lords Hansard Vol. 695 Col. 973
House of Commons Hansard Vol. 465 Col. 187

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11/2007 384637 19585