

# Chapter 6

## Capital

## 6.1 Shares

- 6.1** **G** This chapter provides information and guidance on societies' use of capital. Societies use many forms of capital, but we only cover shares and loans here, as they are some of the most commonly used ways to raise capital. The way a society finances its activities can be an indicator of whether it is complying with its condition for registration.
- 6.1.1** **G** Societies are limited by shares. All societies must have share capital.
- 6.1.2** **G** We believe that how a society uses share capital can show if it is complying with the conditions for registration (i.e. that it is a bona fide co-operative or that the society is conducting its business for the benefit of the community).
- 6.1.3** **G** In our view there are some unique features of society shares:
- (1) their number can fluctuate significantly;
  - (2) they remain at par value (unless written down);
  - (3) they do not automatically give the shareholder a share in the underlying value of the society;
  - (4) they cannot be held by the issuing society itself;
  - (5) they do not carry votes in proportion to the amount of shares held.
- 6.1.4** **G** It is important to keep these unique features in mind when reading the rest of this chapter.
- 6.1.5** **G** For society shares, legislation requires that the rules specify:
- (1) whether shares are withdrawable or not and
  - (2) whether shares are transferable or not
- 6.1.6** **G** **Withdrawable shares**  
Societies may, and generally do, issue withdrawable shares.

- 6.1.7** **G** Society rules have to state if shares are withdrawable. If they are, the rules must state how they can be withdrawn, and how any residual balance will be paid to a member leaving the society.
- 6.1.8** **G** Society rules must also state the maximum interest in the shares of the society someone may have. This can include stating the statutory limit (currently £100,000 for people other than societies).
- 6.1.9** **G** The Act does not define withdrawable shares. The process of withdrawal should be laid down in the society's rules. Most society rules give the board power to suspend all share withdrawals. Others impose long notice periods for withdrawing shares. Some societies only allow shares to be withdrawn at fixed times or after a certain period of holding the shares.
- 6.1.10** **G** Our view is that it is an indicator that a society is meeting its condition for registration if it only allows the withdrawal of shares if:
- (1) it has trading surpluses that match or exceed the value of shares involved; and
  - (2) the directors believe the society can afford to pay its debts, taking into account:
    - (a) all of its liabilities (including whether it will be able to pay its debts at the date of withdrawal and, for a year after that, any contingent or prospective liabilities); and
    - (b) the society's situation at the date of the transaction.
- 6.1.11** **G** In our view it is an indicator that a society is complying with its condition for registration if:
- (1) the society's board has power to suspend withdrawals of share capital;
  - (2) the society's directors monitor withdrawals and, if the society's financial position becomes uncertain, can suspend members' ability to withdraw shares; and
  - (3) the directors have agreed whether there should be an annual limit on how many shares can be withdrawn, or a limit to the amount of profits which can be distributed.
- 6.1.12** **G** **Transferable shares**  
 The Act allows societies to have 'transferable shares' and states that society rules must:
- (1) state if any or all of the society shares are transferable;
  - (2) provide for the form of transfer;

- (3) provide for registration of the shares; and
- (4) require consent of the board to transfer or registration.

**6.1.13** **G** In our view, a market in society shares allowing capital gains for members is normally inconsistent with registration as a society. This is because it may encourage the society's members and officials to operate the business to achieve capital gains rather than to serve either the members or the community through operating its business. Society rules are required by the Act to make every share transfer, other than on the death or bankruptcy of a member, subject to board consent as well as registration.

**6.1.14** **G** If issuing transferable shares, societies may wish to take legal advice as to whether the issue falls within the Financial Services and Markets Act 2000 (FSMA).

### Forfeiture and cancellation of shares

**6.1.15** **G** Society rules can also cover forfeiture and cancellation of shares in certain circumstances:

- (1) arrears in paying instalments due on a purchase of shares may lead to the forfeiture and cancellation of the shares;
- (2) if a nominal shareholding is a condition of membership, society rules may provide for the forfeiture and cancellation of shares when a member leaves;
- (3) shares may also be forfeited and cancelled to remove members who no longer have any active relationship with the society from the register of members. Societies will want to make reasonable attempts to contact or locate the member before removing them from the register.

**6.1.16** **G** Societies may want rules to cater for where shares are forfeited and the former member subsequently contacts the society to claim any share capital.

### Rule amendments

**6.1.17** **G** An amendment of a society's rules registered after a person becomes a member is not binding on a member if and so far as the amendment:

- (1) requires the member to take or subscribe for more shares than the number held by the member at the date of registration of the amendment;
- (2) requires the member to pay upon the shares held by the member at that date any sum exceeding the amount unpaid upon them at that date;
- (3) or in any other way increases the liability of that member to contribute to the share or loan capital of the society.

6.1.18 **G** This applies unless the member has consented in writing.

### Share offers

6.1.19 **G** In general, the share capital of a society should not be more than the level needed to support its activities. If the society can fund its activities from reserves then it ought not to need to issue additional shares. However, if a society does need to raise capital to pursue its purpose, it may wish to seek additional share capital from its members.

6.1.20 **G** Societies are not subject to certain requirements under the Financial Services and Markets Act 2000 (FSMA), in particular for withdrawable non-transferable shares. Societies should take appropriate advice before inviting members and prospective members to acquire shares.

### Share interest

6.1.21 **G** Societies can pay interest on shares.

6.1.22 **G** Generally speaking, interest on shares should only be paid where the society can afford to do so, having taken into account other liabilities and any contribution to the society's reserves. Share interest should not be used as a means of profit or surplus distribution or as a substitute for dividends.

6.1.23 **G** The way a society uses interest on shares can be an indicator of whether it is complying with its condition for registration because:

- (1) in the case of a bona fide co-operative society:
  - (a) the society cannot exist mainly to pay interest on money invested; and
  - (b) in accordance with Principle 3 (see ■ RFCCBS 4.3.3), it would be an indicator that a society is a bona-fide co-operative where the distribution of surplus to members is in the form of a dividend based on a member's participation in the co-operative, rather than through payment of interest on shares;
- (2) in the case of a society conducting its business for the benefit of the community the society's funds must be used to further the community benefit.

6.1.24 **G** The factors below are indicators of where a society is likely to be complying with the conditions for registration:

- (1) societies are primarily inviting people to become members of the society, along with any accompanying request for capital (additional to the minimum required for membership) from the prospective member;
- (2) the maximum rate of interest paid on shares is declared in advance of the period for which it is intended to be paid, whether in its rules or elsewhere;

- (3) the declared maximum rate of interest is the lowest rate sufficient to obtain the necessary funds from members who are committed to furthering the society’s objects;
- (4) in the event the society cannot afford to pay the declared maximum rate of interest, interest payments are reduced, or no interest is paid at all, without compensation in subsequent years;
- (5) societies can justify a decision to pay interest at a particular rate, and be able to demonstrate the basis for that decision.

**6.1.25** **G** The factors below are indicators of where a society is likely to be failing to comply with the conditions for registration:

- (1) the society seeks to attract capital mainly by focusing on potential return on investment;
- (2) the declared maximum rate of interest is in excess of the lowest rate sufficient to obtain the necessary funds from members who are committing to further the society’s objects;
- (3) a rate of interest greater than the declared maximum rate is paid to members where a society is more profitable than expected;
- (4) greater profits in one year are used to compensate members for reduced or no interest payments in previous less profitable years.

**6.1.26** **G** We will consider these factors on a case by case basis. What is appropriate for one society may not be appropriate for another.

**6.1.27** **G** There are some instances where these factors are not appropriate, specifically in the case of non-user investor shares in co-operative societies, and shares in agricultural co-operatives. In these instances other indicators will suggest whether societies comply with the bona fide co-operative society condition for registration. Non-user investor shares are dealt with from **RFCCBS 6.1.30** below. For agricultural co-operatives, requirements in the rules around the use of share capital linked to members’ participation in the business suggest compliance with the legislation.

**Co-operative societies**

**6.1.28** **G** The indicators outlined above on share interest are relevant for co-operative societies in relation to the capital subscribed by members over and above that subscribed as a condition for membership.

**6.1.29** **G** The amount of interest paid on capital subscribed as a condition for membership should be limited, if any at all.

**6.1.30** **G** Generally co-operative societies offer membership to people who can use their services (whether as workers, producers or consumers). However, a co-operative society may sometimes need to raise capital from people who cannot or do not use the society’s services. We describe these members as

'non-user investor members' – people who have only an investment relationship with the society.

**6.1.31** **G** While offering membership to non-user investor members gives a co-operative society access to capital, it also brings risks to its ability to comply with its condition for registration. The way capital is accessed must not compromise the society's compliance with the condition for registration. The following factors are indicators that the society is complying with its condition for registration as a bona fide co-operative society:

- (1) The rules of a society which wants to raise capital from non-user investor members expressly provide for non-user investor shares, and the terms attached to these shares are clearly stated.
- (2) The voting rights of non-user investor shareholders are restricted by the rules of the society. The society's rules prevent this category of shareholders voting on a motion to convert the co-operative to a company. Societies can, however, include a power to elect one or more non-user investor share representatives to the board.
- (3) Ultimate control of the society remains with members other than non-user investor members at all times. Non-user investor members do not together have voting rights that when combined would result in user-members losing control of the society.

#### **Community benefit societies**

**6.1.32** **G** Share terms, whether in community benefit society rules or a separate document, must be consistent with the society's purpose of community benefit.

**6.1.33** **G** We consider the following factors as indicators that the society is complying with its condition for registration:

- (1) any surplus is used to benefit the community by reinvestment in the business, or by application to some external but related community benefit;
- (2) any retained reserves are committed to community benefit;
- (3) the society's rules prohibit any distribution of assets to members unless sold at market value to those members;
- (4) the society only pays interest set at the lowest rate sufficient to obtain the necessary funds from members committed to furthering the society's objects;
- (5) on dissolution, society assets are either:
  - (a) transferred to one or more other bodies with similar objects; or
  - (b) used for similar charitable or benevolent purposes.

**6.1.34** **G** The assets of a community benefit society may be subject to a statutory restriction on use (statutory asset lock), see ■ RFCCBS 3.4.12 for further information.

**6.1.35** **G** Community benefit societies that are exempt charities in England and Wales, and all societies that are charities in Scotland, are subject to particular restrictions on the rates of interest payable to members in addition to those set out above. The Charity Commission for England and Wales, and the Office of the Scottish Charity Regulator (OSCR) for Scotland take the following view:

A power of a community benefit society to pay interest on shares is not incompatible with charitable status, provided that the following features are required by the society's rules:

1. The interest rate is set at a level which is not in itself a motivation to buy shares and which the charity trustees can justify as being in the interests of the charity by reference to available commercial rates for borrowing.
2. The cost is part of the society's revenue expenses and met before the surplus is determined.
3. The rates are declared in advance of the period for which they will become payable, just as for a bank or building society account, and never retrospectively.
4. There is a power to suspend interest payments in the interests of the society.
5. There is a power of the society to withhold repayment of the shares, either temporarily or indefinitely and to write the value down below the nominal £1.
6. The shareholding does not confer any rights to the underlying assets of the society.
7. In the event of a solvent dissolution, shareholders can not be paid more than the nominal value of their shares.

[**Note:** <https://www.gov.uk/government/publications/exempt-charities-cc23> ]



## 6.2 Loans

- 6.2.1** **G** The rights given to loan-stock holders or other lenders should not undermine the society's compliance with the conditions for registration. The main areas of concern are the constitutional and financial rights which an instrument may confer to the holders of such instrument.

### Constitutional rights

- 6.2.2** **G** A holder of loan stock is one of the society's creditors, and so will not normally have any constitutional rights in the society. However, sometimes the loan stock or another instrument for lending gives the creditor the right to appoint a member of the society's board. This appointment can start at the point the loan is made or in specific circumstances, such as the society running into financial difficulties. This is likely to be acceptable so long as the society complies with its condition for registration by, for instance, not compromising member control of the society.

### Financial rights

- 6.2.3** **G** Loan securities are private contractual arrangements between the society and the holder of the security. There is nothing to prevent a society from issuing loan securities in accordance with its own rules.

- 6.2.4** **G** The rate of interest offered is a commercial matter.

- 6.2.5** **G** If a society uses loans or similar methods to distribute profits this is an indicator that the society is not meeting its condition for registration.

### Conversion of loan stock

- 6.2.6** **G** Loan stock or other debt securities might be issued on the basis that they can be converted into shares in the society at a later stage. The society should consider the factors we have outlined above when it decides what rights it attaches to these shares on conversion.

