



**Withdrawable
share capital**

**Code of Best
Practice on
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May 2018

Code of Best Practice on Withdrawable Share Capital

Introduction

1. This Code was first developed in 2000 by Co-operatives UK with the agreement of HM Treasury and sets out the minimum standards of good practice that a consumer retail co-operative society should observe in their use of Withdrawable Share Capital (WSC). In this context, it is concerned with shares which are withdrawable but not transferable.
2. This Code is for the benefit of consumer retail co-operative societies in managing their ongoing share capital. It is not intended for new start societies planning to raise finance through WSC.
3. The Code was first reviewed in 2004 and amended in 2005, then reviewed again in 2010 and amended in 2011, in both cases in consultation with the Financial Services Authority. The latest review was in 2018, in consultation with the Financial Conduct Authority.
4. An explanation of WSC is set out in the Appendix.

Governing principles

5. The governing principles of this Code are:
 - (a) Societies should take their responsibilities seriously to ensure the accurate, appropriate use and management of WSC, and to act fairly and reasonably in all their dealings with their members in relation to WSC;
 - (b) Societies should ensure that members are fully informed as to the nature of WSC and the risks attached to it, including using the explanation set out in the Appendix below;
 - (c) Information should be provided in the most accessible and easily understood form so members can understand how WSC accounts (Share Accounts) operate. This will include the information being made available in writing at relevant outlets, on the society's website, in other electronic forms as appropriate and in material provided when a Share Account is opened or important changes to terms are made;
 - (d) Societies should ensure literature is available which explains clearly the nature of WSC, the risks attached to it and the terms that apply to it, including timely notice of any changes in the terms and conditions applicable in their case and details of the procedure to be followed to deal with a member's complaint;
 - (e) Where societies have more than one type or class of share, clear information should be provided to members explaining any differences between such different types or classes.

Code of Conduct

Opening Share Accounts

6. Societies should satisfy themselves about the identity of any persons seeking to open a Share Account. Although WSC does not currently fall within the requirements of money laundering regulations,¹ good practice requires that care is taken in this regard. Societies should be mindful of the guidance which accompanies the money laundering regulations² and note that in some circumstances simplified or enhanced due diligence may need to be conducted in order to comply with that guidance.

¹ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017 no.692

² The Joint Money Laundering Steering Group, Prevention of Money Laundering/Combating Terrorist Financing, Part 1, Annex 5 (pages 136-156) 23 June 2017 - <http://www.jmlsg.org.uk/>

7. It is recognised that societies, because they are co-operative and mutual bodies, have an on-going relationship with members through their use of services and democratic engagement. Knowing your members is an important part of being a co-operative; systems used to engage with members are part of this process.

Documents issued before/as a Share Account is opened

8. Before accepting money for WSC from a member or prospective member beyond the minimum required for membership by the society's rules, a society should request the completion of an identification form for anti-money laundering purposes.
9. Members and prospective members must be informed in writing at the earliest opportunity as follows in relation to any type or class of WSC:

"..... Limited ("the Society") follows a Code of Best Practice which obliges it to provide a statement to its members of the nature of their financial interest in the Society and any change affecting it.

- As a member of the Society you are the owner of one or more shares in the Society. If the Society is unable to meet its debts and other liabilities, you risk losing the amount you hold in shares in the Society. Hence the Society's shares are known as risk capital. This may make it inappropriate for you as a place to keep your savings. [Those societies that have share protection schemes may wish to insert a sentence to that effect here, but they should take legal advice before doing so, to ensure that the statement is accurate and fair in relation to the society's specific arrangements.]
- Owning WSC is not the same as investing in the shares of a company. It is primarily for the purpose of supporting the Society in furthering its purpose and objects. There are various important differences between WSC and company shares and these are set out in the Appendix. For example, WSC held in your Share Account may receive interest but will not increase in value.
- The Financial Services Compensation Scheme, which covers bank, building society and credit union accounts, does not apply to your Share Account with the Society, so you cannot claim compensation under the Scheme in the event of the Society not being able to meet requests for withdrawal of shares. This is because the Society does not require authorisation under the Financial Services and Markets Act 2000 to operate WSC. Societies are therefore not subject to supervision either by the Prudential Regulation Authority or by the Financial Conduct Authority in relation to WSC.
- You may withdraw money from your Share Account at any time unless the Society's board of directors has removed this facility under the Society's rules.
- [If the society rules allow for the write down of the value of shares – a statement should be included which clearly explains this]
- The Financial Ombudsman Service does not apply to your Share Account or your relationship with the Society but under the Society's rules any dispute may be the subject of arbitration by[insert as applicable]

If you have any questions regarding the Code please address them to:

X Society Name and Address [Each Society should include here its business name and the address of its Registered Office and relevant Department.]”

Operating Share Accounts

10. To maintain confidence in the security and integrity of their acceptance of WSC, societies recognise that their systems need to be efficient and reliable to protect their members and themselves.

11. For that purpose, societies should retain a record of each transaction on a member's Share Account for at least five years from the date of the transaction as well as retaining customer identification evidence for at least five years after the account is closed.
12. This is in addition to the statutory requirement for a society to keep a register of members including the number of shares held.

Terms and Conditions other than Interest

13. The written terms and conditions of WSC should be in plain language, should provide a fair and balanced view of the relationship between the member and the society and be clearly legible.
14. Societies should tell members how any variation of the terms and conditions will be notified. Societies should give members 30 days' notice before any variation takes effect.
15. Each year, societies shall make available to their members, if there have been sufficient changes to warrant it, a single document to provide a consolidation of the variations made to their terms and conditions over that period.
16. In addition to any further requirements set out in their own rules, societies should not close the Share Account of any member without first giving at least 30 days' notice to the member, unless the closure is at the request of the member.
17. A copy or a summary of the latest Annual Report containing an appropriate audit report should be available to every member on demand for no charge and shall be made available on the society's website. When a Share Account is opened, a member should be made aware of how to access the society's financial information.
18. Societies should explain to members their right to nominate a person to inherit the proceeds of their Share Account on death and how that is to be done.

Interest

19. 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.
20. Societies should refer to paragraphs 6.22 – 6.28 headed "Share interest" of the Financial Conduct Authority's Guidance on the FCA's Registration Function under the Co-operative and Community Benefit Societies Act 2014.³ In particular societies should observe the indicators of compliance with the conditions for registration set out in paragraphs 6.25, and of non-compliance set out in paragraph 6.26.

Advertising of WSC

21. Societies should act responsibly in marketing their WSC. All advertising will comply with the spirit and letter of the British Code of Advertising, Sales Promotion and Direct Marketing, this Code, and other relevant Codes of Practice of similar standing as applicable at the time of the advertisement.
22. For the purpose of this Code the term "advertisement" includes letters to society members, press and broadcast advertisements, direct marketing, window displays, posters, brochures, leaflets, websites, automated teller machine displays and advertisements in any other electronic form.
23. Advertisements must conform to the requirements of clause 10 above (Terms and Conditions other than interest) and the Governing Principles of this Code.
24. Advertisers of WSC must take special care to ensure that members of the general public are fully aware of the nature of any commitment into which they may enter as a result of responding to an advertisement,

³ <https://www.fca.org.uk/publication/finalised-guidance/fg15-12.pdf>

including the risks of WSC and the terms of withdrawal. Fundamentally the purpose of the financial transaction must be to support the society rather than to receive interest.

25. The registered name and address of the society must be clearly stated.

26. Advertisements must:

- a) include the full terms and conditions or state that they are available on request;
- b) clearly state in any part of the advertisement to be retained by the consumer a full postal address at which the advertiser can be contacted during normal business hours and the description and details of the advertised product including the information required by this Code;
- c) state that Share Accounts are not covered by the Financial Services Compensation Scheme.

27. The explanatory phrases and statements required by this Code must be clearly legible.

Advertising Interest

28. Whilst many societies only pay nominal interest in accordance with operating Share Accounts for membership purposes, there are principles in relation to the advertisement of interest which should be followed.
29. Societies should provide members with details of the interest earned by their WSC (including the Annual Equivalent Rate (AER) in respect of the gross rate). This is to allow a member to make a comparison with other interest rates. These should be in the form of published tariffs which will be available in appropriate outlets, on websites or on request.
30. Societies offering different levels of interest must provide AER representative examples for each level.
31. Societies should tell members the basis on which interest is calculated and when it will accrue or be added to their account, as well as the AER. Societies should also explain the basis on which they may vary interest rates.
32. When societies change interest rates with immediate effect they should publicise those changes by notices in their appropriate outlets and websites which include the new AER.
33. Advertisements quoting a rate of interest must contain a specific statement indicating the frequency of payment of interest; and either that
 - a) the rate quoted is fixed for any term specified; or
 - b) interest rates are subject to variation
34. Advertisements should not quote a rate which includes all or part of the original amount placed in the Share Account e.g. 110% return where the original amount plus 10% is paid back.
35. Advertisements quoting a rate of interest which are intended for media or direct mail with long copy dates must contain a suitable qualification, such as “rate correct at time of going to press” and may state that time.
36. Where interest is forfeited on any withdrawal without notice, words such as “instant access” or “immediate withdrawals” must not be displayed together with the rate of interest without clear qualification. Advertisements must also state that the right to withdraw is subject to the power of the society's board to suspend withdrawals or change the required notice period.
37. For Share Accounts which do not allow withdrawals even after notice, without forfeiting interest, the text of the advertisement must include a statement indicating that, if a withdrawal is made, the stated interest rate will not be achieved.
38. Where a maximum or minimum amount must be received to achieve the stated interest rate, the text of the advertisement must include a clear statement to this effect.

Complaints

39. When societies receive a complaint about the operation of this Code, they must investigate it promptly and efficiently. They should notify the member complaining of the procedures being adopted and of further means of redress if they are not satisfied with the initial investigation, including the possibility of arbitration under the society's rules, if applicable.

Monitoring and Compliance

40. This Code is drawn up by Co-operatives UK and is subject to review. Societies operating WSC should include in their annual report a statement of compliance with this Code, or explain where they do not comply.

Appendix

Explanation of withdrawable share capital in a Consumer retail co-operative society

Withdrawable share capital (WSC) in a consumer retail co-operative society is fundamentally different from shares in a company. The following are the key differences, which are explained below:

- WSC is turned into cash by withdrawing the funds, not selling the shares
- WSC does not increase in value
- WSC does not give the member a share in the underlying value of their society
- Co-operative shares do not form the basis for the distribution of surplus
- Co-operative shares do not carry votes in proportion to the shares

Withdrawal not sale

There needs to be a mechanism for a member to realise (turn into cash) the value of their shares in a society. In companies, this is done by selling the shares to somebody else. In co-operative retail societies this is different, because the shares are not transferable. Instead, shares are withdrawable, and a member can realise the value of their shares by withdrawing the money held in shares from the society, subject to any restrictions contained in the society's rules.

No increase in value

Co-operative shares remain at the same (par) value. In other words a member is entitled to their money back, but no more. This is different from a company, where the value of shares can increase or decrease. The reason for this difference is explained in the next point below (Underlying Value).

Underlying value

WSC does not give the member a share in the underlying value of their society, which is why WSC remains at the same value. By contrast, shares in a company do give shareholders a share in the underlying value of the company, which means that if the company was wound up whilst solvent, shareholders would receive a proportionate share of that underlying value (which might be more or less than what was paid for the shares). The Model Rules of UK consumer retail co-operative societies provide that on a solvent winding up, members are entitled to repayment of their WSC, but any remaining surplus after that is transferred to another co-operative society or Co-operatives UK.

Distribution of surplus

The primary mechanism for a co-operative to distribute surplus or profits is via a dividend to members in proportion to their trade with the society. Although a society can pay interest on share capital as compensation to the members for the use of their funds, such interest is not a mechanism to share profits. By contrast, in a company the payment of a dividend to shareholders is the primary mechanism for a company to distribute surplus or profits.

Democratic control

Co-operative societies operate on the basis of one member, one vote, not like companies where there is one vote per share. This means that greater power and influence cannot be achieved in a co-operative by owning more shares.

Note to accompany revised draft Code

The approach to this redraft has been to update it to reflect developments since the last review, and to reflect matters raised in Phase 1 of the Members Money project.

In reviewing the Code, we noted that there are various areas of potential best practice which the Code might cover, if Societies wished it do so, but which would require more extensive consideration and discussion before they could be progressed further. The obvious areas are:

- The monitoring and management of WSC to ensure capital stability
- The approach to be taken in decision-making about rates of interest and whether payment should be made
- The situations in which the board of a society might decide to suspend withdrawals
- The principles to be followed in relation to the repayment of capital where it is restricted, or where a society decides to repay capital that exceeds its requirements

We flag this up in passing, but without expressing a view either way ourselves.

This revised draft reflects discussion with the FCA. Subject to any comments from participating societies (or such other consultation as Co-operatives UK feels to be needed), we would propose to let the FCA see a final version of the draft as a matter of courtesy.