

**Guide to
Building Society
Law, Regulation
& Constitutions**

2009



SCOPE of the Guide

This Guide was compiled by the BSA Legal & Practice Department. It covers the main elements of building society law, regulation and constitutions; in particular –

- the Building Societies Act 1986,
- regulation by the Financial Services Authority, and
- building society constitutional documents and arrangements.

The material in the Guide is drawn largely from the BSA Members' website - revised, updated and brought together in this single, easy-reference, Manual. The Guide –

- is most likely to be of interest to building society officers – especially secretaries – and to lawyers and compliance officers. It is available in paper and electronic formats (on disk and at www.bsa.org.uk/members/index.htm)
- **does not constitute, or replace, legal advice and is not a substitute for a reading of regulations etc. It is in no way regulatory or quasi-regulatory**
- is one in a series of guides on law and regulations affecting building societies; the others are the BSA Guides to –
 - *Residential Mortgage Law & Regulation* (published January 2009)
www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf.
 - *Consumer Credit Law* (July 2009)
www.bsa.org.uk/docs/policy/consumer_relations/consumer_credit_law_guidance.pdf
 - *Personal Savings and Banking Law & Regulation* (planned for early 2010).

The text of this Guide was completed in late August 2009. In the current fast-moving climate, the Guide will become out-of-date and we will address this in the following ways –

- all components of the Guide are on the policy section of the BSA Members' Website www.bsa.org.uk/members/policy/index.htm and this section is regularly updated
- we will publish revised editions of the Guide from time-to-time
- the table that follows the contents section - '*In the Pipeline*' - highlights important developments expected in relation to the subject areas covered by the Guide.

If you have any comments on the Guide, or suggestions for further topics that might be included in future editions, please contact –

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Further Information

The Building Societies Association is the trade association for the UK's building societies. Every building society in the UK is a member of the BSA. Our associate members include other mutual organisations, representatives of the co-operative sector, and suppliers of business services to building societies. The BSA's annual most recent report, for 2008, is at www.bsa.org.uk/docs/publications/ann_report_2008.pdf.

The BSA Members' website is at www.bsa.org.uk/members/index.htm. It contains a wide range of information including policy material, practical guidance, market updates, financial crime alerts, BSA circulars, key statistics, key messages, latest press releases, links to BSA publications such as *Newsbite*, and *Meet the Team* (contact details for BSA staff)

The policy section on the Members' website www.bsa.org.uk/members/policy/index.htm comprises regularly updated policy briefs on all matters affecting building society businesses and operations, such as –

- building society legislation
- constitutional and corporate governance
- consumer relations –
 - Banking Code/Banking Conduct of Business/Lending Code
 - consumer responsibilities
 - consumer law simplification
 - 'fair play' laws, regulations and codes
 - financial capability
 - financial inclusion
 - lost accounts
 - mental capacity
 - treating customers fairly
 - unfair commercial practices
 - unfair terms
- financial crime prevention
- investments and banking
- mortgages
- payments systems
- prudential and financial regulation
- savings policy.

The invaluable leading textbook on building society law, including the Building Societies Act 1986, is ***Wurtzburg and Mills Building Society Law*** (Malcolm Waters QC, Elizabeth Ovey, Kate Selway, Sir Timothy Lloyd QC) - Sweet & Maxwell.

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IN THE PIPELINE

Significant developments expected in relation to subject areas covered by this Guide

Subject	Topic	Date	Page(s)
FSA Handbook of Rules and Guidance	BCOBS – will replace the <i>Banking Code</i>	1 November 2009	123, 141, 156
	PERG 15 – will contain FSA guidance on the Payment Services Regulations 2009	1 November 2009	147
	BIPRU – new liquidity requirements	Late 2009/early 2010	141
	SYSC 19 – Remuneration Code	1 January 2010	136-137
	BSOCS – FSA plans a policy statement in Q4 2009 and implementation early in 2010	Early 2010	141
FSA Mortgage Market Review	FSA plans to publish a discussion paper (in due course, likely to affect MCOB)	September 2009	143
Banking Act 2009	HM Treasury consultation concerning statutory instruments for building societies	Closes 30 October 2009	96
Financial Services Authority	<ul style="list-style-type: none"> The FSA's internal structure will change following its 'supervisory enhancement programme' A Government White Paper <i>Reforming Financial Markets</i> proposes (among other things) new supervisory and enforcement powers for the FSA 	1 October 2009 During 2010: exact dates not decided	127 130
Lending Standards Board	Will replace the Banking Code Standards Board	1 November 2009	156
UK Financial Services Regulation	It is likely that decisions will be made on future arrangements for UK financial services regulation	2010	157

Building Society Law



INTRODUCTION

This section of the guidance provides a commentary on the Building Societies Act 1986 (the 1986 Act). If you would prefer a summary of the 1986 Act, one may be found at www.bsa.org.uk/consumer/factsheets/100003.htm.

Building societies are regulated by the Financial Services Authority (FSA), subject to legislation set out in the 1986 Act. That Act has subsequently been amended on numerous occasions, and was substantively revised by the Building Societies Act 1997 (the 1997 Act) and by the Financial Services and Markets Act 2000 (the FSMA).

The 1986 Act was prescriptive in respect of societies' powers and the way that they were to be exercised. The 1997 Act significantly amended, but did not supersede, the 1986 Act. It replaced the prescriptive powers regime with a permissive regime, thus increasing the commercial freedom of societies and enhancing the scope for increased competition and wider choice for consumers.

The 1986 Act as now amended sets out detailed provisions in relation to the following –

- the constitution of building societies
- limits on raising funds other than from individuals lending other than fully secured on residential property, and restrictions on powers
- certain powers of the FSA
- management of building societies
- accounts and audit
- building society general meetings
- the use of a society's name and use of business names
- maintenance of a register of members
- mergers and transfers of business.

In the guidance below, provisions in the 1986 Act are highlighted in italics.

Obviously, there are many other laws and regulations affecting building societies and their operations eg mortgage law, savings and banking law, financial crime regulations, fairness laws etc. Detailed guidance is provided on the BSA Members' website and through the other Guides in this series – see pages 3-4 above and www.bsa.org.uk/members/policy/index.htm.

ESTABLISHMENT AND POWERS

This sub-section covers the establishment, including the rules for setting up, and powers of a building society, including statutory restrictions on powers.

1. Establishment of a Building Society

(i) The 1986 Act

A building society must have –

- its principal office in the United Kingdom, and
- a purpose or principal purpose of making loans secured on residential property funded substantially by its members

(*section 5(1)*).

A building society is incorporated under the 1986 Act as from the date of registration by the FSA (*section 5(2)*). The last new building society was the Ecology, incorporated in 1981.

The procedures are set out in *paragraph 1 of Part I of Schedule 2*. Briefly, the *Schedule 2* requirements are that a minimum of ten persons –

- must agree the society's purpose, principal purpose, powers and rules, and
- send four copies of the memorandum and rules (signed by ten persons and by the intended secretary) to the FSA.

It is advisable, but not required, to send drafts of the documents in advance.

The BSA website has a FAQ on the matter www.bsa.org.uk/faq/setupnewsociety.

If satisfied that the rules and memorandum conform to the 1986 Act, and that the intended name is not undesirable, the FSA will register the society and issue a certificate of incorporation. There are certain other FSA procedures set out in *paragraph 1*.

There are certain very substantial capital requirements for building societies that require FSA authorisation (see below). Overall, the FSA must be satisfied that the resources are adequate in relation to the regulated activities that a society seeks to carry on (*paragraph 4, Schedule 6 to the FSMA*). Specifically, a society must maintain its own funds of at least £1 million (*Article 5 Banking Consolidation Directive (2000/12)*).

The FSA will open and maintain a public file relating to each building society, which contains documents, or copies, and records required by the 1986 Act to be kept on a public file (*section 106*).

One copy each of the memorandum, the rules, the certificate of incorporation and the certificate of registration will be kept on the public file (*paragraph 4 of Schedule 2*).

If a building society fails to comply with the requirements in *section 5(1)* concerning the definition of its purpose or principal purpose and the location of its principal office, the FSA may exercise the powers in *sections 36 and 37* (to direct restructuring of business etc or to petition for winding up) (*section 5(4A)*).

A society is required to comply, on demand, with a request for a copy of its "statutory documents" - ie its rules (with a copy of the certificate of incorporation annexed) and its memorandum. A member is entitled free of charge to a copy of documents not previously given to that member. Any other person may be required by the society to pay a fee not exceeding the prescribed amount (currently £1). It is a criminal offence for a society not to comply (*paragraph 12 of Schedule 2*).

A building society may change its principal office in accordance with its rules or, if the rules are silent on the point, by ordinary resolution. The Act contains certain administrative requirements (*paragraph 11 of Schedule 2*).

(ii) The FSMA

The FSA prudentially regulates the authorised person (ie the firm, eg a building society or bank) carrying out one or more of a range of activities - including accepting deposits, regulated mortgage contracts, various investment-related activities etc (The Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001 No 544)). For more details, see *Financial Services Regulation* below.

2. Memorandum of Powers

(i) Background

Since the inception of the 1986 Act, the Association has provided societies with model memoranda (see pages 162-169 below). Until implementation of the relevant provisions under the 1986 Act, as amended by the 1997 Act, the content of building society memoranda was constrained by the prescriptive powers regime in the pre-1997 Act legislation.

This meant that, broadly speaking, if the legislation did not say explicitly that a society could exercise a particular power (or it was clearly incidental to a power the society was allowed to exercise) then the society was not permitted to operate that power.

Since the 1997 Act introduced the 'permissive' powers regime, a building society may carry on any activities allowed by its memorandum, subject to certain specific statutory restrictions.

(ii) Statutory Provisions

The provisions of the 1986 Act (as amended by the 1997 Act) relevant to societies' memoranda are as follows.

"Subject to the provisions of this Act, a building society shall have the powers conferred on it by its memorandum" (*section 5(5)*).

Section 5(8) states that *Schedule 2* has effect as respects the powers of building societies; that *Part I of Schedule 2* makes provision with respect to memorandum; and *Part II* makes provision with respect to capacity of a society and powers of its directors to bind it.

In conducting its activities, a society must observe the following statutory provisions -

- (a) the principal purpose,
- (b) the financial limits in *sections 6 and 7* - the lending limit (at least 75% of its business assets must be loans fully secured on residential property) and the funding limit (at least 50% of its funds must be raised in the form of shares held by individual members),

- (c) the restrictions in *section 8* on the categories of deposit accounts which an individual may hold and the prohibition on accepting corporate bodies as members other than by the holding of deferred shares such as permanent interest bearing shares (PIBS),
- (d) certain financial restrictions in *section 9A* (ie not to - act as a market maker in securities, commodities or currencies; trade in commodities or currencies; or enter into transactions involving derivatives, except in relation to hedging),
- (e) the prohibition in *section 9B* on creating floating charges, and
- (f) under *section 92A*, a building society is required to seek the approval of its members to the acquisition or establishment of a significant "non-core" business (*sections 9A, 9B and 92A*).

The memorandum of a building society must (*paragraph 2 of Schedule 2*) -

- (a) state the purpose or principal purpose of the society to be that of making loans that are secured on residential property and are funded substantially by its members,
- (b) specify any other purposes of the society,
- (c) state the name of the society and the address of its principal office, and
- (d) set out the powers of the society.

Any document purporting to be a copy of the memorandum of a building society, and certified by the secretary or other officer of the society to be a true copy of its memorandum as registered, is deemed to be a true copy, unless there is evidence to the contrary (*section 113*).

No memorandum provision is binding to the extent that it would prevent a society from receiving relevant financial assistance from the Bank of England (see Paragraph 8(2) of the Building Societies (Financial Assistance) Order 2008 (SI 2008 No 860).

(iii) Alteration of Powers

A building society may by special resolution (ie at an annual, or special, general meeting) alter its purposes, powers or rules. Any provision in the rules of a society that the memorandum or rules may be altered without a special resolution is void. *Paragraph 4 of Schedule 2* sets out the requirements for alteration of purpose, powers and rules; it is a criminal offence not to comply

A society that has altered its purpose or powers or rules is required to send the FSA –

- three copies of a record of the alteration signed by the secretary and,
- a statutory declaration signed by the secretary that the alteration was effected by a resolution passed as a special resolution and that the record is a true record of the resolution.

Provided the FSA is satisfied that such alterations conform with the legislation, then it will retain and register one copy, return another to the society with a certificate of registration of the alteration, and keep the other copy (together with a copy of the certificate) in the public file of the society.

There is also a requirement that, if a society publishes its rules and memorandum in a consolidated form, a copy be sent to the FSA.

On altering its purpose, powers or rules under *paragraph 4* a society must determine a date on which it intends the alterations to take effect and specify that date in the record of alteration. The alteration will take effect on the specified date or, if registration is not effected until a later date, then that date.

3. Capacity of Society and Powers of Directors to Bind

(i) Background

Paragraphs 16 to 18 of Schedule 2 contain "safe harbour" provisions, in parallel with those in the Companies Act 2006, whereby –

- a building society's capacity is not limited by its memorandum and,
- in favour of persons dealing with a society in good faith, the powers of the directors to bind the society are free from any such limitation.

Before the 1986 Act was amended by the 1997 Act, although the powers of a building society were set out in its memorandum, the permitted extent of those powers derived entirely from the 1986 Act.

The powers of a building society are now as specified in the memorandum - rather than as stated in the Act - subject only to a principal purpose requirement, overall limits on assets and liabilities, the restrictions on certain transactions (see above), and the prudential control of the FSA.

This fundamental change placed building societies in a similar position to companies and accordingly it became necessary to include provisions, equivalent to those under the Companies Act, ensuring a "safe harbour" for third parties dealing with a society in good faith.

This enables them to enforce against the society contracts entered into by the society, despite any limitation in the society's constitution (ie memorandum and rules). A similar provision is needed to enable directors to bind the society free of any limitation on their powers in the society's constitution.

Provisions elsewhere ensure that certain infringements of the legislation - as opposed to the society's constitution - shall not invalidate any transaction or other act - see, for example, sections 6(5), 7(5), 8(4), 9A(1), 36A(12) and 92A(1).

(ii) Capacity of the Society

Paragraph 16 of Part II of Schedule 2 to the 1986 Act broadly mirrors section 39 of the Companies Act 2006. *Paragraph 16(1)* is intended to restrict the doctrine of ultra vires (excess of powers) so that the society and persons dealing with the society can acquire rights and obligations with respect to an act done by the society even though it was not authorised by the society's memorandum.

Later sub-paragraphs preserve, to a limited extent, the rights of society members to seek to restrain ultra vires acts and the duties of society directors in respect of such acts.

Paragraph 16(2) provides that a member may bring legal proceedings to restrain acts that, were it not for *paragraph 16(1)*, would have been beyond a society's capacity.

However, the member will have no such right in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the society. In other words, a member of a building society (like a company shareholder) would not be able to prevent the society from carrying out its contractual obligations even though - but for *paragraph 16(1)* - they had been entered into in excess of powers.

On the other hand, a member would be able to seek an injunction to prevent the society from entering into an ultra vires transaction; or from carrying out an ultra vires act that was entirely within its own control; eg, exercising an option vested in the society or making a gift that had been promised but not completed.

Paragraph 16(3) makes it clear that directors are not absolved from their responsibility to act within the powers of the society. It goes on to provide that a society may ratify, by special resolution, actions by directors which (but for *paragraph 16(1)*) would have been beyond the society's capacity.

This would formalise the position from the society's point of view, but would presumably not affect the third party dealing with the society, who would be protected by *paragraph 16(1)*. Neither would such ratification absolve the directors of any breach of duty - *paragraph 16(4)* specifically provides that relief from such liability must be agreed to by a separate special resolution.

(iii) Power of Directors to Bind the Society

Paragraph 17 broadly mirrors section 40 of the Companies Act 2006 and deals with the extent to which transactions entered into, or authorised by, the board of directors of a society (eg contracts) are binding on the society - even though they contravene a limitation (in the society's memorandum or rules) on the power of directors.

Therefore, *paragraph 16* differs from *paragraph 17* in that the former relates to restrictions on the society's capacity, whereas the latter is concerned with limitations on the *directors'* capacity.

Paragraph 17(1) provides that, in favour of a person dealing with a building society in good faith, the power of the board of directors to bind the society, or to authorise others to do so, is not limited because of anything included in its memorandum or rules.

Therefore, the board can bind the society in favour of a third party acting in good faith, even where the board is acting beyond its powers as set out in the society's constitutional documents. (It should be noted that the position is different where the transaction is between a building society and a director of the society or "connected person"; see *section 66A*).

The next two sub-paragraphs are supplementary and help to clarify what is meant by "a person dealing with a building society in good faith" and by "limitations on directors' powers".

In company law judgment on (what is now) section 40 of the Companies Act 2006 (*EIC Services Ltd v Phipps* [2005] 1 AER 338; 1 WLR 1377) the Court of Appeal held that "a person dealing with the company" did not include a member dealing with the company.

Paragraph 17(2) does not provide an exhaustive definition of "good faith" but makes it clear that a person is not to be regarded as acting in bad faith only because he knew an act was beyond the directors' powers.

To establish bad faith is likely to be difficult in practice. It would require more than simple knowledge of the excess of powers; for example, perhaps where it could be shown that the

third party had conspired with the directors in an illegal transaction. *Paragraph 17(2)(c)* contains a presumption that a person shall have acted in good faith unless the contrary is proved.

Paragraph 17(3) includes (within the reference to limitations on the directors' powers under the society's constitution), limitations deriving from resolutions of the society or agreements between members of the society.

Paragraph 17(4) is intended to ensure that members (though not officers), and persons claiming on account of members or under a society's rules, dealing with the society should have the benefit of the statutory presumption in *paragraph 17(1)* - in spite of the provision in *paragraph 3(2) of Schedule 2* that the rules are binding on the members.

Paragraphs 17(5) and (6) contain provisions, corresponding to those in paragraph 16, giving members limited rights to bring proceedings to restrain acts that are beyond directors' powers and preserving directors' liability for exceeding their powers.

(iv) No Duty of Enquiry on Third Parties

Paragraph 18 relieves a person entering into a transaction with a society of any duty to enquire as to whether the transaction is permitted by the society's memorandum or any limitation on the directors' powers. Again, the same provision applies in relation to companies (section 40 of the Companies Act 2006).

4. Restrictions on Certain Transactions

(i) The Restrictions

Section 9A imposes restrictions on the powers of a building society in relation to transactions in securities, commodities, currencies and derivatives. *Section 9A(1)* provides that a building society may not -

(a) act as a market maker in securities, commodities or currencies (unless the consideration for a transaction, or series of related transactions, in securities or currencies does not exceed £100,000, or where any transaction is entered into in the society's capacity as the manager of a collective investment scheme (*section 9A(2) and (8)*),

(b) trade in commodities or currencies (unless the consideration for a transaction, or series of related transactions, in currencies does not exceed £100,000, or a transaction is ancillary or incidental to another transaction entered into by the society (*section 9A(3) and (8)*), or

(c) enter into any transaction involving derivatives (ie, instruments giving entitlements to investments; options; futures; and contracts for differences), apart from -

(i) a transaction entered into in the society's capacity as the manager of a collective investment scheme (*section 9A(4)(a)*),

(ii) a transaction entered into for the purpose of limiting the extent to which the society or a connected undertaking will be affected by changes in interest rates, exchange rates or any index of retail prices, residential property prices, securities prices or the willingness of one or more persons to pay a sum owed to the society or a connected undertaking (*section 9A(4)(b)* – as amended by the Building Societies (Restricted Transactions) Order 2001 (SI 2001 No 1826)),

(iii) where the transaction involves a derivative investment (being a contract for differences within paragraph 9 of Schedule 1 to the Financial Services Act 1986)

entered into for the purpose of limiting the extent to which an investor or borrower will be affected by changes in interest rates or exchange rates in connection with their share, deposit or loan account with the society or a connected undertaking (*section 9A(4)(c)*), or

(iv) a transaction entered into by a subsidiary undertaking of the society in that undertaking's capacity as a life insurance company (*section 9A(5)*).

The FSA has given guidance on building societies' use of hedging instruments (IPRU(BSOC) – Chapter 4: financial risk management). Most of IPRU (BSOC) has been deleted, but this chapter remains in place.

A building society is required to secure that each of its subsidiary undertakings complies with the restrictions set out above. A contravention of the restrictions in *section 9A(1)* shall not invalidate any transaction or other act.

(ii) Supplementary Provisions

Section 9A(6) requires a society to do all that is reasonably practicable to ensure that, together with any of its subsidiary undertakings, it does not –

- hold more than 5% of the issued share capital, or
- is not entitled to exercise more than 5% of the voting power,

of an undertaking that (or an undertaking a subsidiary undertaking of which) does any of the activities prohibited to the society by *section 9A(1)*.

Section 9A(7) provides that the £100,000 limit in *section 9A(2)* or (3) refers to the time when the transaction is entered into and that where the consideration etc is not in sterling it is to be converted at the rate of exchange prevailing at that time.

Section 9A(9) and (10) defines various terms used in the section.

Section 9A(11),(13) and (14) provides for the restricted activities in *section 9A(1)*, and the exceptions and requirements in *section 9(2) to (10)*, to be modified by a statutory instrument made by the Treasury subject to the affirmative resolution procedure.

Section 9A(12),(13) and (15) provides for -

- (a) the reference to £100,000 in *section 9A(2) or (3)*,
- (b) the 5% limit referred to in *section 9A(6)*, and
- (c) the list of factors in *section 9A(4)(b)*,

to be varied by a statutory instrument made by the Treasury, subject to the negative resolution procedure (ie the SI is automatically approved if there are no objections within 40 days of it being shown to Parliament (ie the SI is automatically approved if there are no objections within 40 days of it being shown to Parliament)).

5. Restriction on Creation of Floating Charges

The 1986 Act prohibits a building society from creating a floating charge over the whole or part of its undertaking or property. Any floating charge so created is void (*section 9B(1 – 2)*). A minor exception is that a building society may create a floating charge when the Bank of

England has provided it with relevant financial assistance (paragraph 7 of the Building Societies (Financial Assistance Order 2008 (SI 2008 No 1427)).

Section 104A allows the Secretary of State for Trade and Industry, by order made by statutory instrument, to provide that appropriate provisions of the Companies Act 2006 shall apply in relation to the registration of fixed charges created by building societies over their assets.

6. Acquisition or Establishment of a Business

A building society must seek the approval of members to the acquisition or establishment of a significant "non-core" business (*section 92A*).

In order for a society to acquire or establish (or allow a subsidiary undertaking to acquire or establish) a significant "non-core" business, the society must resolve to do so by ordinary resolution of the members (*section 92A(1)*). "Ordinary resolution" is defined in *section 119(1)*. The resolution must be the subject of a poll by proxy votes or of a postal ballot (*section 92A(2)*).

The acquisition or establishment of a business requires the approval of members if, in the opinion of the directors, the greater part of the income, resources or activities of the business have no connection with loans secured on residential property ("non-core" business) (*section 92A(2)*).

The Act requires a resolution where –

- the society or a subsidiary undertaking is to acquire a "non-core" business and the consideration to be given for the shares, voting rights or assets amounts to 15% or more of the society's own funds (*section 92A(4)*), or
- a new "non-core" business is to be established by the society or a subsidiary undertaking and the estimated establishment and other "start up" costs to be incurred in the first 12 months after establishment amount to 15% or more of the society's own funds (*section 92A(5)*).

There is provision for appropriate apportionment of the consideration or costs where the society or subsidiary undertaking is acquiring or establishing the business as part of a syndicate (*section 92A(6)*).

For the purposes of *section 92A(1)(a)* and (4), any number of proposed acquisitions which form part of a larger acquisition or series of acquisitions shall be treated as a single acquisition (*section 92A(7)*).

Section 92A(7) is an anti-avoidance provision, preventing the artificial division of an acquisition into a series of smaller transactions below the relevant limit. Presumably this provision applies only where there is some intention to link the acquisitions, rather than the mere fact of two or more acquisitions of similar businesses.

Section 92A does not apply to a transfer of engagements of one building society to another under *section 94* (*section 92A(8)*).

Section 92A(9) provides definitions, including that of the relevant date for taking the society's own funds; normally this is to be the end of the previous financial year.

Section 92A(10) to (12) provides for the 15% figure in *section 92A(4)* or (5), and for the detailed provisions concerning the costs to be included in relation to establishing a new

business in *section 92A(5)* and *(9)*, to be varied by a statutory instrument made by the Treasury, subject to the negative resolution procedure.

Section 75 requires the directors of a society to state in their annual directors' report -

- (a) whether the society has acquired or established, or allowed a subsidiary undertaking to acquire or establish, a business within *section 92A*,
- (b) if so, what the business is and whether the necessary ordinary resolution was passed, and
- (c) if the necessary resolution was not put or passed, why the society nevertheless proceeded, or allowed the undertaking to proceed, with the acquisition or establishment of the business.

A failure to comply with that provision shall not invalidate any transaction or other act, but the FSA would be likely to question a society that disregarded statutory provisions (see FSA Handbook, SUP <http://fsahandbook.info/FSA/html/handbook/SUP>).

CONSTITUTION AND MEETINGS

This sub-section covers the rules of a building society, membership, the register of members, society documents, and general meetings and voting.

1. Rules

(i) General

The main 1986 Act provisions on the constitution of building societies are in Schedule 2 (introduced by *Section 5(8)*) –

- rules and membership (*Part I of Schedule 2*)
- meetings, postal ballots and resolutions (*Part III*).

Any document purporting to be a copy of the rules of a building society, and certified by the secretary or other officer of the society to be a true copy of its rules as registered, shall be deemed to be a true copy, in the absence of contrary evidence (*section 113*).

A society's *rules* cover the internal regulation and arrangements of the society – a society's *memorandum* deals with the society's powers. As such, they – respectively - are similar in principle to a company's articles and memorandum. Some societies regard it as convenient to print their rules and memorandum together in one publication. An excellent discussion of different approaches to rules can be found in *Wurtzburg & Mills Building Society Law* (Chapter 2).

(ii) Content

The rules of a building society are binding on each of the members and officers of the society and on all persons claiming on account of a member or under the rules; and they shall be taken to have notice of the rules (*Paragraph 3 of Schedule 2*). However, nothing in *paragraph 3* shall be taken to authorise any rules provision that contradicts legislation (*paragraph 3(3)*).

No provision in the rules is binding to the extent that it would prevent a society from receiving relevant financial assistance from the Bank of England (*paragraph 2A* inserted by The Building Societies (Financial Assistance) Order 2008 (SI 2008 No 1427). Also, nothing in a society's rules prevents electronic communications under *paragraph 3(5)* inserted by The Building Societies Act 1986 (Electronic Communications) Order 2003 (SI 2003 No 404).

The rules of a society must cover, as a minimum, the matters listed in *paragraph 3(4) of Schedule 2*; such as –

- the name of the society and address of its principal office
- the manner in which funds are to be raised
- arrangements for issue of shares, including preferential or deferred shares (Permanent Interest Bearing Shares - PIBS)
- making and repayment of loans
- ascertainment of, and provision for, losses
- termination of membership
- certain provisions relating to directors and auditors
- the powers and duties of the Board
- the custody of mortgage deeds, etc
- the use of the society's seal
- the calling and holding of meetings, etc

- distribution of surplus assets.

(Paragraph 3(1) of Schedule 2).

This requirement does not prevent a society from having rules on other matters for operational convenience, provided of course that such rules do not contravene the 1986 Act, its subordinate legislation, or any other legislation.

(iii) Alteration of the Rules

Paragraph 4 of Schedule 2 sets out the requirements for alteration of purpose, powers and rules. It is a criminal offence not to comply.

A building society may by special resolution (ie at an annual, or special, general meeting) alter its purposes, powers or rules. Any provision in the rules of a society that the memorandum or rules may be altered without a special resolution is void (*paragraph 4(6)*).

Paragraph 4 requires a society that has altered its purpose or powers or rules to send to the FSA three copies of a record of the alteration, signed by the secretary. The society must also send the FSA a statutory declaration signed by the secretary. The statutory declaration must state that the alteration was effected by a resolution passed as a special resolution and that the record is a true record of it.

The FSA website provides copies of the relevant documents for societies to download and use - www.fsa.gov.uk/Pages/Doing/small_firms/MSR/Building/index.shtml.

Provided the FSA is satisfied that such alterations conform to the legislation, then it will

- retain and register one copy,
- return another to the society with a certificate of registration of the alteration, and
- keep the other copy (together with a copy of the certificate) in the public file of the society.

There is also a requirement that, if a society publishes its rules and memorandum in a consolidated form, a copy be sent to the FSA.

On altering its purpose, powers or rules under *paragraph 4* a society must determine a date on which it intends the alterations to take effect and specify that date in the record of alteration. The alteration will take effect on the specified date or, if registration is not effected until a later date, then that date.

2. Membership

(i) Meaning

A member of a building society is a shareholding member and/or a borrowing member and this must be specified in the society's rules (*paragraph 5(1) of Schedule 2*; see Rule 4(1) of the *Model Rules*).

A minor may be a member, provided there is no restriction in the society's rules, but may not vote, propose a resolution, hold any office in the society, join in requisitioning a special meeting, or nominate - or join in nominating - a person for election as a director of the society (*paragraph 5(3) of Schedule 2*).

(ii) Borrowing Member

A borrowing member is an individual who is indebted to the society in respect of a loan that is fully secured on land or, if the rules provide, in respect of a loan which is substantially secured on land (*paragraph 5(2) of Schedule 2*).

The above definition is qualified as follows -

(a) If the rules provide, an individual ceases to be a borrowing member if the society takes possession of, or exercises its power of sale in relation to, the whole or any part of the land on which the loan is fully secured or obtains a foreclosure absolute (or, in Scotland, foreclosure in respect of the whole or any part of the land) (*paragraph 5(2A) of Schedule 2*).

(Foreclosure is, nowadays, a rarely used alternative remedy to possession and sale whereby an order, at the court's discretion, makes the lender's title absolute, thus transferring legal title to the security from the borrower. See the *BSA Guide to Residential Mortgage Law & Regulation (January 2009)*

www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf.)

(b) *Unless* the rules provide, an individual is not a borrowing member if the loan is owed in equity rather than at law (*paragraph 5(2B) of Schedule 2*). The rules could provide for this if it was envisaged that the society might, at some stage, wish to confer membership on borrowers; for example, where a mortgage book was bought from another lender.

(c) An individual, who is indebted to a society in respect of a loan fully secured on land, is not a borrowing member if the amount of his mortgage debt is less than the prescribed amount (*paragraph 29(2) of Schedule 2*). The "prescribed amount" is currently £100.

The 1986 Act limits a borrowing member's liability at any time to the amount which, at that time, is payable under the mortgage or other security by which his indebtedness to the society in respect of the loan is secured (*paragraph 6(2)*).

The use of the word "individual" in *paragraph 5(2)* means that a corporate body with a secured loan from a society cannot be a borrowing member (but some corporate borrowing members might still exist from the time before the Building Societies Act 1997 introduced this restriction).

(iii) Shareholding Member

A shareholding member as a person who holds a share in the society (*paragraph 5(2) of Schedule 2*).

"Person" includes both an individual and a body corporate, but the latter can be a member only in respect of any share issued before the society's "effective date" for implementation of the 1997 Act changes, or in relation to deferred shares (PIBS).

The term "share" must be interpreted in accordance with *section 8 (Section 119)*. Rule 1(a) of the *Model Rules* defines a share as a share account opened or a share issued by the society -

- (a) in return for payment, or
- (b) in pursuance of the fulfilment by the society of the engagements of another society, or
- (c) by way of capitalisation of interest credited,

and including stock or part of or fraction of a share.

The liability, at any time, of a shareholding member is limited to the amount, which, at that time, has actually been paid, or is in arrear, on his shares in the society (*Paragraph 6(1) of Schedule 2*).

(iv) Joint Shareholders and Joint Borrowers

Where two or more persons jointly hold shares in a building society, the first named in the society's records is known as the "representative joint holder" and has the main membership rights (*paragraph 7(1) to (2) of Schedule 2*).

This has a number of obvious consequences -

- (a) unless the rules provide otherwise, notices or other documents sent to the representative joint holder will be deemed to have also been sent to the other joint holder(s) (*paragraph 7(3)*),
- (b) only the representative joint holder is entitled to vote in an election of directors or on a resolution of the society (*paragraphs 7(4) and 8(4)*),
- (c) it has been the case so far that usually only the representative joint holder has received share distributions or cash payments where societies have transferred the business on a takeover or conversion to plc status.

Some rules preclude members, other than the representative joint shareholder from attending meetings, but it is understood that some societies no longer impose this requirement.

Broadly speaking, the second (or subsequent) named, although still a member, has fewer rights - ie to obtain on demand a copy of the summary financial statement, the annual accounts and the annual business statement.

In relation to joint accounts, the 1986 Act is silent on the exact time when, upon the death of the representative joint shareholder, the second named becomes sole/first named. Societies usually make it clear in their literature whether it is the date of death or the date of notification of death or the date on which the society's records/register of members is amended.

Very similar provisions to those in *paragraph 7* are set out in *paragraph 8* in relation to joint borrowers.

Both (or all) joint shareholders and joint borrowers are entitled to choose the order in which they are named in the records of the society. In practice, this is usually made clear to those applying to become shareholders and borrowers. *The Banking Code* also contains provisions about this matter, but the Code will be replaced (from 1 November 2009) by BCOBS – see pages 132 and 141 below.

(v) Termination of Membership

The rules cover this matter; see www.bsa.org.uk/docs/policy/model_rules.pdf. The BSA has provided building society chief executives with guidance on termination of membership.

3. Register of Members

(i) Duty to Maintain

Every building society must maintain a register of members showing the name and postal address of each member and whether each member is a shareholding or borrowing member or both (*Paragraph 13(1) of Schedule 2*). The register must, in relevant cases, show who is a representative joint holder or borrower - *paragraphs 7(7) and 8(7)*.

If notified by the customer, the register must also show the customer's electronic address and purposes for which the customer notified the electronic address (*paragraph 13A*).

A society must keep the register at the principal office, or such other place or places as the directors see fit. It is a criminal offence to fail to maintain a register of members. How the register is constructed (eg in what form) is a matter for each society (see *paragraph 15(6)*).

(ii) Applications for Access

A member may make a written application to the FSA for the right to obtain names and addresses from the society's register (*paragraph 15(2) of Schedule 2*).

The member must be qualified under the society's rules to join in a members' requisition for a special meeting, or to join in nominating a person for election as a director (ie applications would normally be accepted only from two year "qualifying members").

The applicant must pay a fee of £25 (or such other amount as may be prescribed - see *paragraph 15(9) and (10)*).

Slightly different provisions apply if the society in question has had its authorisation revoked and it has not been re-authorised.

If the FSA is satisfied that the applicant requires the right for the purpose of communicating with members of the society on a subject related to its affairs and that the applicant has not (since the application) voluntarily ceased to be a member, it may direct that the applicant should have the right to obtain from the register the names and addresses for the purpose of communicating with them on that subject.

The FSA must have regard to the interests of the members as a whole and to all other relevant circumstances. Any direction may be given subject to such limitations and conditions as the FSA thinks fit.

Before giving a direction, the FSA must give particulars to the society concerned and permit the society to make representations, if it wishes. In addition, the applicant or the society may, if either wishes, be given the opportunity of a hearing (*paragraph 15(4)*).

Paragraph 15(5) to (8) prescribes the arrangements for compliance with a direction under this paragraph. The society must provide necessary information and facilities to the member, but is only obliged to disclose names and addresses. The information given is confidential and there are criminal penalties if the information is disclosed without the consent of the member to whom the information relates.

The FSA's guidance on application for access now appears in the FSA Handbook at BSOG 1A .

Most of the BSOG 1A derives from guidance originally prepared by the Building Societies Commission, during the 'carpetbagger' activist period of the late 1990s. It was subsequently moved to IPRU(BSOC) before being transferred to BSOG. The material contains some very important information in relation to applications to access.

4. Society Documents

(i) Duties to Send Documents

A society is exempt from any obligation imposed by the Act, or by its rules, to give or send notices or other documents to members, if the society has reason to believe that communications sent to the member at his registered address are unlikely to be received by him (*section 5(9) and paragraph 14 of Schedule 2*).

However, where the requirement relates to a notice of a meeting or a postal or electronic ballot, the society must instead comply with the advertising requirements set out in *paragraph 35*; namely, that notice of the holding of the meeting or of the postal ballot must be given either -

- (a) by displaying a notice in a prominent position in every branch office, or
- (b) by advertisement in one or more newspapers circulating in the areas in which the members of the society reside,

according as the rules of the society provide.

The society must give this notice not later than 21 days before the date of the proposed meeting or, as the case may be, the final date for the receipt of completed ballot papers.

The notice must state where members may obtain copies of the resolutions and any statements with respect to the matter referred to in a resolution, forms relating to voting by proxy and, in the case of a postal ballot, the ballot papers. In the case of an electronic ballot, the notice must state how members may access electronic voting facilities.

(ii) Copies of Statutory Documents

A building society must comply, on demand, with a request for a copy of its "statutory documents" (namely, its rules (with a copy of the certificate of incorporation annexed) and its memorandum) (*paragraph 12 of Schedule 2*).

A member is entitled free of charge to a copy of documents not previously given to that member. The society may require any other applicant to pay a fee not exceeding the prescribed amount (currently £1). It is a criminal offence for a society not to comply.

5. Meetings and Votings

The guidance that follows deals only with the legislative provisions. Practical guidance on preparing and running general meetings can be found on pages 191–226 below.

(i) The Combined Code on Corporate Governance

A revised Combined Code on Corporate Governance, for listed companies, came into effect in June 2006 and applies to reporting years beginning on or after 1 November 2006. Building societies are not obliged to follow the Combined Code, but the FSA encourages

them to 'have regard to it when establishing and reviewing their own corporate governance arrangements'.

Most of the Code relates to the constitution and accountability of Boards; topics concerning directors, such as performance evaluation and remuneration; and relations with shareholders. However, some limited aspects are broader and relevant to some of the matters covered in this Brief - notably Annual General Meetings (AGMs) and shareholder voting.

In September 2004, the BSA issued an annotated version of the 2003 Code to assist building societies in adhering to the elements of the Combined Code that are relevant to the sector. This was updated in most recently in September 2008 to reflect the most recent revision of the Combined Code -

www.bsa.org.uk/publications/industrypublications/100667.htm.

The annotated Code gives guidance to societies on alternative approaches where the Combined Code is not directly applicable, such as the where the Code refers to 'institutional investors' – a concept that does not apply to building societies as all members are individuals. The paragraphs that follow do not deal specifically with the requirements of the Combined Code, but focus on the 1986 Act provisions.

(ii) Electronic Communications

The Building Societies Act 1986 (Electronic Communications) Order 2003 (SI No 2003 No 404) (the Electronic Communications Order) came into effect on 20 March 2003. The Electronic Communications Order enables building societies, if they wish, to communicate with their members on constitutional matters, eg summary financial statements, notices of meetings, voting etc. For more information on electronic communications, see pages 103-108 below.

The Electronic Communications Order amended the 1986 Act to allow building societies to make and receive electronic communications. The paragraphs that follow refer to the amendments, in context. Briefly, the matters covered in relation to meetings, voting etc are as follows –

- **Notice of a meeting** - *paragraphs 22A and 22B in Schedule 2*
- **Notice of postal ballots** – *33(1A), (5A) to (5D), (6A) to (6C) and (7A)*
- **Appointment of proxies** – *24(1A) and (1B)*
- **Electronic ballots** – *33(A)*
- **Notices and statements in connection with a members' resolution**
– *32(2A), (2B), (2C), (2D), and (3A)*
- **Statement of matters to be dealt with at a special meeting of the society**
– *20A(1A), (1B) and (11A)*
- **Directors' election addresses** – *section 61 (7A) to (7E).*

By 2006 AGMs, at least three societies had organised an electronic voting facility, with a number of others advanced in their plans to do so at future AGMs.

(iii) Annual General Meetings

A building society must hold its AGM in the first four months of each financial year and specify the meeting as such in the notices calling it (*paragraph 20 of Schedule 2*). If a society fails to do so, the FSA may call, or direct the calling of, an AGM in that financial year, and give such ancillary or consequential directions as it thinks expedient. It is a criminal offence not to hold the meeting or to fail to comply with the FSA's directions.

However, a society is not obliged to hold an AGM in the calendar year in which it is incorporated.

Irrespective of anything in a society's rules, the business which to be dealt with at the AGM must include any resolution whether special or not.

(iv) Notice for Calling Meetings

21 days notice is needed to call a meeting of a building society, unless the rules provide for longer notice of the meeting to be given (*paragraph 21(1)*). Any rules provision to the contrary is void. Where a notice complies with paragraph 21, the law regards notice as complying with the society's rules.

Notice is usually regarded as referring to clear days. Thus, a typical timetable for a society with a financial year-end of 31 December would run -

2 April	Last date for receipt of notices by members
3 April	23 clear days start to run
23 April	Proxies must be received not later than this date so under paragraph 21(1) the statutory notice period expires on this date
25 April	Last of 23 clear days before the meeting
26 April	Day of meeting

This meets *paragraph 21(1)*, and Model Rule 48(2) provides that a notice be deemed to have reached the member 72 hours after it has been posted. Societies should be careful, however, when constructing such a timetable to ensure that, for example, the last date for receipt of proxies does not fall on a Sunday when there is no postal delivery.

The society must give notice to every member who would be eligible to vote at the meeting if the meeting were held on the date of the notice. The society must also give notice to every person -

- (a) who becomes a shareholding or borrowing member of the society after the date of the notice and before the specified date; or
- (b) who, being such a member at the date of that notice, attains the age of 18 after that date and on or before the date of the meeting,

and who would (in either case) be eligible to vote at the meeting if he remained such a member until the date of the meeting (*paragraph 22*).

"The specified date" means the date specified by the society as the final date for the receipt of instruments appointing proxies to vote at the meeting.

Accidental omission to give notice of a meeting to, or non-receipt of notice of a meeting by, any person entitled to receive notice of the meeting does not invalidate the proceedings at that meeting (*paragraphs 22(3)*).

A society may send a notice of a meeting electronically to an electronic address that the recipient has notified to the society. The Act treats such a notice as given on the day that

the society transmits it (*paragraph 22A*). The Act also provides for publication of notices on a web site (*paragraph 22B*).

(v) Entitlement to Vote on Resolutions

Generally speaking, a member of a building society is entitled to vote -

- (a) on an ordinary resolution or a special resolution if he was, at the end of the last financial year before the voting date, and is, on that date, a shareholding or borrowing member of the society;
- (b) on a shareholding members' resolution, if he was, at the end of that year, and is, on that date, a shareholding member of the society; and
- (c) on a borrowing members' resolution if he was, at the end of that year, and is, on that date, a borrowing member of the society.

(*paragraph 23(1) of Schedule 2*).

This entitlement is subject to certain exceptions –

- It does not apply to **minors, joint shareholders and joint borrowers** - *paragraphs 5(3), 7(4) and 8(4) of Schedule 2* (see Membership above).
- If the rules of the society so provide, it is also subject to a **qualifying shareholding requirement**.

A shareholding member is not entitled to vote on an ordinary resolution or a special resolution as such a member, or to vote on a shareholding members' resolution -

- (a) if he did not have a qualifying shareholding at the qualifying shareholding date; or
- (b) if he ceased to hold shares at some time between that date and the voting date.

(*paragraph 23(3)*).

Where a building society's rules make such provision, a shareholding member shall be taken to have had a qualifying shareholding at the qualifying shareholding date if he had such a holding -

- (a) at the end of the last financial year before the voting date, except where (b) below applies; or
- (b) in a case where the voting date falls during that part of a financial year which follows the conclusion of the AGM commenced in that year, at the beginning of the period of 56 days immediately preceding the voting date for members voting in person at a meeting or, as the case may be, on a postal ballot.

A member of a building society has a "qualifying shareholding" at any time if at that time he holds shares in the society to a value not less than the prescribed amount or such lesser amount as may be specified in the rules. The current maximum, permitted by *paragraph 36*, is £100.

Apart from the exceptions set out above, any provision in the rules of a building society is void to the extent that it would restrict the rights conferred on members by *paragraph 23(1)*.

"Voting date", with reference to any resolution, means -

- (a) the date of the meeting at which the resolution is to be moved, except where (b) or (c) below applies,
- (b) where voting on the resolution is to be by postal ballot, the date that the society specifies as the final date for the receipt of completed ballot papers,
- (c) in the case of a member appointing a proxy to vote instead of him at a meeting, the date that the society specifies as the final date for the receipt of instruments appointing proxies to vote on that resolution.

(vi) Proxies

A member of a building society, who is entitled to attend and vote at a meeting of the society, may appoint another person as proxy, to attend and to vote at the meeting instead of the member. The member may direct the proxy how to vote at the meeting. A proxy is entitled to vote on a poll but, subject to any provision in the rules of the building society, not otherwise (*paragraph 24 of Schedule 2*).

A person lawfully appointed a proxy by a member (entitled to attend and vote at the meeting) may act as proxy even if, later, the member ceases to be so entitled.

Every notice calling a meeting of a building society must contain a reasonably prominent statement that -

- (a) a member entitled to attend and vote may appoint a proxy (or, where it is allowed, one or more proxies) to attend and vote at the meeting instead of him,
- (b) the proxy need not be a member of the society, and
- (c) the member may direct the proxy how to vote at the meeting (and contain a provision enabling such direction).

(*paragraph 24(4) and (4A)*).

Although a proxy does not have a legal right to speak at the meeting, an optional provision to allow this is often included in societies' rules. (The Companies Act 2006 allows proxies to vote and speak at meetings despite a provision to the contrary in the company's articles - section 324(1)).

A society's rule will be void if it requires the appointment of a proxy to be received by the society (or any other person) more than seven days before a meeting in order for the appointment to be effective (*paragraph 24(6)*).

The Act provides for electronic appointment of proxies in certain circumstances (*paragraph 24(1A) and (1B)*).

It is a criminal offence to fail to comply with the provisions in *paragraph 24* in respect of a meeting of a building society or in respect of a form of appointment of a proxy.

In August 2006, the Association consulted with societies, among other things in the context of the Combined Code (see above), about the inclusion of a 'vote withheld' option to be included on proxy appointment forms.

(vii) Methods of Voting at Building Society Meetings

The following table outlines the different options for voting.

A **show of hands** is the traditional method of voting called by the Chairman at the appropriate stage of the proceedings. It is separate from a poll, which includes proxy votes. Only members – not proxies – may vote on a show of hands. Often, a vote is first taken by show of hands, before going on to a poll.

A **poll** is the taking of a vote at a general meeting. It includes proxy votes. A typical reason for demanding a poll is to admit the votes given by proxy into the count. A related reason is to ensure that votes are properly and accurately recorded. A proxy may demand, or join in demanding, a poll (*paragraph 25(2)*).

If a poll is demanded and taken, the usual method is for each member who is entitled to vote to sign a paper headed "for" or "against" the resolution. Resolutions must be put to the poll separately, although they may be included on one piece of paper.

The instrument appointing a proxy to vote at a meeting of a building society shall be taken also to confer authority to demand or join in demanding a poll; and a demand by a person as proxy of a member shall be the same as a demand by the member.

A society's rules may (and invariably will) contain a provision allowing for **postal ballots** – ie a vote by post (see below). It is especially useful for elections, such as director elections, where there are a number of candidates and helps ensure secrecy. Society rules may also provide for **electronic ballots** (see *paragraph 33 A*).

(viii) Polls

Any provision contained in a building society's rules shall be void if it has the effect either -

- (a) of excluding the right to demand a poll at a meeting of the society on any question (other than the election of a chairman of the meeting or the adjournment of the meeting), or
- (b) of making ineffective a demand for a poll on any such question made by not less than ten members having the right to vote at the meeting.

(paragraph 25 of Schedule 2).

(ix) Resolutions

- **Ordinary resolution**

An ordinary resolution is one that will be effective without being passed as a special resolution, shareholding members' resolution or borrowing members' resolution. Accordingly, this resolution is required to be passed by a **simple majority** of those entitled to vote and actually voting.

The purposes of such resolutions are governed by societies' rules (for example, election of directors, appointment of auditors etc).

Since the changes made by the 1997 Act, borrowing members have equal voting rights with shareholding members on ordinary and special resolutions (except in relation to the separate shareholders' and borrowers' resolutions on mergers and transfers to plc.

- **Special resolution**

A resolution of a building society may be passed as a special resolution only if this is required by the 1986 Act or by the society's rules of the society (*paragraph 26 of Schedule 2*).

A special resolution must be passed by **not less than three-quarters** of the number of the members qualified to vote on a special resolution, and voting either -

- (a) in person or by proxy on a poll on the resolution at a meeting of the society of which notice specifying the intention to move the resolution as a special resolution has been duly given, or
- (b) in a postal ballot on the resolution of which notice specifying that the resolution will not be effective unless it is passed as a special resolution has been duly given

(*paragraph 27*).

The purposes of special resolutions include –

- alterations of purpose, powers or rules (*paragraph 4(1) of Schedule 2*)
- change of name (*paragraph 9(3)*)
- payment of compensation for loss of office on amalgamation or transfer of engagements (*section 96(1)*)
- payment of compensation for loss of office on transfer of business (*section 99(2)*)
- winding up of the society (*section 88(1) and 89(1)*).

- **Shareholding members' resolution and borrowing members' resolution**

A resolution may be passed as a shareholding members' resolution only if this is required by the 1986 Act or by the rules of the society (*paragraph 26 of Schedule 2*).

A shareholding members' resolution must be passed by **not less than three-quarters** of the number of the shareholding members of the society -

- (a) qualified to vote on a shareholding members' resolution; and
- (b) voting in person or by proxy on a poll on the resolution at a meeting of the society of which notice specifying the intention to move the resolution as a shareholding members' resolution has been duly given

(*paragraph 27A*). (See also the definition of a shareholding member - above)

A resolution may be passed as a borrowing members' resolution, only if this is required by the 1986 Act or by the rules of the society (*paragraph 28*).

A borrowing members' resolution must be passed by a simple majority of the borrowing members of the society voting in person or by proxy on a poll on the resolution at a meeting of the society of which notice specifying the intention to move the resolution as a borrowing members' resolution has been duly given (*paragraph 29*).

Where a borrowing members' resolution approving a transfer of engagements by a building society is moved, only those borrowing members whose mortgages are to be transferred shall be entitled to vote on the resolution. (See also the definition of a borrowing member - above.)

The purposes of borrowing members' resolutions and shareholding members' resolutions are the same and include –

- approval of amalgamations (*section 93(2)*)
- transfers of engagements (*section 94(2)*)
- undertakings to fulfil the engagements of another society (*section 94(5)*)
- bonuses to members on amalgamations or transfers of engagements (*section 96(4)*)
- transfers of business (*section 97(4) and paragraph 30(1) of Schedule 2*).

For further information on mergers and transfers of business see the guidance below on dissolution, winding up, mergers and transfers (pages 96-102).

- **Transfer resolution**

The transfer resolutions required for the purposes of section 97 are covered in *paragraph 30 of Schedule 2*.

(x) Postal Ballots

The rules of a building society may provide for the voting in an election of directors or on any resolution of the society (other than a shareholding members' resolution or a borrowing members' resolution) to be conducted in all, or in any particular, circumstances by postal ballot (*paragraph 33 of Schedule 2*).

Notice of a postal ballot must be given not less than 21 or more than 56 days before the date that the society specifies as the final date for the receipt of completed ballot papers ("the voting date").

The notice must be given -

(a) to every member of the society who would be entitled to vote in the election or on the resolution if the voting date for the election or the resolution fell on the date of the notice, and

(b) to every person who becomes a shareholding or borrowing member of the society after the date of the notice and before the voting date;

or who, being such a member at the date of that notice, reaches the age of 18 after that date and on or before the voting date,

and who would (in either case) be eligible to vote in the election or on the resolution if he remained such a member until that date.

Notice of a postal ballot -

(a) must contain such other notices relating to the election or resolution, and

(b) must be accompanied by such other documents,

as would be required to be given or sent to a member in connection with notice of a meeting, had it been intended to hold the election or vote on the resolution at a meeting instead of by postal ballot (with the exception of any notice relating to voting by proxy at a meeting).

Accidental omission to give notice of a postal ballot, or to send any document to accompany such a notice, to any person entitled to receive it, or non-receipt of such a notice or document, does not invalidate the postal ballot (*paragraph 33(7) of Schedule 2*).

The rules of a society may provide for the use of electronic communications in the conduct of a postal ballot, ie electronic notice of postal ballots and accompanying documents (*paragraphs 33(1A), (5A), (5B), (5C), (5D), (5E), (6A), (6B) and (7A)*).

(xi) Electronic Ballots

A society may hold an electronic ballot, if its rules provide for one. *Paragraph 33A of Schedule 2* sets out the arrangements for electronic ballots.

(xii) Declarations in Proxy and Ballot Forms

In the case of a society member who purports to exercise the right to -

- (a) appoint a proxy to vote instead of the member at a meeting of the society, or
- (b) vote in a postal ballot, or
- (c) vote on a poll at a meeting of the society,

but who fails to make a declaration (as specified below) in the instrument of appointment or on the voting paper, the appointment made or the vote cast is invalid (*paragraph 34*).

The declaration must -

- (a) declare that the member has reached 18 years, or will have by the voting date or, where voting by proxy, by the date of the meeting,
- (b) where the vote is to be cast on a shareholding members' resolution, declare that on the voting date the member is or, as far as the member can reasonably foresee, will be a shareholder of the society;

and a qualifying shareholding on the qualifying shareholding date is required to vote, that the member had or, so far as the member can reasonably foresee, will have such a shareholding on that date,
- (c) where the vote is to be cast on a borrowing members' resolution, declare that on the voting date the member is or, so far as he can reasonably foresee, will be a borrowing member of the society, and
- (d) where the vote is to be cast on an ordinary or special resolution, declare either as mentioned in paragraph (b) above, or as mentioned in paragraph (c) above, or both.

A society must ensure that every document issued by it for use as a voting paper or as an instrument for the appointment of a proxy incorporates a form of declaration under *paragraph 34* for completion by the member using it.

Failure to comply with the requirements in *paragraph 34* is a criminal offence.

(xiii) Members' Right to Propose and Circulate Resolutions

- **Nature of the right**

If at least the requisite number (see below) of qualified members of a building society give notice to the society of their intention to have moved on their behalf an ordinary or special resolution specified in the notice at an AGM of the society, then the society must -

- (a) include in the AGM notice of the AGM a notice specifying the intention to have the resolution moved on their behalf at the meeting and, where applicable, the intention to move it as a special resolution, and
- (b) at the request of the members intending to have the resolution moved on their behalf, send to each member entitled to receive notice of the meeting a copy of any statement of not more than 500 words with respect to the matter referred to in the resolution.

(*paragraph 31(1) of Schedule 2*).

It is a criminal offence for a society to fail to comply with this requirement (*paragraph 31(8)*).

"**The requisite number**" is -

- (a) in the case of a society with commercial assets of £100 million or more, 500 or such lesser number as is specified for the purpose in the rules of the society, and
- (b) in the case of any other society, 100 or such lesser number as is specified for the purpose in the rules of the society.

(The requisite number is defined by *paragraph 31(2)(a)* as amended by the Building Societies (Members' Resolutions) Order 1997 (SI 1997 No 2840) and by the Building Societies (Members' Resolutions) Order 1999 (SI 1999 No 3033)).

Every member of a building society is a "qualified member" unless the rules make other provision. However, any provision contained in the rules shall, in relation to proposal of members' resolutions, be void if it requires a qualifying member -

- (a) to hold or have at any time held shares in the society to a value greater than the prescribed amount (by *paragraph 36*, £100) in force on the qualifying date, or
- (b) to have held shares in the society at any time before the commencement of the period of two years ending with the qualifying date.

The qualifying date for these purposes is the date on which the notice is given to the society under *paragraph 31(1)*.

Paragraph 32 contains a number of supplementary provisions concerning members' right to propose and circulate resolutions.

- **Qualifications on the right**

A building society does not have to send notices of a resolution or copies of a statement to members of the society if –

- (a) publicity for the resolution or the statement would be likely to diminish substantially the confidence in the society of investing members of the public,

(b) the rights conferred by paragraph 31(1) are being abused to seek needless publicity for defamatory matter or for frivolous or vexatious purposes,

(c) in respect of a resolution or statement which does not relate directly to the affairs of the society, or

(d) as long as the society's rules provide, the resolution is in substantially the same terms as any resolution defeated in the period covered by the last three AGMs.

(paragraph 31(4) and (5))

(e) as long as the rules provide, the resolution would purport to interfere with the Board's right and duty to manage the affairs of the society - this derives from the judgment in *Hickmott v Woolwich Equitable Building Society* (1974) Reg.Rep.

The FSA has a duty to hear and determine any dispute arising under (a) above, whether on the application of the society or of any other person who claims to be aggrieved (*paragraph 31(7)*). The courts would determine any disputes over the other qualifications.

Electronic communication of notices and statements in connection with a members' resolution are dealt with in *paragraphs 32(2A) to (2D) and (3A) of Schedule 2*.

(xiv) Special Meeting on Members' Requisition

Paragraphs 20A and 20B of Schedule 2 deal with arrangements for members to requisition special meetings. *Paragraphs 20A(1A), (1B) and (11A)* make modifications, in this context, for the use of electronic communications.

- **Nature of the right**

On a members' requisition, a building society must -

- (a) duly call a special meeting, and specify the meeting as such in the notice calling it, and
- (b) if so required by the requisition, send to each member entitled to receive notice of the meeting a copy of a statement of not more than 500 words with respect to the matters to be dealt with at the meeting.

No business may be conducted at such a meeting other than that stated in the notice calling it (*paragraph 20A(1)*, but also see *paragraph 20A(8)(b)* below).

A members' requisition needs not less than the requisite number of members society members - currently 500, or a lower number if specified in the society's rules.

The requisition -

- (a) must state the objects of the meeting, be signed by the requisitionists and be deposited at the society's principal office, and
- (b) may consist of several documents in like form each signed by one or more requisitionists and each after the first deposited within three months of the date on which the first was deposited.

(paragraph 20A(3)).

Where the requisition consists of several documents, the date of its deposit shall be taken to be the date on which the document signed by the requisitioner making up the requisite number is deposited at the society's principal office.

The rules of the society may require a requisitioner -

- (a) to state his full name and address
- (b) to fulfil one or other of the following conditions, namely -
 - (i) to have been a shareholding member for a specified period and to hold, or to have held at any time during that period, shares in the society to such value (not greater than the prescribed amount) as is specified in the rules, and
 - (ii) to have been a borrowing member for a specified period and to owe to the society, or to have owed to the society at any time during that period, a mortgage debt of such amount (not greater than the prescribed amount) as is so specified, and
- (c) to identify a share or mortgage account with the society which will evidence the fact that he fulfils one or other of those conditions.

(paragraph 20A(5)).

"Specified period" means such period (not more than two years) before the date of the requisition as is specified in the rules. By *paragraph 36*, the prescribed amount is £100.

Any objection to the requisition must be made within 14 days of the being deposited at the society's principal office.

The rules of the society may also require a sum of money, not exceeding £50 per requisitioner (this sum may be changed by order: *paragraph 20A(13)*) to be deposited with the requisition and, where any money is so deposited, it shall be forfeited to the society, or returned to the persons who deposited it, as provided by the rules www.bsa.org.uk/members/circular/6548.htm.

The rules must not provide for any deposited money to be forfeited to the society except -

- (a) where a quorum is not present within half an hour after the time appointed for the meeting, or
- (b) where and to the extent that those eligible to vote at the meeting decide by ordinary resolution that the money should be applied to defray the whole or any part of the expenses of holding the meeting (*paragraph 20A(8)*).

Accidental omission to send a copy of the statement to a member entitled to receive one, or the non-receipt of such a copy by such a member does not invalidate the proceedings at the meeting.

The FSA must hear and determine any dispute arising in relation to members' requisition of meetings, whether on the application of the society or of any other person who claims to be aggrieved.

- **Qualifications on the right**

If the rules of a society so provide the society is not obliged -

(a) to call a special meeting if the only or main object of the meeting is to move a resolution in substantially the same terms as any resolution which has been defeated at a meeting or on a postal ballot during the period beginning with the third AGM before the date the requisition is deposited at the society's principal office, or

(b) to call a special meeting to be held during the period of four months beginning one month after the end of its financial year (*paragraph 20A(9)*).

The society is not obliged to send copies of a statement to members entitled to receive notice of a meeting if -

(a) the statement does not relate directly to the affairs of the society, or

(b) publicity for the statement would be likely to diminish substantially the confidence in the society of investing members of the public, or

(c) the right to receive a copy of the statement is being abused to seek needless publicity for defamatory matter or for frivolous or vexatious purposes (*paragraph 20A(10)*).

(d) as long as the rules provide, the resolution would purport to interfere with the Board's right and duty to manage the affairs of the society - this derives from the judgment in *Hickmott v Woolwich Equitable Building Society* (1974) Reg.Rep.

- **Failure to comply with members' requisition**

Where a members' requisition is deposited at a building society's principal office then, if the society does not within 28 days from the date of the deposit of the requisition duly call a meeting to be held within 63 days from that date -

(a) the requisitionists, or any proportion of them exceeding one half, may themselves call a meeting to be held within five months from that date; and

(b) no business shall be conducted at a meeting so called other than that stated in the notice calling it or (where applicable) that mentioned in *paragraph 20A(8)(b)*

(*paragraph 20B*).

The meeting must be called as near as possible in the same manner as the society has to call meetings.

By *paragraph 20B(4)* -

(a) as *paragraph 20A(1)(b)* above requires the society to send to each member entitled to receive notice of the meeting a copy of a statement of not more than 500 words with respect to the matters to be dealt with at the meeting; and

(b) if the society does not comply with the requisition within 28 days from its deposit, the requisitionists (or any proportion of them exceeding one half) may send a copy of the statement to each such member. In practice, it is difficult to see how they could do this without access to the register of members and considerable funding.

If the rules of the society make provision as mentioned in *paragraph 20A(9)(b)* above, any days falling within the period there mentioned are disregarded in determining any period for the purposes of *paragraph 20B(2)* or *(4)(b)* above.

The society must repay any reasonable expenses incurred by the requisitionists because of its failure to call a meeting or to distribute a copy of the statement. The society may recover the money from the directors responsible for the failure. (by the retention of fees or other remuneration in respect of services or otherwise).

LENDING

This sub-section covers the 1986 requirements regarding mortgage lending by building societies.

1. Significance of the Lending Provisions

The lending provisions are relevant, not to powers (which are mainly governed by the society's memorandum), but to -

- classification of assets - because only loans fully secured on residential property can be counted towards "Y" in relation to the lending limit, and
- eligibility for borrowing membership (since only individuals who are indebted to the society in respect of loans fully secured on land have to be made borrowing members. The rules can extend such membership to individuals where the loan is substantially secured on land (see below).

For *either* purpose, a society must determine whether or not a loan is –

- secured on land
- "fully" secured.

And, for classification of assets only, whether the loan is –

- fully secured on residential property.

The text deals with these matters in a logical order (starting with an explanation of the lending limit mechanism).

2. The Lending Limit

(i) The Mechanism for the Lending Limit

Since the amendment of the 1986 Act by the Building Societies Act 1997, a building society is no longer subject to a restrictive powers regime. It has the powers conferred on it by its memorandum. However, in conducting its activities, a society must observe certain statutory provisions, such as those dealt with below.

The "lending limit" states that at least 75% of the "business assets" of a building society (or of the society and any subsidiary undertakings) must be –

in the form of loans owed to the society and those undertakings which are fully secured on residential property (FSRP) - "the lending limit".

(Section 6(1) and (2))

"Business assets" are the total assets of a society (or total assets of the society and its subsidiary undertakings)

- *plus* provisions for bad and doubtful debts,
- *less* fixed assets, liquid assets and any long term insurance funds.

("Business assets" is not a term actually used in the 1986 Act but is used here to help distinguish the new position from the pre-1997 Act position).

A society must calculate the position in relation to the lending limit on each "quarter day" - ie the end of a society's financial year and at subsequent three-monthly intervals (*section 6(14)(15)*). This is subject to flexibility by agreement with the FSA, eg where a society has a financial year end which falls other than at the end of a month.

A society's ratio of loans fully secured on residential property to business assets might be only just above 75%. If so, circumstances could arise, outside the society's control where the ratio unexpectedly fell below that level on a quarter day. This might happen eg because of substantial repayments or redemptions of residential mortgages.

Therefore, a society is allowed time to adjust the position (by the next quarter day) by taking the loans fully secured on residential property on the immediately preceding quarter day instead of the current amount of such loans (*section 6(1)(b)*).

The definition of "X" in *section 6(2)* - total assets, plus provisions for bad and doubtful debts, less liquid assets, fixed assets and assets representing long term insurance funds (defined in *section 6(12)*) of an insurance company - gives a broadly similar result to the pre 1997 Act amount known as "total commercial assets".

The definition of "Y" in *section 6(2)* - loans fully secured on residential property - covers principal owing and interest accrued but not yet payable; it does not cover any premium paid on the acquisition of a loan.

"Y" includes loans secured on residential property which is let, including loans to housing associations, private landlords or developers, be they individuals or bodies corporate. It does not, however, include unsecured loans for deposits on property purchases. The "X - Y" formula appears complicated; the following illustrations might be helpful -

Society A (on a quarter day)	Society B (on a quarter day)
<p>X (total business assets) £100million</p> <p>LESS</p> <p>Y (loans FSRP) <u>£ 74million</u> £ 26million</p>	<p>X (total business assets) = £100million</p> <p>LESS</p> <p>Y (loans FSRP) <u>£ 76million</u> £ 24million</p> <p><i>£24million does not exceed 25% of X.</i></p>
<p><i>£26million exceeds 25% of X. Society A does not meet the lending limit on the quarter day in question.</i></p>	<p><i>Society B does meet the lending limit on the quarter day in question</i></p>

The term "lending limit" is potentially misleading, since the constituents of "X - Y" (limited to 25% of "X" by *section 6(1)*), while including loans fully secured on land other than residential property and unsecured loans, may include other categories of asset (apart from liquid assets, fixed assets and long term insurance funds). The section 6 limit is actually a limit on "business assets" other than loans fully secured on residential property.

(ii) Additional Points

The Act effectively provides for the "linked presentation" accounting treatment for certain non-recourse finance arrangements, such as securitisation, to be reflected in the application of the lending limit (*Section 6(3)*).

At the end of a society's financial year, the society must take the amounts to be included in the calculation of the position in relation to the lending limit from the balance sheet in the society's annual accounts. On the other quarter days the society must take the amounts from a balance sheet prepared on a similar basis (*section 6(4)*).

The accounts concerned are the society's individual accounts or, where the society has subsidiary undertakings, its consolidated group accounts (*section 6(14)*). The society's position in relation to the lending limit at the end of its financial year is required to be shown in the annual business statement.

Unlike the funding limit in section 7, which focuses on shares in the society held by members who are individuals, the lending limit takes no account of whether or not the borrower is a member of the society (although fully secured mortgage borrowers who are individuals will be members).

(iii) Consequences of Failure to Comply with Lending Limit

The Act provides that where a society fails to comply with the lending limit then the powers conferred on the FSA under *section 36* shall become exercisable, although any "excess" transactions remain valid (*Section 6(5)*). Also see IPRU (BSOC) chapter 6.6.

(iv) Modification of Lending Limit

There is provision for the lending limit to be reduced, to a percentage not less than 60%, through a statutory instrument made by the Treasury subject to the affirmative resolution procedure (*section 6(6), (9) and (10)*).

The Act provides for the detailed calculation of the position in relation to the lending limit on a group basis, under *section 6(2) and (3)*, to be modified by a statutory instrument made by the Treasury, subject to the negative resolution procedure (*Section 6(7), (8), (9) and (11)*).

Such a statutory instrument may also apply the lending limit to assets of associated undertakings (essentially an undertaking - not being a subsidiary undertaking - in which the society has a shareholding of 20% or more).

The Treasury exercised this power by making an order in the context of the International Accounting Standards and securitisation – The Building Societies (Modification of the Lending Limit and Funding Limit Calculations) Order 2004 (SI 2004 No 3200). International Accounting standards (IAS) require a society's accounts to show securitised assets at their gross value.

There could be a problem if a society using IAS had a subsidiary undertaking that was a special purpose vehicle holding securitised assets. Use of this gross value could distort the application of the lending limit. SI 2004 No 3200 modifies *section 6(2)* to allow these assets to be taken at net value.

(v) Loans Acquired by Equitable Transfer

References in the 1986 Act to loans being owed to a building society (or a subsidiary undertaking of a building society) include references to their being so owed in equity as well as at law (*section 119(3A)*). Accordingly, loans acquired by a society or subsidiary undertaking from another lender by an equitable assignment are, where appropriate, treated as fully secured on land in the same way as loans acquired by a legal transfer.

An equitable assignment arises where there is an express agreement to grant a legal mortgage. (See also *paragraph 5(2B) of Schedule 2* which allows the rules of a building society to provide for an individual to be a borrowing member where the loan is owed to the society in equity rather than at law.)

3. Loans Secured on Land

(i) Basic Definition

Sections 6A and 6B provide for the determination of whether a loan secured on residential property is "fully secured" for the purposes of the 1986 Act.

Section 6A defines "loans secured on land" and a loan will be "fully secured on land" if it meets the further requirements of *section 6B* (see below).

NOTE –

- *Section 5(1)(a)* makes it clear that a loan secured on land will fall within the purpose or principal purpose of a society only if land qualifies as residential property. (Residential property is defined in *section 5(10)* as where at least 40% of the land is normally used as, or in connection with, one or more dwellings or is to be developed etc accordingly. More information is given below)
- The lending limit requires that at least 75% of the business assets of a building society (or of the society's group) must be loans fully secured on residential property.
- A "borrowing member" is an individual indebted to a society in respect of a loan fully secured on land.

Before defining "**fully** secured", we must define "loans secured on land" -

A loan is "**secured on land**" if it is –

- secured by a **mortgage** of a **legal estate** (or, in certain circumstances prescribed by order, an **equitable interest**) in land in England and Wales or Northern Ireland,
- a **heritable security** over land in Scotland, or
- a "**qualifying security**" over land in a European Economic Area (EEA) country or territory (see below)

(*section 6A(1) and (2)*).

(ii) "Mortgage"

Mortgage is defined by *section 119(1)* to include a charge, therefore putting it beyond doubt (if there was any) that what is now the almost universal method of effecting a legal mortgage, ie the legal charge, falls within *section 6A(1)(a)*.

Under section 1 of the Law of Property Act 1925, there are only two legal estates, the "fee simple absolute in possession" (broadly speaking, what is normally recognised as a freehold) and the "term of years absolute" (broadly speaking, a lease for a certain fixed period).

A heritable security is created by means of a standard security, the form of which is regulated by the Conveyancing and Feudal Reform (Scotland) Act 1970.

For more information, see *the BSA Guide Residential Mortgage Law & Regulation* (January 2009) www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf.

(iii) “Prescribed Equitable Interests”

Equitable interests are, in effect, third party rights over land (traditionally recognised by the court of equity but not by common law).

The Treasury may prescribe (by statutory instrument subject to the negative resolution procedure), equitable interests which, for the purposes of the Act, may form the basis of the security (*Section 6A(2), (5) and (6)*).

The Building Societies (Prescribed Equitable Interests) Order 1997 (SI 1997 No 2693) prescribes three types of equitable interest in land for the purposes of *section 6A(2)* -

- (a) rights to acquire freehold or greater leasehold interest,
- (b) any easement, profit or similar right which belongs with land, and
- (c) contracts for the development of residential land.

An easement is a right enjoyed by an owner of land over someone else's land (eg a right of way, a right of support etc). A profit is similar to an easement except that it is the right to take something from the land (eg produce, soil, grazing rights).

A loan secured by mortgage of any of the three types of equitable interest to a society or its subsidiary undertaking is secured on land for the purposes of the 1986 Act.

(iv) “Qualifying Security”

A qualifying security is, in essence, is a mortgage over land situated in the EEA (other than the United Kingdom) *Section 6A(7)*.

The EEA comprises the countries of the European Union together with certain other countries and, for purposes of *section 6A* (and also *section 6B*), the Channel Islands, the Isle of Man and Gibraltar. The full list can be found at –

http://europa.eu/abc/european_countries/index_en.htm

(The definition of "EEA country or territory" in *section 6A(7)* appears to cover the same ground as the definition of "EEA State" in *section 97(13)*. It is not clear why a single definition was not provided in *section 119(1)*.)

Section 6A(4), (5) and (6) empowers the Treasury to provide (by statutory instrument subject to the negative resolution procedure) for loans secured on land outside the European Economic Area to be brought within "loans secured on land". The Treasury has not used this power.

(These provisions do not limit societies' powers but give control and certainty on the application of the lending limit.)

(v) Registered Land

Section 6A(3) confirms that a loan is still secured even if made before the mortgagor's title is registered or, in Scotland, transferred. Without this provision, the loan would not be secured by a mortgage of a legal estate (or by a heritable security).

(vi) Syndicated Lending

Certain 1986 Act provisions together ensure that a loan held in trust for a society or connected undertaking (such as in a syndicated lending arrangement) -

- counts towards the value of "Y" in *section 6*, and
- is secured on land for the purposes of *section 6A*

(see *sections 6(13), 6A(2) and 6B(8)*).

The words near the end of *section 6A(2)* ("securities held by or on behalf of building societies or connected undertakings") ensure, in this context, that where the security is held by someone other than the society or the undertaking (eg by a trustee under a syndicated lending arrangement) the loan can still be fully secured on land.

4. Loans Fully Secured on Land

(i) Basic Definition

Section 6B defines "loans fully secured on land".

This provision supplements *section 6A* (which defines "loans secured on land" above), by defining the element of **full** security, and is therefore important both for classification of assets and eligibility for borrowing membership.

References throughout *section 6B* are to "a building society or a subsidiary undertaking", so references to "society" below should be taken to include "subsidiary undertakings" (defined in *section 119(1)*). "Undertaking" and "Subsidiary Undertaking" now have the same meaning as in the Companies Act 2006 (sections 1161 and 1162, and Schedule 7).

Section 6B(1) is the basic provision and specifies the two requirements for a loan to be *fully* secured on land –

- **The principal of, and interest accrued on, the loan owed to the society must not exceed the value of the "requisite security" (*section 6B(1)(a)*).**

Requisite security as the security constituted in the land itself ie the basic security (ie that constituted by the legal estate in, or the heritable security over, the land, or the equitable interest in the land) and not any collateral security; for example, guarantees (*section 6B(8)*). Accordingly, the requisite security is the security required for a loan to qualify as a loan secured on land under *section 6A*.

References in the 1986 Act to loans being owed to a building society include references to their being so owed in equity as well as at law (*section 119(3A)*). Accordingly, loans acquired by a society from another lender by an equitable transfer are, where appropriate, treated as fully secured on land.

Section 6B(2) requires a loan secured by prior mortgage to be deducted from the value of the requisite security for the purposes of *section 6B(1)(a)* where the mortgage to the society is a second mortgage (unless the society is the first mortgagee).

- **The society's mortgage must be a first or second mortgage,**

unless, of course, the "prior" mortgagee does not have priority (such as where it has entered a deed of postponement) or the prior mortgagee is -

- the society itself,
- a subsidiary undertaking of the society,
- a lending syndicate of which the society or subsidiary undertaking is a member, or
- trustees of a trust under which the society or such undertaking is a beneficiary (this also covers syndicated lending, but where the security is held by a trustee on behalf of the lender-participants).

(section 6B(1)(b))

Anyone else is an "outside person" *(section 6A(8))*.

(ii) "Residential Property"

The loan must be secured on "residential property or other land" (see above).

"Residential property" is defined *(section 5(10))* as land at least 40% of which is normally used as, or in connection with, one or more dwellings or has been, is being or is to be developed or adapted for such use.

The Act provides for the position where any land comprises a building or other structure containing two or more stories, in which case the area is taken to be the aggregate of the floor areas of each of the two storeys.

Land used "in connection with" one or more dwellings would include, for example, garden areas. Apart from dwellings, "residential property" includes land for residential development but not hotels, hostels, nursing homes etc.

Section 6B(3) excludes certain charges, such as local land charges, from the scope of *section 6B(1)(b) and (2)*.

(iii) Classification of Loans Secured on Land

There are three categories of loans secured on land –

- FSRP (fully secured on residential property),
- fully secured on other land, or
- not fully secured on land.

(Section 6B(4)).

The test of whether a loan is "fully secured" must be satisfied "on the occasion on which" the society makes the loan.

Where the society acquires the loan from another lender (as under an acquisition of a mortgage book), the relevant time is the occasion on which the loan is acquired.

The provision extends beyond residential property to "other land" because it is not only relevant to the lending limit, but also for other reasons when the society needs to know whether a loan is fully secured – for instance, to ascertain whether someone is a borrowing member (eg where, a borrower (who is an individual) has mortgaged a shop to the society).

Section 6B(5) governs the effect that *section 6B(4)* shall have regarding loans made by two or more payments on different dates, such as instalment loans. This also includes revolving loans where the amounts advanced can be repaid and subsequently re-drawn, so the amount outstanding can increase and decrease during the life of the loan.

The relevant time is the occasion on which the society makes the first of the payments ie the occasion on which the first instalment is lent. The society would need to be satisfied at that time that the total amount, that may be outstanding at any time under the loan, would be covered by the expected maximum value of the basic security.

In the case of a loan to be lent by regular instalments, the society would have to be satisfied that the value of the security covered the first instalment when it was paid and (having regard to the security's expected future value) further instalments would be covered as and when they were lent. In the case of a revolving loan the total amount that could be outstanding at any time would be the relevant factor.

A society must treat all loans secured on land made or acquired as being not fully secured until such time as it is satisfied that each loan is appropriately fully secured (*section 6B(6)*).

(iv) Re-classification

A loan must be re-classified if a society is satisfied -

- on a revaluation that the value of the requisite security has changed – but see *section 6B(7)(c)* below
- on a notice from the borrower that there has been a change in the use of the land,
- that the amount of principal outstanding on the mortgage has changed,
- that the principal outstanding on a prior mortgage has changed or been repaid, or
- that the relative priority of the mortgage has changed,

and

- if the society is also satisfied that were it to make a new loan in the altered circumstances, it would fall into a different classification under *section 6B(4)*.

(*Section 6B(7)*).

Where a loan ceases to be fully secured in one of the circumstances listed above, and the borrower is an individual, the borrower will cease to qualify as a borrowing member unless the society's rules provided for membership where a loan is substantially secured on land (*paragraph 5(2) of Schedule 2*) (see Rule 1 - definition of "Loan" - in *Model Rules for Building Societies* (fifth edition)).

However, a society is not required to reclassify a loan merely because a revaluation, undertaken at a time after the loan was made or acquired, revealed that it was no longer fully secured. This is because, by *section 6B(7)(c)*, a society may elect that the subsection shall apply, and it will not apply unless such an election takes place.

Section 6B(8) contains certain definitions. Apart from "the requisite security" and "outside person" (see paragraphs 27 and 30 above), "trust" is also defined. The latter definition is framed in such a way as to make it clear that not only trustees in the UK legal sense, but also persons holding and administering property in a fiduciary capacity in other countries, are included.

(v) Valuations

The old section 13 of the 1986 Act, repealed by the 1997 Act, required every director of a building society to satisfy himself that the society had arrangements for assessing the adequacy of the security for any advance to be fully secured on land.

A similar requirement was contained in the FSA Handbook, under IPRU (BSOC), but that has now been deleted.

This Rule did not stipulate how a society should carry out the valuation or assessment, or that the society should carry them out in all cases (see 6.5.1G). However, it specified that -

- a society's policies should be clearly documented, and
- the extent to which valuations or assessments are carried out will be a factor the FSA will take into account when assessing a society's threshold solvency ratio
- any valuer should be have sufficient experience and be free of conflicts of interest

Therefore, there is no specific requirement for a physical inspection of property to be mortgaged. It would be for an individual society to satisfy itself that arrangements other than physical inspection were adequate. Under SYSC 3.3.IR, a firm must take reasonable care to establish systems and controls appropriate to its business.

A society would also need to be satisfied, if a loan was to be counted within the 75% in the lending limit, that it was fully secured on residential property; ie that its arrangements for assessing the adequacy of a security were adequate to ensure that the loan was FSRP.

For more information, see *the BSA Guide Residential Mortgage Law & Regulation* (January 2009) www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf

5. Discharge of Mortgages

Schedule 2A, given effect by *section 6C*, sets out the mechanics by which a mortgage may be discharged when the loan is fully repaid. It also gives the Treasury power, by statutory instrument, to prescribe the form of documents to be used.

- In **unregistered land**, a building society mortgage may be discharged by a receipt in the prescribed form signed by any person acting under the authority of the board of directors (see the Building Societies (Prescribed Form of Receipt) Rules 1997 (SI 1997 No 2869).

The 1997 Rules provide two alternative forms for use by societies in discharging unregistered charges, one executed by seal and the other by signing. Two other methods are available, but seldom used in practice. The first is by a receipt under section 115 Law of Property Act 1925, which is a more complicated form that may operate as a transfer of the mortgage. The second is by a reconveyance of the mortgaged property to the mortgagor.

- In **registered land** in England and Wales, the mortgage may be discharged by statutory receipt under the 1986 Act or by Land Registry Form DSI. Electronic discharge is also available, under the Land Registration Rules 2003 (SI No 1417), through FORM ED and the new Form e-DSI.

For more information, see the mortgages area of the BSA Members' Website www.bsa.org.uk/members/policy/mortgages/mortgages_main.htm and the Land Registry Website www.landregistry.gov.uk/.

6. Sale of Mortgaged Property in Possession

Since 1997, a building society has owed a borrower the same duty as other lenders to obtain a proper price or true market value on the sale of a mortgaged property in possession, if the society decides to sell (*Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949).

It is doubtful if there was ever more than a theoretical distinction between building societies and other lenders in relation to the price they were required to obtain for property sold in possession - societies used to be under a duty to take reasonable care to obtain the best price that they could obtain.

For more information, see *the BSA Guide Residential Mortgage Law & Regulation* (January 2009) www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf

There are certain relevant duties under MCOB (see especially MCOB 13.16R). For more information, visit –

www.bsa.org.uk/members/policy/mortgages/arrears_posSESSIONS/MCOB13_and_PAP.htm.

7. Notice of Sale

Under the former Schedule 4 to the 1986 Act a society, which had exercised its power to sell mortgaged property, was under an obligation to send to the mortgagor at his last known address a notice containing prescribed particulars of sale. Old Schedule 4 was repealed on 1 December 1997, so that the 1986 Act no longer places an obligation in this respect. Societies are, therefore, in the same position as other lenders in relation to possessions and sales.

8. Abolished Mortgage Codes of Practice

At its meeting in March 2006, the BSA Council decided that the three BSA mortgage codes of practice should be abolished with immediate effect –

- The Code of Practice on Linking of Services (The Linking of Services Code)
- The Code of Practice on Additional Security (The Additional Security Code)
- The Code of Practice on Transfer of Mortgages by Building Societies or their Associated Bodies (The Transfer of Mortgages Code).

This note is included in the Guide for clarification, because the BSA sometimes receives queries from members about the codes. Notification of this decision, plus the background to the Codes and the reasons for their abolition (essentially, following from the introduction of MCOB, to place building societies on a level playing field with other lenders) were set out in Circular No 6393, issued on 14 March 2006 www.bsa.org.uk/members/circular/6393.htm.

FUNDING AND DEPOSITS

This sub-section covers the 1986 requirements regarding funding for building societies and restrictions on raising funds and borrowing by building societies.

1. The Funding Limit

(i) The Mechanism for the Funding Limit

The “funding limit” states that at least 50% of the liabilities of a building society must be shares in the society held by individuals (*Section 7(1) and (2)*). The calculation is based on an ‘X’ and ‘Y’ formula similar to that employed for the lending limit (see link to Policy Brief below).

Section 1 of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 gives HM Treasury the power to amend the 1986 Act to give building societies the flexibility to borrow up to 75% of their funding on the wholesale markets. No order has been made and none is likely to be made in the short term. (See Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003 (SI 2003 No 1633)). For more information see www.bsa.org.uk/members/policybrief/bill.htm.

“**Liabilities**” includes interest accrued and relates to shares, deposits, and debt securities of a building society (or of the society and any subsidiary undertakings).

“**Individuals**” does not include bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

“**A bare trustee**” is someone who holds property in trust for the absolute benefit (and at the absolute disposal) of other persons. Apart from a duty to transfer the property to them on request, the bare trustee has no other duties regarding the property. A person with an existing beneficial interest in the property cannot be a bare trustee.

The position in relation to the funding limit is to be calculated on each “quarter day”, defined in *section 6(14) and (15)* as meaning the end of a society's financial year and at subsequent three-monthly intervals. This is subject to flexibility by agreement with the FSA, eg where a society has a financial year-end, which falls other than at the end of a month.

A society's ratio of shares held by individuals to total shares, deposits and debt securities might be only just above 50%. If so, circumstances could arise, outside the society's control, where the ratio unexpectedly fell below that level on a quarter day. This might happen eg because of sudden substantial outflows from share accounts.

Therefore, a society is allowed time to adjust the position (by the next quarter day) by taking the shares held by individuals on the immediately preceding quarter day, instead of the current amount of such shares (*section 7(1)(b)*).

The calculation excludes liabilities in respect of amounts which are own funds for capital adequacy purposes - eg subordinated debt and permanent interest bearing shares (PIBS) - *Section 7(3)*.

Section 7(3) also effectively provides, where appropriate, for the application of the funding limit to a society and its subsidiary undertakings on a consolidated group basis, using the same method as the society uses in its group accounts. This also reflects the effect of the “linked presentation” accounting treatment for certain non-recourse finance arrangements, such as securitisation.

Where *section 7(3)* applies, the society should, at the end of its financial year, disregard (in the calculation of the position in relation to the funding limit) amounts not included in the balance sheet in the society's annual accounts (*section 7(4)*). On the other quarter days, the amounts are to be those not included in a balance sheet prepared on a similar basis.

The Treasury may modify *sections 7(2)* and *(3)* in their application to subsidiary undertakings. The Treasury exercised this power by making an order in the context of the International Accounting Standards (IAS) and securitisation – The Building Societies (Modification of the Lending Limit and Funding Limit Calculations) Order 2004 (SI 2004 No 3200). Under IAS, a society's accounts must show securitised assets at their gross value in a society's accounts.

The Treasury also exercised its power by making SI 2004 No 3200 (see above). This Order, which took effect on 6 April 2007, means that building societies will be able to disregard deposits by individuals held by their offshore deposit-taking subsidiaries (if any), subject to a limit of 10% of total shares, deposits and debt securities, from a the funding limit calculation.

There could be a problem if a society using IAS had a subsidiary undertaking that was a special purpose vehicle holding securitised assets. The application of the funding limit could be distorted by use of this gross value. SI 2004 No 3200 modifies *section 6(2)* to allow a society's accounts to take these assets at net value.

"Accounts" means the society's individual accounts or, where the society has subsidiary undertakings, its group accounts (*section 6(14)*).

(ii) Consequences of Failure to Comply with Funding Limit

Where a society fails to comply with the funding limit, the FSA can exercise its powers under *section 36 (Section 7(5))*. Any "excess" transaction remains valid.

The FSA expects societies to draw up their corporate and other business plans to provide reasonable assurance that they will comply with the funding limit. This requirement is contained in one of the few remaining parts of IPRU (BSOC) - 4.5.1-2G.

(iii) Declaration by Individuals

There is a declaration procedure for a society to be sure that the relevant individual does not hold the shares held as a bare trustee for bodies corporate *section 7(6)*.

This is to stop corporate bodies getting round the *section 8(1)(c)* restriction (on such bodies opening share accounts). Otherwise, it might have been possible to evade the restriction by putting the investment in the name of an individual who, being a bare trustee, was obliged to deal with the investment in accordance with the body corporate's instructions, so that they retained complete control over it as if it were in their name.

(iv) Modification of Funding Limit

A statutory instrument, made by the Treasury, may modify the detailed calculation of the position in relation to the funding limit on a group basis, subject to the negative resolution procedure (*Section 7(7) to (9)*) - ie the SI is automatically approved if there are no objections within two days of it being shown to Parliament.

Such a statutory instrument may also apply the funding limit to liabilities of associated undertakings (essentially, an undertaking - other than a subsidiary undertaking - in which the society has a shareholding of 20% or more).

2. Raising Funds and Borrowing

(i) The Shares and Deposits Restrictions

A building society may not -

- accept a deposit from an individual,
- raise funds from an individual except by the issue of shares, or
- raise funds from a body corporate, or from a bare trustee for a body corporate, except by the issue of deferred shares. (*Section 8(1)*).

It is not clear that the second point above would prevent anything that the first point does not prevent. It seems that Parliament included the second to stop attempts to create new instruments claiming to be neither deposits nor shares, as a way of taking money from individuals without conferring membership.

These restrictions were introduced by the 1997 Act because the Government believed that the distinction between shares and deposits was not well understood by the general public, and membership rights could be lost by switching from one to another.

Section 8(9) defines "**raise funds**", but *section 8(8)* cuts down the scope of the definition considerably. It provides that the acceptance of deposits (including the issue of debt securities) does not constitute the raising of funds – therefore, a society may accept deposits from, and issue debt securities to, bodies corporate.

"**Deposit**" includes a loan and a subordinated deposit (*section 119(1)*).

The Act does not define "**body corporate**" and therefore has its usual meaning – ie an association of persons regarded in law as a corporate body, with an identity separate from those making up the association.

The status of body corporate must be conferred by some legal process eg by Royal Charter, by special Act of Parliament, or by registration under general legislation such as the Companies Acts. These include companies, local authorities, parish councils, building societies etc. However, some types of organisation do not have to be, though *might* be, bodies corporate, eg trades unions and charities.

A partnership comprising wholly of individuals is in the same position as an individual or individuals jointly, as far as *section 8* is concerned. A partnership of one or more of the partners of which is a body corporate appears to be in the same position as a body corporate.

A Scottish partnership differs from its English equivalent since the law regards it as a person, distinct from the individual partners, with its own legal personality (existence). This means that the name of a Scottish partnership, unlike an English partnership, could be included in the membership register. But Scottish partnerships are understood not to be corporate bodies and, accordingly, to be in the same position as English partnerships in the context of *section 8*.

Summary of the Effect of the Restrictions and Prohibitions in Section 8		
Investor	Shares	Deposits
Individual (or individuals jointly) -		
• on own behalf	Yes	Limited ¹
• as trustee for another individual(s)	Yes	Yes ²
• as bare trustee for a body corporate	No ³	Yes ²
• as trustee (other than a bare trustee) for a body corporate	Yes	Yes ²
• as trustee for an unincorporated association	Yes ⁴	Yes ²
• as nominee/ attorney/ executor etc for another individual	Yes	Limited ¹
Body corporate -		
• on own behalf	No ³	Yes
• as trustee for an individual(s)	No ³	Yes
• as nominee/ attorney/ executor etc for an individual	No ³	Yes
• as trustee for another body corporate or an unincorporated association	No ³	Yes
Partnership	See below ⁵	See below ⁵
NOTES		
<p>1 Subject to the exceptions in <i>section 8(2)</i>(current account, trustee account, client account etc) or where they chose to take an equivalent share account.</p> <p>2 Subject to the account containing the word “trust” or “trustee” in the title.</p> <p>3 Except for deferred shares (eg permanent interest bearing shares).</p> <p>4 Subject to there being no member of the association that is a body corporate.</p> <p>5 A partnership that consists solely of individuals is in the same position as an individual or individuals jointly. A partnership of one or more partners that is a body corporate appears to be in the same position as a body corporate. In Scotland, a partnership is deemed in law to be a person, distinct from the individual partners, with its own legal personality, but is understood not to be a corporate body. A limited liability partnership is a corporate body.</p>		

(ii) Permitted Deposits by Individuals

There are a number of exceptions to the prohibition on the acceptance by a society of deposits from individuals (*Section 8(2)*). A society may accept the following categories of deposits (and loans) from individuals -

- **Current accounts**

The 1986 Act does not define the term and there appears to be no direct definition in case law or in statute. But, it appears that because the function of a current account is to allow day-to-day payments, the two essential characteristics are that -

- balances must be repayable on demand, and
- the customer has the right to draw personal cheques on the account.

Although certain other features may be common in current accounts (such as overdraft and other money transmission facilities) these are not essential characteristics. It is possible that, as banking practices change, eg reduced use of cheques, banking practice etc, the definition of a current account will also change.

(A society may continue to operate current accounts for individuals as share accounts if it wishes.)

- **Deposit accounts that contain certain words in their title**

These are the word "client", "trust" or "trustee" (see below).

(A society may continue to operate trust accounts as share accounts where the trustee is an individual, there are no corporate beneficiaries and the trust does not prohibit such an investment.)

- **A deposit with reference to which a transferable instrument is issued**

Section 8(9) and (10) define a transferable instrument. There is also no prohibition in the legislation on an individual acquiring a transferable instrument that a society originally issued to a body corporate (but the instrument's terms may specify descriptions of persons who may not hold it).

(See Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003 (SI 2003 No 1633).

- **Qualifying time deposits**

These are defined in *section 8(9)* as having the meaning given by *section 482(6)* of the Income and Corporation Taxes Act 1988 (payment of interest without deduction of income tax on deposits of £50,000 or more for a fixed term of up to five years).

- **Overseas deposits**

An overseas deposit is a deposit that a branch or agency of the society in a country or territory outside the UK accepts and is repayable in such a country or territory (*section 8(9)*). (Deposits with an overseas subsidiary undertaking of a society are unaffected by the provisions of *section 8*.)

- **Any deposit where the society has announced publicly that it intends to transfer the whole of its business to a company**

The FSA may extend the initial period for this exception, of two years from the date of the announcement, under *section 8(3)*.

(iii) Trust Accounts

If an account already has the words "client", "trust", or "trustee" in the title, then it will come within the *section 8(2)(a)* exception. However, a number of accounts may be trust accounts without such wording in the account title. The most obvious examples are where the trust is indicated by eg "A re B" or "A ex parte B" etc.

A trust account is one where the beneficial interest in the account monies vests in a person (B) other than the account holder (A). Therefore, a trust would usually exist where A used the account for transactions in money that belonged to another person or people (B).

Apart from the obvious examples of solicitors' and estate agents' client accounts, and executors and administrators, a trust would usually also exist where the account was held in the name of a treasurer of a club or other unincorporated association, society, church, chapel, fund, appeal etc, or held in some other representative capacity.

However, one should distinguish certain accounts from trust accounts. For example, nominee accounts are accounts put by one person (B) into the name of another (A) purely for B's own convenience and, accordingly, (although, on the face of it, they look like trust accounts) there is not necessarily a trust element.

In some circumstances, the arrangement might in fact be a trust (bare or otherwise) or an agency relationship (but, again, to come within the *section 8(2)(a)* exception, the word "trust" or "trustee" must be in the account title). Also, where B grants a power of attorney to A, A becomes B's agent - not normally his trustee.

In cases of doubt, societies might (where practicable) contact the account holder to establish whether it is appropriate to include the words "trust" or "trustee" in the account title.

In 1997, the Association sought advice from Malcolm Waters QC as to whether an account code to indicate certain types of account (eg "t/t" for "trust account") or some similar abbreviation for "trust", "trustee" or "client" would comply with the exception in *section 8(2)(a)*.

Counsel took the view that, provided the abbreviation was in the title itself (eg "J Smith t/t"), then it was reasonable to conclude that the exception applied and the account may run on a deposit basis – this is because it can be shown that eg "t/t" means "trust account". But this would probably not apply if the abbreviation appeared in a field other than the account name.

(iv) Transitional Provisions

By provisions under the Building Societies Act 1997 Act nothing in section 8 of the 1986 Act affects -

- any deposit accepted by a society from an individual, or
- any share issued by a society to a corporate body,

before *section 8* applied to the building society in question (this varied from society-to-society, depending on when they adopted new memoranda and rules reflecting the new statutory provisions).

This provision preserves the previous rights and obligations in relation to deposit accounts held by individuals, and share accounts held by corporate bodies. Generally speaking, account-holders could make no further deposits or investments could in such accounts, although the society could continue to credit interest.

(v) Non-Compliance with Section 8

A contravention of the prohibitions in *section 8(1)* does not invalidate any transaction or other act (*Section 8(4)*). There is no explicit "penalty" for inadvertently taking a prohibited deposit or share investment.

However, any such "breaches" of section 8 would (unless they were extremely isolated incidents) obviously raise questions as to whether the society had complied with the systems requirements of the FSA's Prudential Sourcebook – see SYSC 3.2.6R.

(vi) "Powers" in Relation to Shares

The 1997 Act expanded certain provisions of the 1986 Act –

- effectively defining a building society share (*section 8(5)*) and clarifying that shares may be issued in currencies other than sterling (see the definition of "interest" in *section 119(1)* - "interest", in relation to shares, includes dividends"),
- providing that a society may issue deferred shares at a premium (*section 8(6)*), and
- providing that a society must transfer any premium on deferred shares to its reserves (*section 8(7)*).

(vii) Declaration by Individuals

In terms identical to *section 7(6)*, *section 8(11)* provides a declaration procedure for a society to be sure that shares held by individuals are not held by them as bare trustees for bodies corporate.

(viii) Modifications to Section 8

Section 8(12) and *(13)* provides for the exceptions to the prohibition on accepting deposits from individuals, in *section 8(2)*, *(9)* and *(10)*, to be modified by a statutory instrument made by the Treasury, subject to the negative resolution procedure ie the SI is automatically approved if there are no objections within 40 days of it being shown to Parliament.

POWERS OF CONTROL OF THE FSA

This sub-section covers the 1986 requirements regarding the FSA's powers of control of building societies.

1. Introduction

The Financial Services Authority (the FSA), a company limited by guarantee, is the body responsible for the regulation of deposit-taking, mortgage-lending, insurance, and investment business in the UK – www.fsa.gov.uk.

The FSA is independent and non-governmental, but has statutory powers under the Financial Services and Markets Act 2000 (FSMA). HM Treasury is the sole shareholder in the FSA.

The FSA's aim is –

“to maintain efficient, orderly and clean financial markets and help consumers achieve a fair deal.”

Its objectives, functions, principles to which it must have regard, and accountability provisions are set out in Part I of the FSMA (sections 1-18).

For more information about FSA regulation see *Financial Services Regulation* below.

The FSA has been the regulator for building societies since it took over the functions of the former Building Societies Commission on 1 December 2001. Parts I and VI of the 1986 Act contains certain provisions relating to the FSA and its powers, in the context of building societies. However, the FSA's powers are much wider than those conferred by the 1986 Act.

2. Functions of the Authority

The FSA has the following functions under the 1986 Act; to –

- secure that the principal purpose of building societies remains that of making loans which are secured on residential property and funded substantially by their members
- administer the system of regulation of building societies provided for by or under the 1986 Act
- advise and make recommendations to the Treasury or other government departments on any matter relating to building societies (*section 1(1)*).

The FSA also has any other powers in relation to building societies conferred on it by the 1986 Act or any other enactment (*section 1(2)*).

3. Powers of Control of the Authority

The 1986 Act sets out certain express powers of the FSA in relation to building societies but, as noted above, the FSA's powers are much wider than those covered in the 1986 Act.

(i) Powers in Relation to Principal Purpose and Nature Limits

Sections 36, 36A and 37 set out powers of control by the FSA exercisable because a society has failed to comply with the provisions in *sections 5-7* concerning principal purpose, principal office, the lending limit, or the funding limit.

The FSA is empowered to direct a society, within a specified period, to –

- submit for approval a restructuring plan to bring it within the statutory requirements (*section 36(3)-(4)*)
- call a general meeting to (at the society's option) approve a restructuring plan or consider converting to company status (*section 36(5)-(6)*)

Sections 36(7)-(16) contain a range of supplementary provisions to facilitate the exercised of the above powers. *Section 36(13)* provides a range of further FSA powers in cases where a society fails to carry out the relevant directions properly, or at all, or where the FSA rejects a restructuring plan.

Additional, related, powers are as follows –

- to issue a prohibition order where a society has failed to carry out a restructuring plan (*section 36A*). This provision was introduced by the 1997 Act.
- to present a petition for winding up of a society (*section 37*).

A prohibition order is an order prohibiting a society from carrying on, or continuing to carry on the activity specified in the order. The activities in question are likely to be those that, by ceasing them, would help the society to comply with the relevant statutory requirement (see above).

There are a number of ancillary and administrative provisions in *section 36A*, such as a requirement to dispose of assets.

The power in *section 37* is to apply to the High Court for the winding up of a society or for an order directing it to carry out a restructuring plan. This power is, in effect, a last resort if the powers set out above were to be ineffective. The power has never been exercised either in their current, or old (pre-FSMA) form.

(ii) Powers in Relation to Authorisation

If the FSA considers it expedient to do so in order to protect the investments of shareholders or depositors of a building society, it may either direct the society to transfer all its engagements to one or more other building societies, or to transfer its business to an existing company (*section 42B(1)*). Ancillary and administrative provisions are set out in *section 42B(2)-(9)*.

Under *section 42C*, the FSA may vary or revoke a direction under *section 42B(1)* by a further direction. The powers in *section 42B* are likely to be exercised where a society faces financial difficulties.

The FSA may also direct that a transfer may proceed by board resolution only rather than by seeking the approval of the members of the society (*section 42B(3)(b)*). In such circumstances, the provisions of *Schedule 8A* to the 1986 Act modify the normal merger or transfer requirements in *Schedule 16* or *Schedule 17* to the 1986 Act. The *section 42B(3)(b)*

power has been used on a number of occasions – eg Gainsborough Building Society (2001), Cheshire Building Society (2008), Barnsley and Derbyshire Building Societies (2008), and Scarborough and Dunfermline Building Societies (2009).

(iii) Notices, Hearings and Appeals

Section 46A sets out the procedural requirements where the FSA proposes to give a direction under the business restructuring power (*section 36* – see above) or that a building society seek a transfer to another society or to an existing company (*section 42B(1)*). A society has a right to refer such a direction to the Financial Services and Markets Tribunal established under the FSMA.

(iv) Information

Sections 52, 52B and 54 of the 1986 Act give the FSA powers to obtain information or documents, and to enter premises with a warrant, and *section 53A* deals with the confidentiality of information obtained by the FSA, in respect of its functions under the 1986 Act.

(v) Inspections etc

Sections 55 to 57 give the FSA power (for the purposes of its functions under the 1986 Act) to appoint inspectors to investigate any aspect of the business of a particular building society, or its affairs generally, or to summon a meeting of members.

DIRECTORS AND OTHER OFFICERS

This sub-section covers constitutional provisions concerning building society officers; eligibility, nomination, election and retirement of directors; and liability, exemption and indemnity. This section focuses on the 1986 Act provisions – for broader information, see the section of the Guide entitled *Building Society Constitutions: Building Society Directors and Other Officers*.

1. The Combined Code on Corporate Governance

A revised Combined Code on Corporate Governance, for listed companies, came into effect in July 2003 and applies to reporting years beginning on or after 1 November 2003. Building societies are not obliged to follow the Combined Code, but the FSA encourages them to ‘have regard to it when establishing and reviewing their own corporate governance arrangements’.

Most of the Code relates to the constitution and accountability of Boards; topics concerning directors, such as performance evaluation and remuneration; and relations with shareholders. Sections particularly relevant to directors are –

A.1 The Board
A.2 Chairman and chief executive
A.3 Board balance and independence
A.4 Appointments to the Board
A.5 Information and professional development
A.6 Performance evaluation
A.7 Re-election
B.1 The level and make-up of remuneration
B.2 Procedure.

The BSA has issued an annotated version of the Code to assist building societies in adhering to the elements of the Combined Code that are relevant to the sector www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf. This gives guidance to societies on alternative approaches where the Combined Code is not directly applicable, such as the where the Code refers to ‘institutional investors’ – a concept that does not apply to building societies as all members are individuals.

The paragraphs that follow do not deal specifically with the requirements of the Combined Code, but focus mainly on the 1986 Act provisions (for more information, see pages 173-190).

2. Officers and Managers

The 1986 Act (*section 119(1)*) defines –

- an “**officer**” as “any director, chief executive, secretary or manager of the society; and, in relation to any offence, “officer” also includes any person who purports to act as an officer of the society....”

An officer must be a fit and proper person to hold office. The approved persons requirements in the FSA’s Supervision Manual (SUP) apply to officers who perform controlled functions (see pages 144-145 below).

- a “**manager**” as “a person (other than the chief executive) employed by the society who, under the immediate authority of a director or the chief executive of the society

exercises managerial functions or is responsible for maintaining accounts or other records of the society”.

Simply because someone has the word ‘manager’ in his or her job title does not make that person a ‘manager’ within the definition – this requires the person in question to carry out one or more of the specified functions – see the definition of ‘executive’ below.

3. Chief Executive, Secretary and Chairman

The law relating to the offices of chief executive and secretary of a building society is set out in *section 59*.

(i) The Chief Executive

The description “chief executive” refers to the person who has immediate responsibility, under the authority of the directors, for the conduct of the society's business. Although a society need not use the title of chief executive, in practice they usually do, although a few societies use other titles eg “managing director”.

The society directors must appoint the chief executive (*section 59(4)*). The appointment of a chief executive is mandatory (*section 59(1)*) and notice of the appointment, together with the person's full name and address, and the date of appointment, must be given to the FSA (*section 59(6)*).

Equivalent notification is also required on cessation of office. The society must give the requisite notice within one month of the appointment or the cessation. The FSA keeps the information on the file that *section 106* requires it to maintain.

The office of chief executive has the following features -

- (a) As an officer of the society (*section 119(1)*) the chief executive will be subject to the statutory provisions relating to building society officers generally (note, in particular, *section 112* regarding liability of officers).
- (b) The chief executive must be employed by the society (*section 59(1)*).
- (c) In accordance with the normal rules of agency, the chief executive may also be an agent of the society and, as far as authorised to do so, may create contractual obligations between the society and third parties.
- (d) Although *section 59* states that the chief executive is "responsible under the immediate authority of the directors" the chief executive may still be a director of the society without prejudice to that status. The definition of "executive" in *section 119(1)* makes this clear -

"executive", in relation to a director, means a person who holds office as a director and as chief executive, secretary or manager.

Indeed, it is standard practice, nowadays, for the chief executive to be appointed to the board (BSOG 1.3.7G). As a director the chief executive will, of course, be subject to the provisions of the Act relating to building society directors generally.

- (e) The situation (still happening in some smaller societies), whereby one person occupies the posts of chief executive and secretary, is reflected in *section 59(3)*, which specifically provides that the same person may hold both offices.

The powers and duties of a chief executive are likely to be wide because the chief executive is the senior manager of the building society with a position analogous to the managing director of a company.

The chief executive's specific functions are largely a matter for the board of directors although certain duties are contained in the Act (see for example, *sections 76(7) and 80(1)* that, respectively, require the chief executive to sign the summary financial statement and the balance sheet).

Section 59(5) requires the directors to take all reasonable steps to ensure that the person appointed has the requisite knowledge and skills to carry out his functions.

In view of the obligation on a building society to have a chief executive, *section 59(7)*, which provides for actions by a deputy when the office is vacant, can relate to temporary vacancies only; such as where a chief executive dies or is incapacitated.

(ii) The Secretary

The secretary is the administrative officer of the society. The main purpose of *section 59* is to ensure that, in the interests of efficient management, every society has a chief executive and a secretary.

The secretary will be subject to other provisions of the Act as an "officer" of the society. However, the central role is that of administrative officer to the society and is likely to have very wide powers in this respect. The directors of the society must appoint the secretary (*section 59(4)*).

The traditional functions of the secretary are well known and, like the chief executive, a matter for the board; although the Act specifies certain duties (see for example, *section 67* which prohibits the secretary (and others) from accepting commissions in connection. Similarly, *section 59(5)-(7)* (see above) applies to secretaries.

(iii) Joint Chief Executives and Secretaries

Until 1990, most people in the industry understood that the Act permitted appointment of joint chief executives. However, in December 1990, the Building Societies Commission (the FSA's predecessor regulator for the sector) wrote to chief executives of building societies on the matter.

The Commission had concluded, as a result of advice received, that the Act permitted only the appointment of a single chief executive and a single secretary to each building society. Both offices may be held by the same person in accordance with *section 59(3)*, but this is very rare and probably only appropriate in very small societies.

(iv) The Chairman

The Act has little to say about the post of chairman, other than the *section 58(2)* requirement that one of the directors must be appointed chairman of the board.

However, BSOG 1.3.6G covers the role of the chairman and particularly stresses that the chairman of a building society should not have any executive post in the society. Also, the Combined Code (paragraph A.2) lists a chairman's main responsibilities, including –

- leading the board, ensuring its effectiveness and setting its agenda
- ensuring that board members receive accurate, timely and clear information

- ensuring effective communication with members, and
- taking a lead in respect of a number of matters concerning individual board members.

4. Directors

(i) Introduction

Every building society must have at least two directors (*section 58(1)*). No doubt this requirement is very much in line with common practice. The 1986 Act prescribes no specific sanction for breach, but it is a ground for winding up of a building society if the number of directors is reduced below two (*section 89(1)*).

A small building society may not need as many executive directors as a large building society, but every society should have at least one (BSOG 1.3.8G).

Section 58(2) requires one of the directors to be appointed chairman of the board. Again, the act prescribes no sanction for breach of this section, but BSOG 1.3.6G refers to the requirement.

The FSA discourages building societies from appointing chief executives or other executive directors as non-executives, after their retirement (BSOG 1.3.10G).

(ii) Notifications to the FSA

Where a person becomes or ceases to be a director of a building society, the society must notify the FSA, also stating the person's name and address and date on which he became, or ceased to be, a director (*section 61(13)*).

The society must give the requisite notice within one month of the appointment or the cessation. The information is kept on the file that *section 106* requires the FSA to maintain. It is a criminal offence to fail to comply with *section 61(13)*.

A society would also have to apply to the FSA for the approval of a new director (or, indeed, of any officer to undertake a controlled function) as an approved person. In May 2006, the FSA provided a helpful note recording its willingness, subject to certain requirements, to treat information provided for one purpose, as being provided for both purposes. The BSA provided details with Circular No 6423 www.bsa.org.uk/members/circular/6423.htm.

5. Eligibility and Nomination of Directors

(i) Eligibility

Any natural person (ie a human being, not a corporation) is eligible to be elected a director of a building society (*section 60(4)*).

The only grounds for exclusion from eligibility are age (see below) or that the FSA has made a prohibition order against a person under section 56(2) of the Financial Services and Markets Act 2000. Although a director must be approved by the FSA, this process takes place after election (see IPRU(BSOC)) paragraph 3.3.1G and 3.3.2G

A minor may not hold any office in a building society (*paragraph 5(3) of Schedule 2*), so could not be a director.

A society's rules may –

- require its directors to retire at a prescribed age (*section 60(6)-(8)*), and
- impose, as a condition of a person's eligibility to be or to remain a director of the society, a requirement that the person must hold shares in the society not less than the value prescribed in the rules - but the minimum holding must not exceed £1,000 (*section 60(9)*).

The rules may, as conditions of the validity of a person's nomination for election as a director, impose requirements as to certain matters not appertaining to the qualifications of the individual to be a director, ie -

- (a) the minimum number of members who must join in nominating him;
- (b) the length of membership and the value of their shares or amount of mortgage debt of those nominating the director; and
- (c) a deposit in connection with the candidature.

The rules must not imposed any other requirements (*section 60(10)*).

The Employment Equality (Age) Regulations 2006 (SI 2006 No 1031), among other things, prohibit discrimination on grounds of age where there is no service contract, unless an objective justification can be shown. This is potentially relevant to non-executive directors, in particular. For more information, see - www.bsa.org.uk/members/circular/6449.htm.

(ii) Nomination

By *section 61(1)* and the Building Societies (Nominations for Directors' Election) Order 1999 (SI 1999 No 3032), rules must not require the minimum number of members to nominate a board candidate to exceed -

- **50** members, for a society with total commercial assets of £100 million or less;
- **100** members, for a society with total commercial assets exceeding £100 million but not exceeding £250 million;
- **150** members, for a society with total commercial assets exceeding £250 million but not exceeding £1,000 million;
- **200** members, for a society with total commercial assets exceeding £1,000 million but not exceeding £5,000 million;
- **250** members, for a society with total commercial assets exceeding £5,000 million.

For the definition of "total commercial assets" see *section 61(3A)*.

Rules must not require a nominating member -

- (a) to have been a member for more than two years before the date of the nomination;
- (b) to hold, or have held at any time during that period, shares in the society to a value greater than £200 (if claiming eligibility as a shareholding member); or
- (c) to owe, or have owed the society at any time during the period, a mortgage debt of an amount greater than £200 (if claiming as a borrowing member)

(*section 61(2)*).

Some societies have rules that permit a nominating member to meet the requirements by a combination of shareholding and borrowing membership.

The 1986 Act places restrictions on provisions in a society's rules concerning the depositing of money with the society in connection with a board candidature. In particular, the rules must not require more than £250 to be deposited with the society and must not require the deposit to be made before the closing date for board nominations.

The Act also requires rules to provide for return of the deposit in certain circumstances. The FSA may, by order, substitute different amounts, numbers or percentages for those specified in (*section 61(1) to (5)*).

Nominating members may nominate a board candidate at any time. If they make the nomination after the closing date for nominations (ie the last day of the financial year-end before the voting date), it must be carried forward as a nomination for the next election, unless the candidate otherwise requires (*section 60(10A)*).

6. Election of Directors

(i) Electronic Communications

The Building Societies Act 1986 (Electronic Communications) Order 2003 (SI No 2003 No 404) (the Electronic Communications Order) came into effect on 20 March 2003. The Electronic Communications Order enables building societies, if they wish, to communicate with their members on constitutional matters.

The Electronic Communications Order amended the 1986 Act to allow building societies to make and receive electronic communications. The matters covered in relation to the election of directors are as follows –

- Electronic ballots – *paragraph 33A in Schedule 2*
- Directors' election addresses – *section 61(7A) to (7E)*
- Board's reasons for approving a director over normal retirement age – *section 60(7A) to (7C)*.

(ii) Election Requirements

The provisions governing the actual election of directors (in *sections 60 and 61*) were amended significantly by the 1997 Act, in particular to effect certain accountability provisions including the requirements to –

- hold an election (ie a vote) even where the number of candidates did not exceed the number of vacancies, and
- take a poll at the AGM where the directors are not elected by postal ballot.

By *section 60(1)*, except in relation to co-opted directors, the directors of a building society must be elected, depending on which method the society's rules provide for, either -

(a) on a poll taken at the society's AGM. A "poll" is the taking of a vote at a general meeting. By *section 60(1A)*, if the directors are to be elected in this way, proxy forms must be sent to each person entitled to notice of the meeting, or

(b) by a postal ballot.

(iii) Entitlement to Vote

Entitlement to vote on a Board election corresponds with entitlement to vote on an ordinary resolution (*section 60(2)*). *Section 60(17)* defines the voting date and provides that, in a case where the rules provide for election by postal ballot, the date of a person's election as director is the date of the meeting at which the declaration of the result of the ballot is made.

In a contested election (ie where there are more candidates than vacancies) each member entitled to vote has one vote in respect of every vacancy, but cannot be required to cast all or any votes (*section 60(3)*).

In an uncontested election, (ie where there are not more candidates than vacancies) there must still be a vote.

Each member entitled to vote has one vote in respect of every candidate, but cannot be required to cast all or any votes (*section 60(3A)*). Each vote must be capable of being cast for or against the candidate concerned and a candidate will be elected only if more votes are cast for him than against him.

(iv) Election Addresses

A duly nominated candidate for election to a board is entitled to furnish the society with an election address of not more than 500 words. If this is done before the closing date for nomination of candidates, the society is under a duty to send a copy to each member entitled to vote in the election.

Each copy must be sent in the same manner and, so far as practicable, at the same time as the notice of the meeting or the ballot papers are sent out, or as soon as practicable afterwards.

Failure to comply with these requirements is a criminal offence (see *section 61(7)(c)*).

A building society is not required to send copies of the address in any case where -

- (a) publicity for the address would be likely to diminish substantially the confidence in the society of investing members of the public,
- (b) the rights conferred by *section 61(7)* are being abused to seek needless publicity for defamatory matter or for frivolous or vexatious purposes, or
- (c) an address does not relate to the affairs of the society.

(*section 61(8)*).

These provisions correspond with the statutory provisions relating to the circulation of members' resolutions and accompanying statements.

7. Co-option

If the society's rules provide, the directors for the time being may co-opt (ie appoint as an additional director or to fill a board vacancy), a person who -

- (a) has not reached the normal retirement age, or the compulsory retirement age (where the age is less than the normal retirement age),

- (b) appears to them to be fit and proper, and
- (c) was not nominated for election as a director at any election held in the preceding twelve months, and not elected.

(*section 60(13)*).

The co-opted director must cease to hold office at the end of the permitted period, unless elected as a director within that period (*section 60(14)*). (For the definition of the "permitted period" see *section 61(12)*.)

8. Retirement

An elected director may not hold office for more than three years without standing for re-election at the third AGM following the date of election. This is subject to earlier retirement on grounds that the director ceased to hold the requisite shares in the society contained in the rules (*section 60(11)*).

There are separate provisions relating to retirement age which may be summarised as follows -

- (a) Any director who has attained the "normal retirement age" (70 or such lesser age as the Rules prescribe - *section 60(8)*) must retire at the next AGM (*section 60(12)*).
- (b) The director will be eligible for re-election at the AGM (unless a society has an applicable "compulsory retirement age") but only if the society has observed the two preliminary procedures set out in *section 60(7)* that the –
 - director has been approved by Board resolution as eligible for re-election and,
 - the director's age, and the reasons for the Board's approval, have been communicated to all those members eligible to vote.

It is a criminal offence to fail to give this notification (*section 61(6)*).

(c) Although there is no explicit requirement, it seems sensible for the Board minute itself to set out the reasons and for these then to be repeated to the members. There is no need for this to be done verbatim - it must be a matter of judgement but depending on the terms of the board resolution, a précis may do. It is essential, however, that the essence of the reasons the Board gives to the members should not differ from those which formed the basis of the Board's decision.

(d) As *section 60* makes no stipulation as to how the reasons must be "notified to every person entitled to vote" (the Bill which became the 1986 Act originally referred to a separate statement) it must remain a matter for each society; the notification could, however, be set out as a note to the formal Notice of Meeting or as a special paragraph in the Chairman's Statement.

(e) Once the *section 60(7)* preliminaries have been complied with, however, the actual election of "over-age" directors is no different from that of those who are below retirement age and no separate rules apply - they need not be denoted particularly as over-age, for example, in the Notice of Meeting.

(f) It is a criminal offence for a director, or board candidate, to fail to give notice to the society no later than 28 days before he reaches the normal retirement age or, as the case may be, the compulsory retirement age for directors of the society (*section 60(15)*).

(g) *Section 61(10)-(11)* envisages rules that provide for retirement by rotation.

The Combined Code (A.7.1 – 2) deals with re-election and terms of office – see www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf.

As noted above, the Employment Equality (Age) Regulations 2006 (SI No 1031) – in force: 1 October 2006 - have implications for directors' retirement ages. BSA Circular No 6449, issued on 17 July 2006, provided information on the matter www.bsa.org.uk/members/circular/6449.htm.

9. Liability, Exemption and Indemnity

(i) Criminal Liability

Breach by directors and officers of a number of provisions in the 1986 Act amounts to a criminal offence. By *section 112(1)*, where such an offence has been committed “with the consent or contrivance of, or to be attributable to any neglect on the part of, any officer of the society” then the officer, as well as the society, is guilty of an offence.

Section 112(3) is the same as *section 112(1)* except that the references to a building society have been replaced by references to a body corporate; this might cover for example a situation where a society has delegated functions to a company, which has then committed an offence under the Act, the officers of the company will be guilty as well as the company itself. A company might commit other offences where it is not in a relationship with the society; for example, in *section 107* (misuse of a building society's name by a third party).

By *section 112(2)*, where a building society has committed one of certain specified serious offences, that could jeopardise investments in the society, then every director and the chief executive of the society is also guilty of the offence. The specified offences are -

- (a) raising money from members or accepting deposits without the necessary authorisation (was *section 9(11)* - now Financial Services and Markets Act 2000);
- (b) failing to comply with any requirement or contravening any prohibition imposed on it (was *section 43A(7)* now Financial Services and Markets Act 2000);
- (c) intentionally altering, suppressing, concealing, destroying or refusing to produce any document required to be produced to an appeal tribunal (*section 46A*);
- (d) furnishing misleading or false information, explanations or statements following a request from the FSA in carrying out its supervisory functions (*section 52(11)*); and
- (e) furnishing misleading or false information in connection with an application for authorisation (*paragraph 3 of Schedule 3*).

By *section 112(4)*, in any proceedings for an offence under the 1986 Act, a person shall have a defence if he took “all reasonable” precautions and exercised “all due diligence” to avoid the commission of the offence by himself or a person under his control. Given the wide range of offences under the Act, the conduct required to establish the defence would depend on the individual circumstances.

(ii) Exemption and Indemnity

Section 110, as amended by the Building Societies Act 1986 (Modifications) (No 2) Order 1991 (SI 1991 No 2738), deals with the subject of the ability of a society to exempt from or indemnify against the liability in law of its directors, other officers or employees. It provides that any provision in rules of a building society or in any contract with a society is void if the section applies to it, subject to certain exceptions.

The scope of the section is wide, dealing with a very broad range of civil and criminal liabilities to the society and, possibly, to third parties. It has always been the view that the words "in relation to the society" in *section 110(2)* - see below - do not clearly limit the actual liability in question to that of the society. Therefore, another person with an appropriate interest (eg an investing member) might be able to demonstrate a liability owed to at person - in which case, the argument would be, *section 110* would also apply.

The section applies to any provision -

(a) exempting a director, other officer (see above), or auditor employed by the society from any liability which, by virtue of a rule of law, would (were it not for the exemption) attach to him in respect of the negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the society, or

(b) indemnifying any such person against any such liability

(*section 110(2)*).

The difference is that an exemption is a provision that seeks to exclude or limit the liabilities of a person X that would otherwise be his, whereas an indemnity is a provision whereby Y agrees to make good a loss suffered because of a default by X.

The effect is that a society cannot exempt a director, other officer or auditor from liability in relation to the society - ie it cannot rely on a provision in rules etc to the effect that an "offence" will not be committed. It cannot indemnify a director etc against such liability - ie it may not, in effect, say "whatever liability in criminal or civil law you are proved to have incurred, it will ensure that you do not suffer financially".

Section 110(4) applies to building society law the companies' legislation, which provides that if, in certain proceedings, it appears that a director, other officer or auditor, has acted honestly and reasonably, and that having regard to all the circumstances of the case, he ought fairly to be excused, the court may relieve him, either wholly or partly, from his liability on such terms it thinks fit.

Company law judgments have established that a director will have acted reasonably if the director did everything a normal person would do in the conduct of his own affairs (see, for example *Re Duomatic Ltd* [1969] 2 Ch 365 cf *Selangor United Rubber Estates Ltd v Craddock* (No 3) [1968] 1 WLR 1555).

The relief applies only to breaches of duty to the company (or, in the context of *section 110(4)*, to the building society) - ie it does not extend to claims by third parties (*Customs and Excise Commrs v Hedon Alpha Ltd* [1981] 2 AER 697).

The section does not prevent a building society from -

(a) purchasing or maintaining for a person insurance against any of the liabilities set out in *section 110(2)*, or

(b) indemnifying a person against any liability incurred by him in defending any proceedings (whether civil or criminal) in which the court gives judgment in the person's favour or acquits the person - ie the person wins his case

(*section 110(3)*).

This means that, subject to *section 110(2)*, a society may exempt or indemnify in respect of the liability of any director, other officer, auditor, or indeed any employee, or insure such liability.

DEALINGS WITH DIRECTORS AND OTHER OFFICERS

This sub-section covers the 1986 Act provisions concerning dealings with directors (and, in some cases other officers) and connected persons, such as disclosure of interests, substantial property transactions, loans, commission etc.

1. Duties of Directors Generally

The 1986 Act has certain provisions concerning building society directors, but is only part of the overall legal and regulatory picture. The general legal position concerning directors is covered below (see pages 173-190).

2. Overview of the 1986 Act Requirements

The 1986 Act provisions concerning dealings with directors and others are complex and there could be potential overlaps to some extent. Apart from the introduction of a new section into the 1986 Act, *section 66A*, the only amendments made by the 1997 Act to the sections on dealings with directors etc were consequential changes to terminology.

The 1986 Act provisions are largely based on provisions in the companies' legislation. The table that follows provides an overview of the provisions, a brief summary of the effect of each and it also specifies the broadly corresponding provisions of the Companies Act 2006 (and the superseded 1985 Act provisions).

Many company law provisions migrate, in time, into the Building Societies Act. This is particularly true of provisions relating to directors, as the table opposite shows. The Companies Act 2006 makes many changes to company law including, for the first time, a statutory statement of directors' duties (largely, but not entirely, drawn from common law) – see page 187 below.

The table below summarises the 1986 Act provisions that relate to dealings with building society directors and, in relation to *sections 67 and 69*, with other officers.

3. Tax-Free Payments

The 1986 Act prohibits tax-free payments of remuneration to directors of building societies (*section 62(1)*). The section catches not only payments made free of income tax, but also payments calculated by reference to or varying with the amount of a director's income tax (or any rate of income tax).

Any building society rule, resolution or any contract provision for payments falling within *section 62(1)* will only have effect as if it provided for payment, as a gross sum subject to income tax, of the net sum that the rule, resolution or contract provides for (*section 62(2)*).

A society's rules must provide for the maximum amount of the remuneration to be paid to directors, unless it is fixed by resolution at the AGM (*paragraph 3(4) of Schedule 2*). The mechanisms prohibited by *section 62(1)* would prevent the intended transparency because the society would not know the directors' overall tax position and directors could pass on to the society the burden of meeting the directors' personal tax obligations.

1986 Act Section	Summary of Provision	Broadly Corresponding Companies Act 2006 Section(s) (1985 Act in brackets)
62	Prohibits tax-free payments and certain payments) to directors.	Repealed by 2006 Act (311)
63	Requires disclosure by directors of the nature of interests** they have in contracts between the society and a third party.	182-7 (317)
64	Prohibits certain substantial property transactions between building societies and their directors, unless approved by a general meeting.	190-6, 1163 (320-21, 739)
66A	Makes 'voidable' transactions involving directors or connected persons and the society, where the directors have exceeded their powers.	41 (322A)
65, 66 and 68	Prohibits certain loans and other transactions made by a society to or with directors or connected persons (section 68 requires a register of certain transactions** to be maintained and for annual statements to be made.	197-214 (330-339)
67	Prohibits certain commission payable to directors and other officers for or in connection with loans made by the society.	-----
69	Requires disclosure by directors and other officers of income from interests in related businesses.**	-----

*** such interest, loan or transaction must first be authorised by the rules*

4. Interests in Contracts

(i) The Duty

Unless there is a specific provision in a society's rules permitting a director to make personal profits from dealings with the society, then the director is prohibited by the general law from doing so (*Regal (Hastings) v Gulliver* [1967] 2 AC 134).

Although the 1986 Act is not explicit on the point, the general view is that *section 63* does not imply into a society's rules a provision allowing such an arrangement (see, for example, paragraph 13.22 of *Wurtzburg & Mills Building Society Law*). Therefore, the section would be relevant only if the rules did permit such an arrangement - as there is, for example, in the *BSA Model Rules*.

The 1986 Act places a duty on a director, who is interested in a contract or a proposed contract between a third party and the society, to declare the nature of the interest to the board of directors (*Section 63(1)*). Also see BSOG 1.3.15.

The duty is wide because it applies to -

- (a) direct or indirect interests - "interest", although not defined, must in practice mean a financial interest;
- (b) a director's interest in a contract made with a specified person to whom the director is "connected" (see "Connected Persons" below) and
- (c) certain other "transactions or arrangements", as well as contracts, that the director, or a connected person, is interested in - by *section 63(6)* these are transactions or arrangements of a kind described in *section 65*; for example, acquisition of non-cash assets (see below).

(ii) The Declaration (or Notice)

The director must declare the interest at the meeting of directors at which the question of entering into the contract, transaction or arrangement is first taken into consideration (*section 63(1)*).

If the director did not have the interest at that date, then the declaration must be at the first meeting after the director became interested (*section 63(2)*).

If the director did not acquire the interest until after the contract etc was made, then the declaration must be made at the first meeting after the director became interested (*section 63(3)*).

The requirements for a declaration (or notice: see below) are limited in a number of ways -

- (a) It need not be made to the society in general meeting.
- (b) Only the nature of the interest need be disclosed (though it is not enough just to state that the director has an interest; the declaration must state what the interest consists of, so that the other directors are "fully informed of the real state of things" - *Imperial Mercantile Credit Association v Coleman* (1873) LR 6HL 189; the amount of detail will depend on *the nature* of the contract, its context etc, but will be limited by the fact that only the nature of the interest must be disclosed).

- (c) A general notice given to the directors is sufficient declaration if it is to the effect that -
- the director is a member of a specified company or firm and is to be regarded as interested in any contract which may be made with the company or firm after the date of the notice, or
 - the director is to be regarded as interested in any contract that may, after the date of the notice, be made with a specified person who is connected with the director (see below)

(*section 63(4)*).

(d) The declaration or notice need not be made in person so long as the director takes reasonable steps to secure that the declaration or notice is brought up and read at the meeting (*section 63(5)*).

(iii) Connected Persons

The concept of a “connected person” is relevant not only to *section 63* but also to *sections 64, 65, 66A, and 68* (see below).

By *section 70(2)* a person is connected with a director of a building society only if he or she is one of the following -

- (a) the director’s **spouse, civil partner, child or step-child** (“child or step-child” includes an illegitimate child but does not include any person who has reached 18 - *section 70(3)(a)*);
- (b) a **body corporate** the director is associated with (he is “associated” with a body corporate not only if he, but also one of various others - spouse, child etc - owns at least one-fifth of the body’s share capital or controls more than one-fifth of the voting power of the body - *section 70(4)*);
- (c) a person acting in his capacity as **trustee** of a trust the beneficiaries of which include the director or a range of other people (broadly speaking, those referred to in (a) and (b) above);
- (d) a person acting in his capacity as **partner** of a director or of any person who, by virtue of (a), (b) or (c) above is connected with the director; or
- (e) a **Scottish partnership** in which the director or certain connected persons is a partner.

The 1997 Act amended *section 70(3)(a)* to bring building societies in line with the provision applying to companies. Accordingly, an adult son or daughter of a director is no longer within the definition of “connected person”. Employees of the society are not exempted from the definition.

Section 70(2)(d) is carefully worded not to cover *every* partner of a director, but only a person “*acting in his capacity as partner*”. Accordingly, it seems that if a loan is made to a partner of a society director for the purposes of the partnership (eg in connection with partnership offices) then *section 70(2)(d)* applies; however, if the loan was completely unrelated to the partnership (eg a loan to the partner to buy the partner’s home) then the sub-section presumably does not apply.

Similar reasoning would apply to *section 70(2)(c)* (a person acting in his capacity as trustee). There might, of course, be grey areas and a society will presumably in practice disclose if in doubt.

As well as children of directors who have reached majority, there are certain others who are excluded from the definition of “connected person” -

(a) *Section 70(2)* expressly provides that a person is not connected with a director of a building society if the person is himself or herself a director of the society; and

(b) A trustee in paragraph 14(c) above does not include a trustee under an employees’ share scheme or pension scheme (*section 70(3)(b)*).

(iv) Non-compliance

Failure by a director to comply with *section 63* is a criminal offence (*section 63(7)*).

The 1986 Act does not state what the effect of non-disclosure would be on any contract – the matter was considered, without final resolution, in *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549, CA and *Guinness Plc v Saunders* [1990] 2 AC 663. One possibility is that the contract would be voidable (valid and binding but open to “avoidance” ie repudiation) by the society, and the director would have to account for any secret profit he made out of it.

5. Substantial Property Transactions

(i) The Prohibition

The 1986 Act prohibits certain substantial property transactions between building societies and their directors, unless approved by a general meeting (*section 64(1)*).

The purpose of the provision, which like most of the others concerning dealings with directors etc derives from companies’ legislation, is to prevent unscrupulous directors stripping the assets of the organisation.

The section prohibits a building society from entering into an arrangement whereby -

(a) a director of the society (or person connected with that director - see above) acquires, or is to acquire, one or more non-cash assets of the requisite value (see below) from the society; or

(b) the society acquires, or is to acquire, one or more non-cash assets of the requisite value from a director of the society or a person connected with that director,

unless the arrangement is first approved by a resolution of the society passed at a general meeting (which may, alternatively, ratify the arrangement at a general meeting no later than the next AGM - see below).

The “**requisite value**” is not less than £200,000 (or, where the balance sheet of the society showed reserves amounting to less than £1million, not less than the higher of £2,000 or the amount which represents 10% of those reserves) (*section 64(2)*). These amounts may be amended by the Treasury and subject to the negative resolution procedure (*section 64(3),(4)*).

(Note the separate requirement, to disclose in the annual business statement any such arrangement entered into during the year, regardless of the value of the assets involved).

“**Non-cash asset**” means any property or interest in property other than cash. It includes the creation or extinction of an estate or interest in, or a right over, any property and also the discharge of a person’s liability, other than liability for a liquidated sum (*section 64(5)*).

Generally speaking, societies' rules authorise directors to enter into property transactions, subject to complying with *section 64*.

(ii) Non-compliance

Unlike *section 63* (see above), the consequences of non-compliance with *section 64* are specified in the Act. By *section 64(6)*, if an arrangement entered into by a building society contravenes the section, the arrangement and any transaction entered into under it (whether by the society or any other person) is voidable (valid and binding but open to "avoidance" ie repudiation) by the society unless -

- (a) restitution of any money or asset which is the subject matter of the arrangement or transaction is not possible;
- (b) the society has been indemnified for the loss or damage it has suffered;
- (c) any rights acquired (in good faith, for value and without actual notice of the contravention) by a third party would be affected by its avoidance; or
- (d) the arrangement was subsequently affirmed by the society at a general meeting held no later than the next AGM after the arrangement was entered into.

A director who entered into an arrangement or transaction in contravention of *section 64* (or a connected person of who did so), and any other director who authorised the arrangement or transaction, is liable -

- (a) to account to the society for any gain made directly or indirectly from the arrangement or transaction; and
- (b) (jointly and severally with any other person liable) to indemnify the society for any loss or damage resulting from the arrangement or transaction (*section 64(7)*).

Section 64(8)-(9) sets out defences where there is a transaction between the building society and a person connected with a director. The director is not liable if he or she took all reasonable steps to secure the society's compliance with the section (*section 64(8)*). As far as a connected person and the other directors are concerned, they are not liable if they show that they did not know the circumstances constituting the contravention (*section 64(9)*).

6. Transactions Exceeding Directors' Powers

(i) 'Voidable' Transactions

The 1986 Act makes certain transactions 'voidable' (ie valid and binding but open to repudiation) by the society. These are transactions –

- to which a director of the society (or a person connected with the director - see above) is a party, and
- in connection with which the of directors exceed any limitation on their powers by reason of any provision in the memorandum or rules

(*section 66A(1) and (2)*).

As explained above in the guidance on establishment and powers (pages 9-17), the 1997 Act amended the 1986 Act to provide that "a building society shall have the powers conferred on it by its memorandum" (*section 5(5)*).

By *section 66A(8)* “transaction” includes any act (ie not just contracts). Also, “limitations” include those deriving from a resolution passed at a general meeting, special meeting or on a ballot, or from any agreement between members of the society.

This wider, “permissive”, approach to building society powers considerably increased the importance of society memoranda in establishing what the powers are. In fact, building society memoranda are now comparable in this respect to company memoranda.

Accordingly, the 1997 Act introduced *section 66A*, which is similar to a provision in the Companies Act 2006, to govern circumstances where the directors exceed the society’s powers. In practice, societies’ rules authorise directors to be party to such transactions, subject to compliance with *section 66A*.

The transaction stops being voidable if -

- (a) restitution of any money or asset that is the subject matter of the transaction is not possible;
- (b) the society has been indemnified for the loss or damage it has suffered;
- (c) any rights acquired *bona fide* - ie in good faith - for value and without actual notice of the exceeding of powers, by a third party would be affected by its avoidance; or
- (d) the transaction is ratified (ie subsequently affirmed) by the society at a general meeting, whether by ordinary or special resolution as the case may require

(*section 66A(5)*).

(ii) Consequences

Whether or not the transaction is avoided, the director or connected person, and any director who authorised the transaction is liable to –

- account to the society for any gain made directly or indirectly from the transaction, and
- indemnify the society for any resulting loss or damage (*section 66A(3)*).

(*Section 66A(4)* makes it clear that other relevant legal provisions continue to apply so that liability might also arise, for example, under common law provisions or other sections in this Part (VII) of the 1986 Act.)

A connected person is not liable under *section 66A(3)* if, when the transaction was entered into, he or she did not know that the directors were exceeding their powers (*section 66A(6)*).

Section 66A(7) provides that *section 66A* does not affect the operation of *paragraph 17(1) of Schedule 2*, which provides that the Board can bind the society in favour of a person acting in good faith, even where the Board is acting beyond its powers.

However, to ensure that innocent third parties are protected, *section 66A(7)* empowers the court to affirm, sever or set aside the transaction, on application by a third party, if the court considers this just. To “sever” a transaction means to cut out invalid parts, but to retain others that are valid, so that the transaction continues to exist.

7. Loans and Other Financial Transactions

(i) Introduction

Sections 65, 66 and 68 of the 1986 Act are linked.

- *Section 65* - with certain exceptions - prohibits loans and other financial transactions made by a society to or with directors and connected persons (see above).
- *Section 66* provides for penalties in the event of breach of section 65.
- *Section 68* requires a society to maintain a register of transactions involving directors and persons connected with them.

A major objective of the provisions is to prevent abuse of position by a director by arranging substantial loans for himself, or herself, or to family members on preferential terms.

In practice, societies' rules authorise directors to enter into loans and similar transactions, subject to compliance with the requirements of *section 65*.

(ii) The Prohibitions

Section 65(1) sets out the broad sweep of the prohibitions. A society must not -

- (a) make a **loan** to a director or a connected person;
- (b) **lease or hire** property to a director or a connected person;
- (c) make a **payment** on behalf of a director or a connected person in connection with the **provision of any service** provided in the ordinary course of business by building societies for individuals;
- (d) enter into a **guarantee** or provide any security which is incidental to (a), (b) or (c) above;
or
- (e) take part in any **arrangement** whereby -
 - o another person enters into a transaction which, if it had been entered into by the society, would have contravened paragraphs (a), (b), (c) or (d) above;
and
 - o that other person has obtained or is to obtain any benefit from the society or a subsidiary of the society under the arrangement.

These prohibitions are however qualified in *section 65(2)-(7)* and it is these provisions that contain the "permitted transactions" (exceptions). The prohibitions and the permitted transactions are set out below. In particular, *section 65(5)-(7)* provides a broad exception to all the prohibitions; namely, expenditure for the society's purpose.

Section 65(8) provides that the sums specified in *section 65* may be increased by statutory instrument, made by the Treasury and subject to the negative resolution procedure (*section 65(9)*) (various financial limits below were increased in 2007).

(iii) Loans

Section 65(1)(a) prohibits the making of a loan to a director or connected person, subject to certain exceptions.

The prohibition does not apply to –

- **Small loans** - ie any loan of an amount which, when aggregated with any other relevant loans, does not exceed £10,000 (*section 65(2)(a)*), or
- **Loans made in the ordinary course of the society's business**, and no greater, and made on other terms no more favourable, than it is reasonable to expect the society to have offered to a person of the same financial standing but unconnected with the society (*section 65(2)(b)*).

This allows “arm's length” transactions (i.e. not on preferential terms) without financial limit to be made to directors or connected persons. However, such permitted transactions must still be reflected in the register maintained under *section 68*, subject to the *section 68(7)* exception (see below).

- Any loan, the amount of which (when aggregated with any other relevant loans) **does not exceed £200,000 made for, or towards, the purchase or improvement of a dwelling house used or to be used as the director's only or main residence** (*section 65(2)(c)*).

This exception applies only if the director is an executive director and loans of that description and on similar terms are ordinarily made by the society to its employees. This means that a loan can be made to an executive director on staff terms up to £200,000 provided it is for the purchase or improvement of the director's main residence. Only the first £200,000 can be on staff terms, over that amount the excess would have to be at arm's length (see above).

BSOG 1.3.16 specifically states, among other things, that “a building society should have written procedures for dealing with loan applications by directors or persons connected with them and every director should be familiar with them”.

Points concerning aggregation of loans sometimes arise. The Secretariat's view is that there is no aggregation between persons - for one loan to be relevant to another both loans must be to the same person.

Also, the Secretariat takes the view that aggregation does not apply in the case of loans made prior to 1987. For example, if a house-purchase loan was made to an executive director in 1986 for £220,000 and this loan was taken into account in working out whether or not the *section 65(2)(c)* exemption applies, then the £200,000 limit would be passed immediately.

Therefore, the word “outstanding” in the definition of “relevant” in *section 65(10)* can only realistically refer to transactions made on or after 1 January 1987. The prohibition in *section 65(1)* cannot affect pre-1987 loans etc. For example, a society could (all things being equal) have made an advance on staff terms to a non-executive director of more than the limit so long as it was completed at the latest by 31 December 1986. With the passage of time, this point naturally becomes less relevant – and, by now (2009) is likely to be redundant.

(iv) Leasing or Hiring

The prohibition in *section 65(1)(b)* regarding leasing or hiring to a director or connected person is mitigated by *section 65(3)* which allows leasing or hiring to directors or connected persons provided the value, when aggregated with other leases or hirings, does not exceed £20,000 or is at arm's length.

(v) Provision of Services

As noted above, there is a general prohibition on a payment on behalf of a director (or a connected person) related to the provision of services provided in the ordinary course of business by building societies for individuals.

The prohibition does not apply to payments that, when aggregated -

- (a) amount to no more than £10,000; and,
- (b) in respect of which the director or connected person is under an obligation to reimburse the society within a period not exceeding two months from the date of payment; or,
- (c) that are at arm's length

(section 65(4)).

(vi) Expenditure for the Purposes of the Society

Section 65(5)-(7) permits a society to make funds available to a director to meet expenditure incurred (or to be incurred) for –

- the purposes of the society or
- for the purposes of enabling the director properly to perform his duties as a director of the society, but -
 - (a) the things must either be done -
 - with the prior approval of the society given at a general meeting at which the "requisite matters" are disclosed. (These matters are the purpose of the expenditure, the amount of funds to be provided by the society and the extent of the society's liability under any transaction which is or is connected with the thing in question), or
 - on condition that, if approval is not given at the next AGM, the loan is to be repaid or other liability under the transaction discharged within six months from the conclusion of that meeting, and
 - (b) the amount provided, when aggregated if necessary, does not exceed £40,000.

(vii) Non-compliance with section 65

Section 66 provides for penalties for breach of section 65. The section falls into two parts, the first (*subsections (1)-(4)*) relating to civil liability and the second (*subsections (5)-(9)*) criminal offences and criminal penalties.

Taking first the **civil liability**, a transaction or arrangement breaching *section 65* is voidable (ie valid and binding unless repudiated) by the society, unless -

- (a) the money or assets can no longer be returned or the society has been indemnified by the director and connected person (see below), or
- (b) where another party - other than the director or connected person - who would be affected by avoidance has acquired rights in good faith for value and without notice of the contravention.

Where a transaction or arrangement is made by a society for a director or connected person, then that director, and the connected person, and any other director who authorised it is liable -

- (a) to account to the society for any gain which he has made directly or indirectly by the transaction, and
- (b) (jointly and severally with any other person liable) to indemnify the society for any loss or damage resulting from the transaction or arrangement (*section 66(2)*).

Section 66(3)-(4) sets out defences where there is a transaction between the building society and a person connected with a director. The director is not liable under *section 66(2)* if the director took all reasonable steps to secure the society's compliance with *section 65*.

As far as a connected person and the other directors are concerned, they are not liable if they show that they did not know the circumstances constituting the contravention. Thus, for example, liability could conceivably fall on a director, who was connected with a person with whom the society enters into a transaction in breach of *section 65*, but who had no knowledge of the transaction.

Turning to the **criminal sanctions** (*section 66(5)-(9)*), a director who authorises or permits the society to enter into a transaction or arrangement knowing or having reasonable cause to believe that *section 65* is being contravened is guilty of an offence.

Likewise a building society entering into a transaction or arrangement contravening *section 65* for one of its directors is guilty of an offence unless it shows that it did not know the circumstances constituting the contravention.

Also, a person who procures a building society to enter into a transaction or arrangement knowing or having reasonable cause to believe that the society is contravening *section 65* is guilty of an offence.

For an individual the penalties are a fine and/or imprisonment and a building society can be fined.

(viii) Records of Transactions etc

The purpose of *section 68* is to ensure proper disclosure of transactions involving directors and persons connected with them.

Section 68(1)-(2) requires a society to maintain register containing a copy of every subsisting transaction or arrangement "falling within" *section 65(1)*, ie, including transactions which are permitted by *section 65(2), (3), (4) or (5)*. Therefore, "falling within" refers to transactions of the types set out in *section 65(1)*, whether or not they are permitted.

The purpose of *section 68*, referred to above should be borne in mind - if prohibited transactions only had to be included in the register, it would be a "public register of offences" which is clearly not the purpose of the section.

The requirements do not apply to certain "excepted transactions and arrangements", but these are strictly defined and at small levels (see below). If a transaction or arrangement is not in writing then the society must include a written memorandum setting out its terms in the register.

The register refers to transactions made "during the current financial year or any of the preceding ten financial years". The Association's view has always been that this period did not start to run until the section came into force, ie 1 January 1987. Thus, only loans made on or after that date need, in its view, be shown even if there was previously a loan outstanding. It is thought that "subsisting" means that the loan has not been redeemed and exists during the financial year in question.

The society must make a statement available for inspection by members at its principal office "during the period of 15 days expiring with the date of its annual general meeting", and also at the AGM. The 1986 Act provides for the electronic communication of registered particulars (*section 68(6A) –(6B) and (11A)*).

The statement must contain the "requisite particulars" of transactions and arrangements falling within *section 65(1)* that the society included in the register at any time during the last complete financial year preceding the meeting.

The "**requisite particulars**" are specified in *Schedule 9*. In outline these are as follows -

- (a) the principal terms of the transaction or arrangement,
- (b) a statement that the transaction or arrangement was made or "subsisted" during the financial year,
- (c) the name of the person for whom it was made and, where that person is or was connected with a director, the name of that director,
- (d) in the case of a loan or related guarantee such matters as –
 - o the amount of the mortgage debt or liability both at the beginning and end of the financial year,
 - o the maximum amount of the debt or liability during that year,
 - o the amount of unpaid due interest,
 - o the amount of any provision made in the accounts in respect of any failure or anticipated failure by the borrower to repay the loan or interest, and
 - o the amount of the payment in the case of any payment made on behalf of the director or connected person.

There are specific provisions in respect of leasing or hiring (*paragraph 2(2)(d)*) and in the case of a guarantee or security (*paragraph 2(2)(f)*).

The Association's view is that the Act does not require the recording of loans subsisting to a director, that were made before the person was appointed a director. This is because the words in *section 68(1)* "made for a director", together with the reference in *section 65(1)* to a loan "to a director", mean that such a transaction need not be recorded.

Questions arose as to whether loans that had been redeemed and loans to a director who had retired needed to be included in the annual statements in respect of years *succeeding* the redemption or retirement. In 2001, the Association issued a paper on these matters - www.bsa.org.uk/docs/policy/practice_briefs/section_68.pdf.

By *section 68(5)*, two copies of the statement are to be sent to the FSA, at the same time as it is made available to members, and the FSA keeps one copy in the public file of the society. *Section 68(6)* provides for a copy of the statement to be sent on demand to any member. A society may charge a fee not exceeding £5.

Under *sections 78(9) and (10)* the auditors are required to examine and report on the statement prepared under *section 68*.

The exceptions to *section 68* ("excepted transactions or arrangements") are contained in *section 68(7) and (8)*; namely, transactions and arrangements -

- to directors if the aggregate of values, less any amount by which the value has been reduced, did not exceed £2,000 at any time during that year.
- comprising leasings or hirings, guarantees or security, or arrangements with others, if the aggregate of the values of each transaction or arrangement, less any reduction in the amount, did not exceed £10,000 at any time during that year.

The figures of £2,000 and £10,000 can be amended by statutory instrument (*section 68(9) and (10)*) and were, indeed, increased in 2007.

A society will be liable to a fine for non-compliance with *section 68* or *Schedule 9*, as will any officer who is also guilty of an offence (*section 68(11)*).

For the separate requirement to disclose in a society's annual accounts information concerning loans and other transactions with directors see paragraph 35 of Schedule 5 to the Building Societies (Accounts and Related Provisions) Regulations 1998 (SI 1998 No 504).

8. Commission Payments

(i) The Prohibition

The purpose of *section 67* is to prevent directors and certain other officers and employees of building societies from accepting two kinds of commission payments -

- (a) in respect of loans made by the society, and
- (b) on insurance.

The section applies not only to directors, but also to any person who holds office in, or is employed, by a building society as a secretary, chief executive, manager, solicitor, surveyor or valuer, or in connection with the assessment of the adequacy of securities for loans secured on land.

The term "commission" includes any gift, bonus or benefit, and "solicitor" includes a licensed conveyancer (and, since the Legal Services Act 2007, certain people authorised to carry out certain legal activities eg preparing transfer of charges for registration at the Land Registry) (*section 67(7)*). The definition of "commission" in *section 67(7)* is very wide - because of the use of the word "includes" it is not *limited* to gifts, bonuses and benefits.

It is therefore important not to lose sight of the ordinary meaning of the word "commission", ie a payment made to an agent for introducing business to a principal. Therefore, the use of the word "includes" would seem to signify that commission is caught whatever form the payment may take, whether in cash or in kind, but the gift, bonus or benefit must still be paid *by way of commission*.

"Manager" is defined by *section 119(1)* a person "employed by the society who, under the immediate authority of a director or the chief executive, exercises managerial functions or is responsible for maintaining accounts or other records of the society". Therefore, a member

of staff could come within the scope of the section on promotion, change of duties or as a result of management re-organisation.

In certain paragraphs below, the officers and employees caught by the section are collectively described as “disqualified persons” which, in the context of *section 67*, means that they are disqualified from receiving commission.

(ii) Loan Commission

The 1986 Act provides that the disqualified persons described in *section 67(1)* above must not “accept from any other person any commission for or in connection with any loan made by the society” (*Section 67(2)*). The sub-section makes it clear that such commission is remuneration in addition to that prescribed or authorised by the rules or any resolution of the society.

Section 67(2) is aimed at preventing payments by third parties (eg an estate agent, solicitor or indeed the prospective borrower) to society employees to induce the society to make a loan. This purpose needs to be borne in mind.

In the past, conflicting views have been expressed on whether *section 67(2)* prevents a disqualified person from receiving *from the society* any commission, bonus or other benefit related to mortgage business; for example, under a results-orientated remuneration scheme. On balance, the prohibition on accepting commission “from any other person” seems to refer to any person other than the disqualified person. If so, commission from the society could not be accepted if it was in connection with any loan made by the society.

Because the commission that is prohibited is “in addition to remuneration prescribed or authorised by the rules or any resolution of the society”, societies’ rules usually give this authority, to be in a take advantage of the statutory qualification.

If a disqualified person contravenes *section 67(2)*, both the person accepting the commission and the person who paid it shall be liable on summary conviction to a fine *section 67(3)(a)*. However, the person paying the commission does not commit an offence unless that person made the payment knowing the circumstances constituted an offence on the part of the person accepting the commission (*section 67(4)*).

Under *section 67(3)(b)*, if the person accepting the commission (having been convicted of an offence under *section 67(3)(a)*), fails to pay over to the society the amount or value of the commission, as and when directed to do so by the court which convicted him, he is guilty of a further offence (and liable on summary conviction to imprisonment for a term not exceeding six months).

(iii) Insurance Commission

Section 67(5) relates to insurance commission and makes it unlawful for disqualified persons to receive certain types of commission from a person by or through whom an insurance policy is issued, i.e. from the insurance company or the broker/agent including the society through which insurance is arranged.

The subsection states, “Where -

- (a) a charge upon a policy of life assurance is given as additional security for a loan made by a building society, or

(b) a building society makes an additional loan to enable payment to be made of a premium on a policy of insurance, or

(c) any policy of insurance is taken out to comply with the terms on which a loan is made by a society, whether by way of insuring the property given as security for the loan or otherwise, and the policy is effected through the building society, or the society nominates or selects a person by whom the policy is to be issued, it shall be unlawful for any person to whom the section applies, to receive any commission from a person by or through whom the commission is issued”.

In Scotland, a charge on a policy of life assurance means an assignation in security in respect of such a policy (*section 67(7)*).

The subsection would catch commission arising from; for example -

(a) a life policy arranged through the society in an endowment mortgage,

(b) an indemnity guarantee policy arranged by the society where the premium is advanced in addition to the loan, and

(c) buildings insurance arranged through the society’s agency.

There is no exception for staff incentive schemes and no provision, corresponding to the one in *section 67(2)*, for commission to be prescribed or authorised by the society; this means that, unlike in relation to mortgage commission, there is no scope for a provision in a society’s rules to mitigate the effect of *section 67(5)*.

These prohibitions would apply if the society arranged the policy of insurance through its own broker subsidiary. However, commission on certain policies would not be caught; for example, mortgage protection, contents, personal sickness, unless taking out such policies was a condition of the mortgage.

While there were in the past conflicting views as to the correct interpretation to be placed on *section 67(5)*, in the Association’s opinion in circumstances where the policy was not effected through the society, and the society does not nominate or select the insurer, commission can be paid and received. It is thought that the *section 67(5)* prohibition is quite separate from that in *section 67(2)* - there is no overlap between them and they operate distinctly. However, if circumstances were such that a payment fell under both sub-sections, then the provisions of both would apply to it.

A person who pays, and a person who accepts, any insurance commission the Receipt of which *section 67(5)* makes unlawful, is liable on summary conviction to a fine (*section 67(6)*).

Before introduction of *section 67* some societies allowed their staff to take the benefit of the commission that would otherwise be earned on any insurance policy (both life and household) which were arranged through the society in connection with their own house, life or effects. The practice developed for insurance companies to agree to accept reduced premiums from staff by virtue of their status as employees of the society.

It is clear that disqualified persons are prohibited from receiving commission relating to policies connected with their *own* mortgage, life or effects in exactly the same way as they are prohibited from commission relating to third parties (ie where a life policy is additional security, or the society makes a loan in respect of the premium, or the policy is a condition of the mortgage).

However, it is the receipt of commission that is prohibited. Therefore, where a society has an arrangement with an insurance company so that its staff pay reduced premiums, which partially or completely discounts the commission which the society would be due, then the disqualified person would not be receiving any "commission" on the basis of the ordinary meaning of the word and the definition in *section 67(7)* (see above).

Where a staff mortgage or life assurance scheme incorporates commission rebates, it might be administratively simpler to arrange all such policies on a concessionary premium basis. This would avoid the need to monitor each member of staff to ensure that commission is not paid to a disqualified person.

The types of policies that could commonly be affected are -

- household insurance policies required as a term of the mortgage
- endowment policies (and similar) used as additional security for a mortgage
- indemnity policies where the premiums are advanced as part of the loan.

Life policies or other insurance taken out not connected with a loan by the society are not affected by the prohibitions.

9. Business Associates

(i) The Duty

The idea behind *section 69* is that directors (or other officers) should not be prohibited from participating in an outside business that derived income from the society, or the society's activities.

However, in principle, details of all such income (whether or not deliberately channelled to the business associate) should -

- be disclosed to the society and,
- be made available to members and to the FSA.

The underlying concern is that it might not be in the interests of the society for excessive amounts of business to be channelled to a small number of businesses in which directors etc have interests. Therefore, provided the rules give authorisation, there should then be transparency in relation to such interests.

The main features of *section 69* are that -

- (a) The director etc must be a director or proprietor of, or a partner in, a "business associate" (ie which provides "relevant services" - conveyancing, surveying/valuing, accountancy and insurance intermediary services - during the financial year in question and that is not a connected undertaking of the society.
- (b) The director etc must furnish the society with the "requisite particulars" of the business during the financial year (*section 69(6)*) and what these consist of depends on whether a society elects to adopt *Part II of Schedule 10* (see paragraphs below), which provides for disclosure by bands. To enable the director etc to furnish the "requisite particulars", the director etc can require anybody in the "business associate" to furnish such information as the director etc may reasonably require for the purpose (*section 69(9)*).

(c) Having furnished the "requisite particulars" to the society, the obligation then changes from the director etc to the society, which is obliged (*section 69(11)*) to keep a register of the particulars supplied to it unless the "volume of business" (defined in *paragraph 10(2) of Schedule 10*).

(c) The society also has to make a statement of the *section 69(11)* particulars, for the last financial year, available for inspection by members for 15 days before and at its AGM, and to send two copies of it to the FSA. The -members are also entitled to receive a copy of the statement on demand. A society may charge a fee not exceeding £5.

(ii) Section 69 Election

Section 69 allows a society to elect to adopt *Part II of Schedule 10* (which provides for disclosure by bands) as regards the "requisite particulars" to be furnished by its directors etc. The adoption of *Part II* means that a society can take advantage of "bands for disclosure" instead of stating exact amounts.

The election must be made in writing to the FSA before the beginning of the financial year in respect of which it is made. The following wording is an acceptable form of election for this purpose -

"The XYZ Building Society hereby elects pursuant to section 69 of the Building Societies Act 1986 to adopt Part II of Schedule 10 to that Act in respect of its financial year commencing on [1 January]".

The Building Societies (Prescribed Bands for Disclosure) Order 1987 SI 1987 No 723 prescribes two sets of bands. The first set concerns the number of cases and bands of 100 cases (starting with up to 100 cases) are prescribed. The second set relates to the aggregate fees and the bands prescribed range from zero - £1,000 to bands of £25,000 where aggregate fees exceed £25,000.

In each case the estimate must fall within one of the prescribed bands. If a society has not elected to adopt Part II of Schedule 10 in respect of the financial year concerned, Part I (which requires disclosure of precise figures) applies.

A suggested form, "Particulars of business of a business associate", was agreed between the Association and the FSA's predecessor regulator for building societies Building Societies Commission to assist societies in complying with the disclosure requirements under *section 69*. The Association also prepared guidance notes were on the completion of the form. Copies of the form and guidance are available at –

www.bsa.org.uk/docs/policy/practice_briefs/buss_ass_form.pdf

www.bsa.org.uk/docs/policy/practice_briefs/buss_ass_guidance.pdf.

The guidance notes explain that the form may be used for all three types of disclosure required under *section 69* since the same information is required in each case. It should be noted that accountants and insurance agents should give an indication of the aggregate amount of fees but are not required to give an indication of the number of cases.

The 1986 Act provides for electronic communications in respect of information that the society is required by *section 69* to provide to members (*section 69(15A)-(15B)*).

ACCOUNTS AND AUDIT

This sub-section covers accounting records and systems, auditors and audit, and procedures on completion of accounts.

1. Introduction

This brief covers the provisions of the Building Societies Act 1986 relevant to accounts and audit.

Section 119 provides definitions of terms used in the accounts and audit section of 1986 Act. *Section 119A* defines associated undertaking and participating interest (see below).

2. Accounting Records, Systems etc

(i) Accounting Records

All building societies must keep accounting records, which explain their transactions and state of business. *Section 71(3)* details what the accounting records should contain. *Section 71(9)* requires the records to be kept for six years.

(ii) Individual Accounts

Section 72A, B and C refer to building societies without subsidiaries which prepare their annual accounts using UK GAAP. They must provide a balance sheet and an income statement, both of which must give a true and fair view.

Section 72C refers to the form and content of the balance sheet, income statement and notes to the accounts, which are prescribed by HM Treasury in the Building Societies (Accounts and Related Provisions) Regulations 1998 (SI No 504) (the BS Regulations). For more details, see – www.bsa.org.uk/docs/policy/prudentialandfinreg/revisedbsregulations.pdf.

Directors of building societies that prepare individual accounts under international accounting standards (also known as international financial reporting standards, IFRS) must make this clear in the accounts (*section 72D*).

(iii) Group Accounts

Section 72E says that if a building society has subsidiaries, it must prepare group accounts as well as individual accounts. It applies to both UK GAAP and IAS societies. Once a society has prepared one year's of group accounts under IAS, it must continue to use IAS for these accounts unless there is a "relevant change of circumstance".

Section 72F and G refer to building societies with subsidiaries which prepare their annual accounts using UK GAAP. They must provide a balance sheet and an income statement, both of which must be prepared on a group basis and give a true and fair view.

These UK GAAP societies must comply with *section 72G*, which refers to the form and content of group accounts and notes to the accounts that are prescribed by HM Treasury in the BS Regulations.

Directors of building societies that prepare group accounts under international accounting standards (also known as international financial reporting standards, IFRS) must make this clear in the accounts (*section 72H*).

(iv) Consistency of Accounts

Where a building society prepares group accounts, it should ensure the society and its subsidiaries use the same financial reporting framework and same financial year unless there are good reasons not to do so (*section 72I*).

But HM Treasury guidance says that if a parent building society prepares individual and consolidated accounts under IAS, its subsidiaries do not have to. It concludes –

“The key point is that the directors of the parent building society must be able to justify any inconsistency to members, regulators or other interested parties.”

(v) Disclosures in Notes to Accounts

Section 72J states that societies must provide the information listed in *Schedule 10A* in the notes to the annual accounts. Part 1 of the schedule relates to emoluments and other benefits of directors and others, and to loans and other dealings in favour of directors and connected persons; part 2 relates to information about the employees of a society. HM Treasury can make an order to modify the provisions in this schedule.

Section 72K states that societies must provide the information listed in *Schedule 10B* in the notes to the annual accounts. Societies not preparing group accounts must provide the information in part 1 of the schedule. Societies preparing group accounts must provide the information in part 2 of the schedule. HM Treasury can make an order to modify the provisions in this schedule.

Information about all off-balance sheet arrangements - enough for the financial position of the society to be assessed - must be given in the notes to the accounts (*section 72L*). Information set out in *Schedule 10C*, providing for disclosure of auditor remuneration, must be given in the notes to the accounts (*section 72M*). The Building Societies Act 1986 (Accounts, Audit and EEA States) Amendments Order 2008 (SI No 1519) makes certain changes in this area to implement various EU Directives.

(vi) Annual Business Statement, Directors' Report, and Business Statement

Every society must prepare an annual business statement. If a society is part of a group, the annual business statement must also refer to the subsidiaries. The content of the annual business statement is prescribed by HM Treasury. It is not subject to statutory audit (*section 74*).

The directors' report must contain an analysis of the development, performance and position of the building society and its connected undertakings, if any, using financial key performance indicators (KPIs) and, where appropriate, other KPIs, including ones on environmental and employee matters. The directors' report must describe the principal risks and uncertainties facing a society's business, taking into account its size and complexity (*section 75 and 75A*).

(vii) Summary Financial Statement

- **General**

Building societies must prepare a summary financial statement every financial year. If a society has subsidiaries, it must give an account of their financial development and position. The SFS should make clear it is only summary and that a copy of the full accounts is available on request and free of charge. SFS have to be sent at least 21 days before the

AGM (*section 76*). The summary financial statement is designed to give individual building society members an indication of -

- how the society has performed during the financial year, and
- its position at the end of the financial year.

The term used for these requirements in the BS Regulations is “relevant matters”. See below for link to the Regulations (no 10 concerns the SFS).

Information for the summary financial statement should be taken from the annual accounts, annual business statement and directors’ report and must be summary ie concise. Given the intended audience is ordinary building society members, it should be written in plain English and be free of jargon.

- **Contents**

The SFS has to contain a –

- summary directors’ report
- summary statement
- summary of key financial ratios
- statement of the auditors’ opinion.

Societies may find it easier to write the SFS from scratch rather than simply cut and paste parts of the full annual report and accounts.

Ideally, the SFS should be a stand-alone document although that is not required by the BS Regulations. But if the SFS does form part of a larger publication, it must be labelled clearly and put it in a prominent place. It should not, for example, be swamped by pages of product information or other marketing material

Societies must send a copy of the SFS to every qualifying member at least 21 days before the annual general meeting. Copies of the full annual report and account remains available free of charge to members on demand.

The BS Regulations (Schedule 10) specify how the information should be set out including order, heading and sub-headings. In April 2007, different formats for IFRS societies were introduced (part 1A of Schedule 10). IAS societies now must include, for example, fair value gains and losses in the results for the year and derivative financial instruments in the position at end of year.

Societies are not allowed to deviate from the prescribed format although they can add in information if it helps “the giving of a summary account of the relevant matters”. Similarly, societies can omit a heading in the summary statement if there is nothing against it for the current or previous year.

While not prescribed, societies may wish to include a summary directors’ remuneration report. Several do this already.

If a society has prepared group accounts, it should cover subsidiaries in the SFS. And if those subsidiaries are material to the business, it should make appropriate reference.

- **Summary directors' report**

This may follow any format but must include a summary of the -

- society's business during the year and position at the end of the year
- events that have affected the society during the year, and since the year end, if any
- likely business developments.

- **Summary statement**

If a society has completed group accounts, it must include its subsidiaries in the summary statement. It must give figures for the previous year, adjusted, if necessary, to match up with the full accounts.

Two sets of figures must be given in this statement -

- results for the year (summarised income and expenditure)
- position at end of year (summarised balance sheet)

While UK GAAP societies should refer to Part 11 paragraph 5 of Schedule 10 of the BS Regulations to see how each item in the summary statement is comprised, the situation for IFRS societies is less clear cut. They are advised to adapt as best as possible the references for UK GAAP societies in Schedule 10 of the BS Regulations. They must still use the prescribed item headings, however.

For examples summary statements for UK GAAP and IFRS, please visit - www.bsa.org.uk/members/policy/prudentialandfinance/Summaryfs.htm.

- **Summary of key financial ratios**

Societies must provide four key ratios and explain what they measure and why they are important -

- gross capital as a percentage of shares and borrowings
- liquid assets as a percentage of shares and borrowings
- profit/loss for the year (after tax) as a percentage of shares and borrowing
- management expenses as percentage of mean total assets

These ratios must be identical to those given in the annual business statement. But societies should show gross capital and liquid asset ratios as being percentages of "shares and borrowings", not "shares deposits and debt securities".

As with other parts of the SFS, societies should include subsidiaries in their calculations if they have prepared group accounts.

The links below provide some practical information on the SFS –

www.bsa.org.uk/docs/policy/prudentialandfinreg/sfslayout.pdf

www.bsa.org.uk/members/policy/prudentialandfinance/commentarysfs.htm

3. Auditors and Audit

Auditors have to be appointed at every AGM (*section 77*). *Schedule 11* deals with the appointment, removal, resignation of auditors, and the notifications required if an auditor ceases to hold office. The definition of a senior statutory auditor is contained in *section 504(1)* of the Companies Act 2006 (*section 78B*).

Auditors have to make a report to members at every AGM and also make a report on a society's annual business statement and directors' report (*section 78*). The auditors' report must state the names of the auditors and be signed and dated by them (*section 78A*).

Section 78C states the auditor's report must give the name of the auditor and (where the auditor is a firm) the name of the person who signed it as senior statutory auditor. *Section 78D* describes the circumstances in which those names may be omitted.

Auditors' duties and powers are set out in *section 79*. Auditors have to form an opinion whether proper accounting records have been kept under *section 71* of the 1986 Act and whether the annual accounts agree with the accounting records.

Auditors of building societies may demand access to the accounting and other records of the society and all other documents relating to its business, and have a right to require from the officers such information and explanations they feel necessary to do their job. *Section 79* goes on to detail other rights of auditors.

4. Procedure on Completion of Accounts

Section 80 deals with the signing of the balance sheet and the documents that have to be annexed to it. Every balance sheet must be signed by two directors and the chief executive of the building society. The income and expenditure account and the annual business statement must be annexed to the balance sheet, as must any group accounts; the auditor's report must be attached to it. The directors' report must be attached to the balance sheet.

Section 81 deals with copies of the annual accounts. The annual accounts have to be presented at the AGM and be made available free of charge to members and depositors at every office of the society. Any member or depositor must be sent a copy of the annual accounts, if they ask for them. These may be sent electronically, via e-mail, or be posted on the society's website, if the member/ depositor agrees. Two copies have to be sent to the FSA at least 14 days before the AGM

Section 81A contains further requirements including one that states that a building society that prepares group accounts must not publish its statutory individual accounts without also publishing with them its statutory group accounts.

Section 81B provides definitions of terms such as annual accounts, income and expenditure account and international accounting standards.

The Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2008 (SI No 1143), among other things, require societies to give certain information about transactions with related parties in the notes to the accounts.

USE AND CHANGE OF NAME

This sub-section covers use by third parties and by building societies of building society, registered and business names.

1. Third Parties: Restriction of Use of Certain Names etc

Any person carrying on business in the United Kingdom (other than a building society) is prohibited from using a name, or in any other way describing or holding himself out, so as to indicate or reasonably be understood to indicate that he -

- (a) is a building society,
- (b) or his business, is connected with one or more building societies, or
- (c) or his business, is connected with building societies generally.

(*section 107(1)*).

Clearly, the intention of the prohibition is to prevent other organisations holding themselves out as building societies in order to benefit from societies' hard-earned reputation for safety and security.

Breach of the prohibition, which applies to individuals and to organisations, is a criminal offence (*section 107(11)*). Though directed towards third parties, *section 107* could nonetheless be of concern to building societies, for example if a society took part in a venture with another entity that wanted to use the society's name.

There are a number of exceptions to the prohibition -

(a) By *section 107(2)* and (3), where an institution carrying on a business similar to that of a building society (basically, a bank that lends on mortgage - see also *section 107(12)*), with its principal place of business outside the UK, uses a name under which it carries on business in that place in immediate conjunction with a description -

- (i) approved by the FSA,
- (ii) which distinguishes it from a building society by reference to all or any of certain matters (situation of its principal place of business; its legal status or constitution; the law, if any, which authorises it to take deposits in the UK) as the FSA determines, and
- (iii) which, if it appears in writing, is prominent enough to ensure that a person who reads the name also reads the description.

(b) A person may carry on a business under a name that indicates a connection with one or more building societies if the name had been approved by the FSA. However, the FSA must be satisfied, having regard to certain specified matters, that the connection indicated by the name is not misleading (*section 107(4)* and (5)).

(c) If the society or societies concerned authorise in writing the person to use the relevant description (*section 107(8)*).

(d) If the connection indicated is not misleading (*section 107(9)*).

Applications for approval under (a) and (b) above must be made in such form as the FSA directs (*section 107(6)*) and such approvals may be revoked in certain circumstances (*section 107(7)*).

Exceptions (c) and (d) were included during the 1986 Act's progress through the House of Commons, following representations from the Association that the provision as originally drafted could cause difficulty for duly appointed agents of a society. Accordingly, the exceptions were intended to protect society agents, but they could presumably encompass others.

If a company's name, or words for inclusion in a business name, appears to the specified authorities to contravene *section 107(1)*, then it must not be registered under the companies or business names legislation.

Using a name for one's business that is deceptively similar to another business name might constitute the tort (a civil wrong) of 'passing off', if the victim can show loss (or damage to goodwill). The victim might be able to obtain a court injunction to restrain the use of the relevant name.

The BSA often contacts organisations that, either deliberately or inadvertently, appear to be passing themselves off as building societies, possibly in breach of *section 107*. The FSA has also contacted certain bodies, from time-to-time, about potential breaches of *section 107*.

Such contact by the trade body and/or regulator is often successful but, with the spread of the Internet, it is becoming increasingly difficult to persuade certain organisations, especially those based abroad, not to mis-use the 'building society' name. However, the Association continues its efforts and encourages societies to notify the Secretariat of examples that come to their attention.

2. Building Societies: Use and Change of Name etc

While *section 107* restricts *third parties* in relation to names indicating a connection with building societies, certain provisions in *Schedule 2* govern use and change of name **by building societies**.

(i) Basic Points

The memorandum must specify the name of the society (*paragraph 2(2)(a) of Schedule 2*).

The common seal of a building society must bear the registered name of the society (*paragraph 9(1)*).

The registered name is the name of the society registered with the central office of the Registry (*paragraph 9(8)*).

(ii) Change of Name

The 1986 Act deals with change of name, as follows -

- (a) a building society's name may be changed by special resolution,
- (b) the notice of the change of name must be sent to the FSA. Unless the FSA considers the change of name undesirable, it will register the notice and give the society a certificate of registration (failure to comply with this provision is a criminal offence - *paragraph 10(5)*),

(c) a change of name does not affect the rights and obligations of the society or any of its members or other person concerned.

(paragraph 9(3) to (7) of Schedule 2).

Societies do occasionally change their names. It is usual to take certain precautions before making the change, such as contacting the FSA in advance and carrying out service mark searches against the planned new name. **NB:** Also see SUP 15.5 (page 152 below)

(iii) Registered Names

An amendment made to the 1986 Act by the Building Societies Act 1997 removed the prohibition on a building society using a name or title other than its registered name (the previous *paragraph 9(2) of Schedule 2* stating that: "A building society shall not use any name or title other than its registered name" was repealed).

Therefore, societies may now trade under any name they choose, subject to certain limitations (see the requirements for business names – *paragraph 10A*, below).

However, since societies now have wider powers, much the same as those of companies, in relation to use of names, they are now subject to provisions similar to those on company identification in the Companies Act 2006 -

(a) **Display of registered name** - a society's registered name must be painted or affixed, and kept painted or affixed, outside premises in which its business is carried on, in a conspicuous position and in letters easily legible (*paragraph 9(2) of Schedule 2*).

(b) **Letters, documents etc** - a society's registered name must be set out legibly in all of its business letters and other documents - effectively, any documents that the public might see or to which it might have access; the list includes the following –

- business letters
- account statements
- passbooks
- notices
- publications
- invoices
- receipts
- letters of credit
- contracts
- agreements
- mortgages
- deeds
- bills of exchange
- promissory notes
- endorsements
- cheques, and
- orders for money or goods.

(The requirement also applies to documents contained in electronic communications or published on a website - *paragraph 9(2A)*).

The 1986 Act creates criminal offences for failing to comply with the above requirements. The offences go into some detail about the responsibility not only of the society itself but of the officers etc who may be liable personally (*paragraph 10*).

A number of practical questions arose in relation to the requirement to display the society's registered name, some of which were considered by the BSA Legal Panel -

(a) *If a society is a business tenant in a building occupying part only of a building, such as one floor, is it necessary to display its registered name outside the building?*

The Association's view is that the words "outside every office or place in which its business is carried on" indicate that it would be sufficient to display the name outside the entrance to the part of the building where it carries on business, for example, a common entrance lobby. It should not be necessary to place the name outside the building itself, as the wording in *paragraph 9(2)* does not refer to "*the building in which the business is carried on*".

(b) *Would it be necessary to display the registered name outside premises to which customers do not have access (eg storage, IT facilities etc) and potential security risks exist if the name of the society is fixed to the premises; namely, the possibility that criminals might believe that there is cash on the premises?*

The Legal Panel considered this question. Some Panel members took the view that there was a statutory obligation to display the name, not mitigated by concerns over security. The counter argument was that storage, IT facilities etc were not places where the society's "business is carried on", because the terminology requires a trading element or activity and this is absent in such premises. In other words, such facilities are not places where the society carries on its business; rather they are places where the society has facilities that enable the business to be carried on at some other place or places.

While this would be a question of degree, depending on the activity carried on, the counter argument is logical. The underlying purpose of the provision is to ensure that those conducting business with the society know who they are dealing with. This might not be a consideration where there is no public (or only limited third party) access.

(c) *Would the registered name have to be displayed outside the premises of society agents?*

In practice, it is assumed that this would seldom be a problem and societies would, broadly speaking, want their names to be displayed and the agents would be happy to co-operate (or, indeed, if they did not it could be imposed as a condition of the agent's appointment or re-appointment).

However, turning to the legal position, consideration with the Legal Panel indicated that there appear to be two possible interpretations; either –

- the agent is carrying on society business and, accordingly, the society's registered name must be painted or affixed outside the office; or,
- in reality, the agent is carrying on the *agent's* business and, therefore, it is not necessary for the society's name to be displayed.

It is instructive to return to the statutory wording - "*every office or place in which its business is carried on*", ie the real question is whether or not the *society's* business is being carried on. Technically, an agent is a person appointed to bring about a contract between his principal and a third party. Therefore, if a person were acting as an agent for the society in that strict technical sense, then it would seem to be the society's business that he is carrying on.

In addition, if there were already a contract between the society and the customer and the agent in carrying out that contract (eg taking investments for the society) then the agent would presumably be carrying on the society's business. Accordingly, while a branch agency bringing about contracts between the society and customers would probably come within this category, an intermediary or introducer of mortgage business, unless a formal agent of the society would probably not.

On a similar point, it seems clear that the business of a society subsidiary is *not* society business since the society and its subsidiary are separate corporate entities, unless the subsidiary is acting as an agent for the society (in the strict contractual sense).

As with other questions of statutory interpretation, while the BSA Secretariat is always happy to help, societies will ultimately need to make their own commercial decisions based on recommendations from their legal advisers.

(iv) Business Names

As noted above, building societies now have similar freedoms to use business names as are enjoyed by companies. In particular, a society may now -

- (a) use a business name other than its registered name for the whole or part of its business, and
- (b) use a business name including the name of a predecessor society (for example, following a merger) but excluding the words 'building society'.

However, as a corollary to these freedoms, societies are subject to similar requirements as companies concerning identification of the organisation (see above) and also to certain restrictions regarding use of business names. The business names requirements do **not** apply where a building society carries on business under any of the following -

- (a) its registered name,
- (b) its registered name with the omission of the words or
- (c) its registered name with an addition that merely indicates that the business is carried on in succession to a former building society with which it has merged

(*paragraph 10A(1)*).

The requirements set out below that apply *only* where a society is using a business name should, therefore, be contrasted with those in *paragraph 9(2) and (2A)* (see above) that apply to *all* societies.

The requirements in relation to use of business names are as follows -

- (a) **Names indicating connection with Government etc** - a society must not, without the written approval of the Commission, carry on a business under a name which might give the impression that it is connected with the Government or any local authority (*paragraph 10A(2)(a)*).
- (b) **Words or expressions specified in regulations** - from 1 March 1999 a society must not, without the written approval of the FSA (or other relevant body), carry on business under a name specified in the specified Schedule to the Building Societies (Business Names) Regulations 1998 (SI 1998 No 3186).

These Regulations are similar to the corresponding provisions affecting companies, which incidentally already apply to company subsidiaries of building societies.

Words such as those indicating national coverage (eg "British", "English" etc), connections with Royalty (eg "Her Majesty", "Royal") etc, are restricted (*paragraph 10A(2)(b)*).

Provisions relating to the giving of relevant approvals are set out in *paragraph 10A(4)*.

(c) **Letters, documents etc** - the documents specified in *paragraph 9(2A)* (see above) must contain the society's registered address in legible characters "which are reasonably prominent" and, in legible characters, an address in the United Kingdom for service of documents (*paragraph 10B(1) and (2)*).

(d) **Display of registered name and address** - the society must also display, in any premises where the business is carried on and to which members, customers or suppliers of goods or services have access, a notice containing its registered name and address for service, in a prominent position so it may easily be read by them (*paragraph 10B(3)*).

(e) **Giving of name and address by written notice** - the society must also give its registered name and address immediately by written notice to anyone with whom anything is done or discussed in the course of business and who asks for the information (*paragraph 10B(4)*).

The Treasury, may make regulations to require a notice referred to in *paragraph 10B(3) and (4)* to be displayed or given in a specified form. Since the Treasury has not made regulations, there are no specific rules about what is meant by "in legible characters" or "reasonably prominent". Societies would have to make a judgement in each case.

However, Companies House provides some useful information on business names www.companieshouse.gov.uk/.

Paragraph 10C creates criminal offences for failing to comply with the requirements above.

DISSOLUTION, MERGERS AND TRANSFERS

This sub-section covers winding-up, dissolution, merger of building societies and mutual societies' transfers.

1. Winding Up and Dissolution

(i) Methods

There are only four ways in which a building society may be dissolved or wound up (the two terms mean broadly the same thing – the termination of the society) -

- Wound up voluntarily (ie with member consent)
- Wound up compulsorily
- Dissolved by instrument of dissolution (ie with member consent)
- Dissolved following a merger or a transfer of business (ie by court order)

(*section 86*).

(ii) Winding Up

The main legislation governing the winding up of a building society is the Insolvency Act 1986. The Building Societies Act 1986 applies relevant insolvency legislation provisions to building societies, with certain modifications (*Schedule 15* applies the companies winding up legislation to building societies and *Schedule 15A* applies the other companies insolvency legislation to them; eg administration orders, voluntary arrangements etc).

The main substantive provisions from the Insolvency Act 1986 now applicable to building societies relate to –

- Voluntary arrangements (Part I)
- Administration Orders (Part II)
- Receivership (Part III, Chapter I))
- Winding Up (Part IV)
- Preferential Debts (Part XII)
- Insolvency Practitioners (Part XIII).

As noted, there are certain modifications for building societies. In July 2009, HM Treasury launched a consultation, which runs till 30 October 2009, covering two main areas: applying the new bank insolvency procedure and bank administration procedure to building societies; and enabling financial assistance to building societies from the Authorities against the security of a floating charge; for more information, see *sections 90A and 90B* and www.bsa.org.uk/members/circular/6941.htm.

A society may be wound up **voluntarily** by special resolution. The 1986 Act contains a number of administrative requirements, such as prior notice to the FSA (*section 88*). (See also regulation 8(1) of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (SI 2004 No 1045).

There are several grounds for **compulsory** winding up; namely, that –

- (a) The society has resolved by special resolution to be wound up by the court
- (b) The number of members has fallen below 10
- (c) The number of directors has fallen to one or none
- (d) The society has not been granted authorisation despite being registered for more than 3 years
- (e) The FSA has revoked the society's authorisation
- (f) The society exists for an illegal purpose (in practice, this seems to mean that the society has ceased to comply with the 1986 Act requirements about purpose or principal purpose)
- (g) The society is unable to pay its debts
- (h) The court is of the opinion that it is just and equitable to wind the society up
(section 89(1))
- (i) The FSA exercises one of its powers of control, under *section 37(1)*, including a winding up order.

The practice and procedures in relation to a building society winding up are, as noted, those set out in the Insolvency Act 1986 and are much the same in substance as for companies.

(iii) Dissolution by Instrument

A building society may be dissolved with the consent of three-quarters of the members, holding not less than two-thirds of the shares in the society. They must sign a dissolution instrument that sets out a number of details, such as the assets and liabilities of the society, the number of members, the amount standing to their credit etc. The dissolution by instrument process is of very long-standing.

The instrument of dissolution binds all members from the date when it is placed on the public file of the society (*section 87*).

The rest of *section 87* contains a number of administrative and procedural provisions. Also note certain provisions in *Schedule 2* – especially *paragraphs 7(5) and 8(5)*, which state that, for instruments of dissolution, only the shares of representative joint holders and representative joint borrowers count with regard to the consent and calculations.

Dissolution differs from voluntary winding up in a number of ways. For example, there is no need for a society resolution for dissolution provided a valid instrument is prepared (voluntary winding up requires a special resolution). Also, it seems that creditors may continue to enforce judgments while dissolution is in process – this would not be possible with a winding up (*Browne v Royal Permanent Building Society (1898) 18 VLR 397*).

(iv) Voluntary Arrangements

A society in serious financial difficulty might be able to use the voluntary arrangement procedure set out in Part I of the Insolvency Act 1986. The procedure must be approved by a meeting of creditors and is then binding on all of them (*paragraphs 7 – 9A of Schedule 15A*).

(v) Administration Orders

An administration order is a court order that gives an organisation a moratorium (breathing space), during which time creditors may not bring proceedings. The main objective is to help the society to survive as a going concern, if possible. The FSA or a shareholding member may apply to the court for an administration order. The arrangements are set out in *paragraphs 10 – 24 of Schedule 15A*).

2. Mergers

(i) Methods

A building society can merge with another building society, but not with a different type of corporate body (such as a company). However, a society may transfer its business to a company (see Transfers of Business, below).

There are two methods for the merger of building societies –

Amalgamation – this is a process whereby two building societies join together in the form a new building society that they have established.

Transfer of Engagements – this is a process whereby a building society transfers its assets and liabilities to another building society and ceases to exist as a separate society.

Many of the statutory requirements for amalgamations and transfers of engagement are the same; notably - bonuses to members; compensation to directors for loss of office; notification to, and confirmation by, the FSA; and statements and notifications to members. *Sections 95 -96 and Schedule 16* set out the provisions relating to both types of merger.

Section 93 deals specifically with amalgamations and *section 94* deals specifically with transfers of engagements.

(ii) Voting Arrangements

Each society must approve an **amalgamation** (and the memorandum and rules of the successor society) by –

- a shareholding members' resolution, and
- a borrowing members' resolution

(section 93(2)(c)).

A shareholding members' resolution must be passed by not less than three-quarters of the number of the shareholding members of the society -

- (a) qualified to vote on a shareholding members' resolution; and
- (b) voting in person or by proxy on a poll on the resolution at a meeting of the society of which notice specifying the intention to move the resolution as a shareholding members' resolution has been duly given

(paragraph 27A of Schedule 2).

A borrowing members' resolution must be passed by a simple majority of the borrowing members of the society voting in person or by proxy on a poll on the resolution at a meeting of the society of which notice specifying the intention to move the resolution as a borrowing members' resolution has been duly given

(paragraph 29 of Schedule 2).

On a **transfer of engagements**, the society wishing to transfer its engagements (the transferor society) must approve the proposal by a shareholding members' resolution and a borrowing members' resolution (*section 94(2)*).

The transferee society must resolve, by the same resolutions, to undertake to fulfil the transferor society's engagements *unless* it opts to do so by Board resolution and the FSA consents (*section 94(5)*).

Until the 1997 Act amended the 1986 Act, the legislation included special provisions for societies that planned to merge and were of a 'disproportionate' size. The relevant provision is now in paragraph 4.41 of Chapter 2 in Volume 2 of IPRU(BSOC) (most of which is now deleted – see page 141 below) - which states –

"Unless it is persuaded otherwise in the circumstances of any particular case, the [FSA] will not normally grant this exemption [ie to use a Board resolution instead of members' votes] unless the total assets of the transferor society are substantially larger than the total assets of the transferee society, and a total asset ratio of 5:1 will be used by [the FSA] as a broad first measure of relative significance."

(iii) Bonuses to Members

There is no obligation on either of the merging societies to pay a bonus to members (*section 96(4)*). A bonus may be in cash, or a special rate of interest available to members for a limited period (*section 96(8)*).

Any distribution must be approved by the two resolutions approving the merger of the society planning to pay the bonus. If the amount to be distributed would exceed 5% of the society's total assets, then the other society must also approve the bonus by the two resolutions approving the merger (*section 96(4)(b)*) and the Building Societies (Mergers) Regulations 1987 (SI 1987 No 2005), amended by the Building Societies (Mergers) (Amendment) Regulations 1995 (SI 1995 No 1874). For more information, see www.bsa.org.uk/docs/policy/practice_briefs/attachment_mergers.pdf.

(iv) BSOG

BSOG 2 contains detailed commentary on the relevant provisions including those, or under, the Building Societies Act 1986 <http://fsahandbook.info/FSA/html/handbook/BSOG>

The Guidance covers, among other things -

- Information provided to members
- general meetings and resolutions
- confirmation
- transfers of engagements under direction
- registration and dissolution
- timetable
- various standard documentation (see BSOG 2 annexes)

3. Mutual Societies' Transfers

(i) Legislative Background

The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (often known as the “Butterfill Act” after the MP who proposed it as a Private Members’ Bill) received Royal Assent in October 2007.

The Butterfill Act enables HM Treasury to make certain changes to the 1986 Act, including changes enabling the transfer of the business of a mutual society to a subsidiary of another mutual society (sections 3 and 4) - the relevant statutory instrument, the Mutual Societies (Transfers) Order 2009 (SI 2009 No 509) (the 2009 Order), came into force on 5 March 2009. The Butterfill Act and the 2009 Order may be accessed at -

www.opsi.gov.uk/acts/acts2007/PDF/ukpga_20070026_en.pdf

www.opsi.gov.uk/si/si2009/uksi_20090509_en_1

(ii) Application and Method

Part 2 of the 2009 Order is the main operative part. It applies to a transfer of the whole of the business of a building society to the subsidiary of another mutual society within the meaning of the Butterfill Act; namely –

- a building society
- a friendly society within the meaning of the Friendly Societies Act 1992
- an industrial and provident society registered (or deemed to be registered) under the Industrial and Provident Societies Act 1965 or
- a EEA mutual society.

It applies only where the transfer agreement contains a statement that it applies (article 3(1)).

Part 2 modifies the application of certain provisions of the 1986 Act and the Building Societies (Transfer of Business) Regulations 1998 (the 1998 Regulations), which apply to a transfer of the business of a building society to a company. Article 7 gives effect to section 4 of the Butterfill Act in relation to such transfers.

Article 5 modifies the application of *paragraph 30 of Schedule 2* to the 1986 Act so that the transfer needs to be approved by –

- a borrowing members’ resolution and
- a shareholding members’ resolution,

instead of by a borrowing members’ resolution and the “requisite shareholders’ resolution” (the requirements for which are set out in *paragraph 30 of Schedule 2*).

Article 6 modifies the application of *section 97* of the 1986 Act so that a specially formed successor company may be formed by the building society itself or by the mutual society of which the company is a subsidiary (“the holding mutual”).

(iii) Distribution of Funds

Article 7 gives effect to section 4 of the Butterfill Act. A distribution of funds may be made by the building society or by the holding mutual, or both. It must be approved by the

resolutions approving the transfer if a distribution made by the building society exceeds the limit specified in article 7(3) –

- 5% of the society's total assets, or
- If less, by the formula based on the deduction of the transferor's fixed assets from its general reserves.

If a distribution made by the holding mutual exceeds the limit specified in article 7(6), it must be approved by the resolution of that mutual approving the transfer, or if the transfer is approved by its board, by a resolution of the members of that mutual.

(iv) Membership of the Holding Mutual

Article 11 modifies the application of the 1986 Act by inserting a new section - *section 100A* - requiring the terms of the transfer to include a provision making membership of the holding mutual available to members of the building society and to persons who, after the transfer, become customers of the building society's successor.

Membership must be available on terms no less favourable than those enjoyed by existing members of the holding mutual, unless membership of any parent undertaking of the holding mutual is made available to members of the building society.

(v) Restrictions on Further Transfer

Article 12 modifies the application of *section 101* of the 1986 Act so that the holding mutual is able to hold more than 15% of the shares in the successor company. It also reduces the protective period during which the restrictions in *section 101* apply from five years to three years, and removes the provision which allows a company to disapply the section by passing a special resolution. *Section 101* applies to a successor company which is an existing company.

(vi) Other Provisions

Article 13 modifies the application of sections *102B* and *102C* of the 1986 Act, which are concerned with protecting the interests of beneficiaries in trustee accounts, so that those sections apply in relation to any distribution made by the holding mutual as well as to a distribution made by the building society.

Articles 14 to 17 modify the application of the 1998 Regulations. Schedules 1 and 2 to those Regulations list the matters of which a society must provide particulars to its members in a transfer statement or transfer summary. Articles 16 and 17 modify the application of those Schedules so that particulars of some specific matters are not required, and particulars of other additional matters are required.

Part 1 of the 2009 Order contains administrative provisions about commencement, interpretation etc. Part 3 provides that a mutual insurer is an EEA mutual society and defines mutual insurer.

4. Transfers of Business

The BSA does not issue guidance on building society conversions to plc status, but BSOG 3 in the FSA Handbook provides relevant information.

5. Electronic Communications

As with certain other areas of the 1986 Act, various provisions relating to dissolution, winding up, mergers, and transfers of business have been amended to accommodate electronic communications; namely –

- **Statement containing required particulars in relation to transfers of engagements** (*paragraphs 3(2A), (2B), (2C) and (3A) in Schedule 8A*)
- **Statement containing required particulars in relation to a transfer of business** (*paragraphs 9(2A), (2B), (2C) and (3A) in Schedule 8A*)
- **Merger statements (where the society wishes to merge)** (*paragraphs 1(2A), (2B), and (2C) in Schedule 16*)
- **Merger statements (where the society has received a merger proposal) where notice of meeting is transmitted electronically** (*paragraphs 4(2A), (2B) and (2C) in Schedule 16*)
- **Transfer statements or summaries** (*paragraphs 4(1A), (1B), (1C), (2A), (2B), and (2C) in Schedule 17*)
- **Transfer proposal notifications where notice of meeting is transmitted electronically** (*Part IA of Schedule 17*).

ELECTRONIC COMMUNICATIONS

This sub-section provides an overview on the statutory provisions regarding electronic communications with building society members on constitutional matters.

1. Introduction

This guidance provides a commentary on the Building Societies Act 1986 (Electronic Communications) Order 2003 (SI 2003 No 404) (the Order). The Order amended numerous provisions in the 1986 Act.

The Order, which came into effect on 20 March 2003, enables building societies, if they wish, to communicate electronically with their members on constitutional matters such as summary financial statements, notices of meetings, voting etc.

When the Government proposed that relevant amendments should be made to the (then) Companies Act 1985 to allow companies to make electronic communications, the Association made representations to HM Treasury that building societies would also need amendments to their own legislation to ensure a level-playing field with other businesses.

The Association and Nationwide Building Society commissioned Malcolm Waters QC to prepare a first draft of the Order. The making of the Order, under the Electronic Communications Act 2000 (the 2000 Act), followed detailed consultation between the Association, Nationwide Building Society and HM Treasury.

Some customers and societies may prefer electronic communications. This could lead to cost savings for societies, mean that information would be received more quickly, and provide the other advantages normally associated with electronic communications, such as space saving.

The Order does not compel either building societies or their members to use electronic communications; it simply enables them to do so, provided both parties agree.

In 2008, nearly half (47%) of the 56 societies replying to the BSA's AGM questionnaire confirmed that they offered members the option to vote online - up from 37% in 2007. In 2009 the figure rose to 66% - www.bsa.org.uk/members/circular/6957.htm.

2. Definition of "Electronic Communications"

"Electronic communication" is defined in section 119 of the 1986 Act (amended by article 9 of the Order) as "an electronic communication within the meaning of the Electronic Communications Act 2000 the processing of which on receipt is intended to produce writing".

Section 15 of the 2000 Act states: "'communication' includes a communication comprising sounds or images or both and a communication effecting payment", and defines 'electronic communication' as "a communication transmitted (whether from one person to another, from one device to another or from a person to a device or vice versa) –

- (a) by means of a telecommunication system (within the meaning of the Telecommunication Act 1984); or
- (b) by other means but while in electronic form".

The definition of ‘telecommunication system’ in the Telecommunications Act is a lengthy, technical one that does not specify particular formats (for example, email).

It is not surprising that these legislative definitions are very wide, because electronic communication is a rapidly developing area and narrow definitions might exclude new forms of communication.

The Order made certain other additions or amendments to definitions in section 119 to accommodate electronic communications, ie “ballot”, “electronic address”. “electronic ballot”, “postal ballot”, and “notice”.

The 2000 Act contains a number of other definitions relevant to the Order, including “authenticity”, “integrity”, “electronic signature” etc.

3. Substantive Communications

Subject to the requirements included by the Order in the 1986 Act, building societies may now make (and, in some cases, receive) electronic communications relating to –

(i) General Meetings

- **Directors’ election addresses** (*Article 3 of the Order, inserting new section 61(7A), (7B), (7C), (7D) and (7E) in the Act*)
- **Statement of matters to be dealt with at a special meeting of the society** (*Article 13, inserting new paragraphs 20A(1A), (1B) and (11A) in Schedule 2 to the Act*)
- **Notice of a meeting** (*Article 14, inserting new paragraphs 22A and 22B in Schedule 2*)
- **Appointment of proxies** (*Article 15, inserting new paragraphs 24(1A) and (1B) in Schedule 2*)
- **Notices and statements in connection with a members’ resolution** (*Article 16, inserting new paragraphs 32(2A), (2B), (2C), (2D) and (3A) in Schedule 2*)
- **Notices of postal ballots** (*Article 17, inserting new paragraphs 33(1A), (5A), (5B), (5C), (5D), (5E), (6A), (6B), (6C) and (7A) in Schedule 2*)
- **Electronic ballots** (*Article 18, inserting a new paragraph 33A in Schedule 2*).

(ii) Management of Societies

- **Board’s reasons for approving a director over normal retirement age** (*Article 2, inserting new section 60(7A), (7B) and (7C) in the Act*)
- **Statement of registered particulars of registered transactions - records of loans etc for directors etc - falling within section 65** (*Article 4, inserting new section 68(6A), (6B) and (11A)*)
- **Statement of the registered particulars of related businesses of directors or officers of the society** (*Article 5, inserting new section 69(15A) and (15B)*).

(iii) Accounts and Audit

- **Summary financial statement or auditor's report** (Article 6, inserting new section 76(8B), (8C), (8D), (9A), (9B), (9C), (9D) and (9E))
- **Copy of the annual accounts** (Article 7, inserting new section 81(3A), (3B) and (5A))
- **Copy of representations made by a retiring auditor or a statement of the effect of a High Court order** (Article 22, inserting new paragraphs 4(9A), (9B), (9C) and (10A) in Schedule 11)
- **An auditor's notice of resignation or a statement setting out the effect of an order of the High Court or the FSA** (Article 23, inserting new paragraphs 7(7A), (7B), (7C) and (8A) in Schedule 11)
- **Statement by a resigning auditor of the circumstances connected with his resignation** (Article 24, inserting new paragraphs 8 (3A), (3B) and (3C) in Schedule 11).

(iv) Dissolution, Winding up, Mergers and Transfer of Business

- **Statement containing required particulars in relation to transfers of engagements** (Article 20, inserting new paragraphs 3(2A), (2B), (2C) and (3A) in Schedule 8A)
- **Statement containing required particulars in relation to a transfer of business** (Article 21, inserting new paragraphs 9(2A), (2B), (2C) and (3A) in Schedule 8A)
- **Merger statements (where the society wishes to merge)** (Article 25, inserting new paragraphs 1(2A), (2B), and (2C) in Schedule 16)
- **Merger statements (where the society has received a merger proposal) where notice of meeting is transmitted electronically** (Article 26, inserting new paragraphs 4(2A), (2B) and (2C) in Schedule 16)
- **Transfer statements or summaries** (Article 27, inserting new paragraphs 4(1A), (1B), (1C), (2A), (2B), and (2C) in Schedule 17)
- **Transfer proposal notifications where notice of meeting is transmitted electronically** (Article 28, amending Part IA of Schedule 17).

Obviously some of the above communications are of a regular, 'routine' nature (eg most of those relating to general meetings), but others are occasional or exceptional (eg the communications relating to dissolution, winding up, mergers).

4. Arrangements for the Communications

Most of the types of communication listed above may be sent electronically to the person's electronic address, or be published on a website.

The exception is that there is no provision for proxy forms to be published on a website, but they may be sent electronically. The legislation, as currently drafted, seems to mean that in order for a society to send to members an e-pack for the AGM, then (whilst the Notice of Meeting and summary financial statement etc) could be accessed via a link to a website, a

proxy form would have to be sent as an attachment to the email. The BSA is looking into this matter.

A communication may be sent electronically only if the member has given consent by notifying the society of his or her electronic address for the purpose of the communication.

Publication on a website will normally satisfy the legislation only if the following conditions are met –

- the society and the relevant person have agreed to that person accessing information on a website
- the published information is the information to which the agreement applies
- the society notifies the person, in a manner they have agreed, of –
 - the publication of the information, notice etc on a website
 - the address of the website, and
 - the place on the website where it may be accessed, and how it may be accessed.
- the society displays the information, notice etc on the website for the period specified by the relevant provision in the Act.

(Typically, there is also a provision to cover circumstances where the society failed to publish for all of the specified period – if this was due entirely to circumstances that the society could not have been reasonably expected to prevent or avoid, the event to which the notice, information etc relates, is not invalidated).

Although that is the typical position, there are some variations in certain provisions, so societies must be careful to check each one that is relevant to the changes they plan to make.

5. Society Rules

Article 10 of the Order amends *paragraph 3 of Schedule 2*, by inserting a new *sub-paragraph (5)*, which states –

“Nothing in the rules of a society shall prevent the service of a notice or other document by the society –

(a) by sending it electronically to an electronic address notified for the purpose in accordance with express provision made by this Act; or

(b) by its publication on a web site in accordance with any such provision.”

Therefore, changes are not generally required to societies’ rules.

Nevertheless, the position regarding electronic ballots requires consideration, especially *paragraph 33A of Schedule 2*. *Paragraph 33A(6)* provides that a society’s rules may make provision as to the consequences of irregularities occurring in the course of the ballot (such as provision as to the validity of multiple votes cast by a member in the same election or on the same resolution).

This provision was introduced because there is a risk that, where there is a combination of electronic voting and a postal ballot, some members might wrongly believe that they are entitled to vote twice. It is even possible that some members might purport to vote twice and do so inconsistently.

Therefore, societies intending to introduce electronic ballots might consider including a provision in their rules to cover these points. For example, a relevant rule might provide for the times at which the society will treat postal and electronic returns as having been received by the society, and specify that the return which the society will treat as being received last will be taken to have been revoked and replaced by any earlier return, or returns, from the same member.

However, it is likely that the instances of double voting would be very small and existing scrutineering procedures should be able to deal with the matter in practice, without the need for a specific rule. Societies exploring electronic communications may want to consult their scrutineers on this matter

A society may (in any election or resolution that may - under its rules - be conducted by postal ballot) conduct a ballot that comprises a combination of electronic voting and postal ballot.

But all the voting may be electronic voting only if the society's rules expressly permit the exclusive use of electronic voting in those circumstances (see *paragraph 33A(4)* of Schedule 2 to the 1986 Act). However, this provision seems to be academic at the moment because, for practical reasons of consumer take-up, there is no chance of this happening for many years.

6. Register of Members

Article 12 of the Order amends paragraph 13 of Schedule 2. Sub-paragraph (1A) states that –

“Where a member has notified to the building society an electronic address for the purpose of receiving notices or documents required to be sent under this Act, the register shall show –

- (a) the electronic address in addition to the postal address of the member; and
- (b) the purposes for which the electronic address has been notified.”

Therefore, the register of members would have to be amended accordingly.

7. Miscellaneous

The other Articles in the Order contain consequential amendments or interpretational provisions –

- Article 8 - electronic service of notices
- Article 9 – interpretation of the 1986 Act
- Article 11 – use of name in documents sent etc by electronic transmission
- Article 29 – electronic appointment of proxies
- Article 30 – electronic ballots.

8. Errors in the Order

The BSA identified a small number of typographical and other minor errors in the Order. HM Treasury officials indicated that their legal advice was that these errors should have no substantive effect on the meaning of the amendments made to the 1986 Act by the Order.

However, the Treasury intends to make appropriate corrections in due course. The errors are as follows –

- Article 3(2) inserts new **subsection 61(7E)** in the 1986 Act. The new subsection includes the following words which appear to be superfluous –

“nothing in subsection (9A) above shall invalidate the election of a director where”

There is no “subsection (9A)” either above or below, and the new subsection anyway ends with the words “the failure shall not invalidate the election of a director”.

- Article 16(3) inserts new *sub-paragraph 32(3A) in Schedule 2* to the 1986 Act. This appears to omit the word “is” in *sub-paragraph (3A)(a)* –

“a notice or copy [is] published for a part”

- Article 26(2) inserts new *paragraph 6(2) in Schedule 16* to the 1986 Act. The reference to –

“a requirement under sub-paragraph (1) or (2) of paragraph 4(2)”

does not make sense. It is assumed that the reference is intended to be to “(a) or (b)” of that paragraph.

- Article 30(7) inserts **new paragraph 23(6)(bb) in Schedule 2** to the 1986 Act. This provision includes the words “if species” instead of the intended word “specifies”.
- Article 30(10) purports to amend **paragraph 33(1) of Schedule 2** to the 1986 Act. However, the same amendment is already made by article 17(2).

At the time of writing, the Treasury had not made the amendments.

MISCELLANEOUS PROVISIONS

This sub-section covers various miscellaneous matters dealt with by the 1986 Act, including deceased investors, disputes, migration of company law to the building societies'

1. Deceased Investors

(i) The Statutory Provision

Section 32 introduces *Schedule 7(1)*, which sets out arrangements when a member or depositor has died, leaving funds in the society of less than £5,000, and a person claims to be beneficially entitled to the money.

Generally speaking, a society would be liable (to the person entitled to the funds) if it paid away a deceased member's or depositor's money to someone who was not entitled to it. However, *Schedule 7(3)* provides the society with protection, if it makes a payment of less than £5,000, having taken the precautions specified in *Schedule 7(2)*, ie –

- Received satisfactory evidence of the death, and
- A statutory declaration that –
 - the member or depositor had died, and
 - the person claiming the money is beneficially entitled under the will or intestacy (ie where there is no valid will) to receive it.

Satisfactory evidence of death would usually be a death certificate.

A society is not *obliged* to make use of this provision – it is voluntary.

(ii) The £5,000 limit

For some years, the Association sought an increase in the £5,000 limit. Unfortunately, this is one of the few statutory limits in the 1986 Act that requires approval by a resolution in each House of Parliament (a 'positive' resolution), as opposed to annulment in pursuance of a resolution in either House of parliament (a 'negative' resolution). The positive resolution procedure is more complicated and time consuming than the negative resolution procedure.

The limit has not changed since 1986 and, if increased in line with inflation, would now considerably exceed £10,000. However, after early indications that it was content to make the change, HM Treasury has made it clear that it is unwilling to increase the limit. This is despite the proposed change being potentially of benefit to consumers (by saving time, possible legal costs etc, often at a time of bereavement) and a proportionate increase having already been effected in broadly equivalent legislation in Northern Ireland.

In March 2006, the Secretariat canvassed societies about their current practices and, of 32 societies responding, 17 had 'voluntarily' increased the limit, typically to £10,000 or £15,000. This means that the society could be liable if the recipient turned out not to be entitled to the money, but some societies have mitigated the risk eg by an indemnity signed by the applicant, restrictions on classes of applicants (eg spouses, children etc of the deceased), indemnity insurance, or self-insurance.

Nonetheless, the Association's formal position remains that the statutory limit should be increased, at least to £10,000. The Association does not believe that a protection given by Parliament should be allowed to wither on the vine.

The Association has provided societies, intending to stick to the £5,000 limit, with two forms of wording (one short, one longer) that they might like to use, or tailor, in relation to queries or if they wanted to produce a consumer leaflet –

www.bsa.org.uk/docs/policy/practice_briefs/misc_1.pdf

www.bsa.org.uk/docs/policy/practice_briefs/misc_2.pdf

(iii) Related Matters

Although not 1986 Act matters, there are two further topics, relating to deceased investors, that can conveniently be dealt with at this point.

- **Death Certificate Verification Protocol**

In 2002, the Association agreed a protocol with the Law Society of England & Wales to allow solicitors to obtain information from building societies when an account holder had died, without having to produce a certified copy of the death certificate (The Association notified members via Circular No 5742 and the, now deleted, *BSA Investment Manual*). This arose from a problem about the copyright of birth, death and marriage certificates.

The public registers and certificates are Crown copyright protected under section 163 of the Copyright, Designs and Patents Act 1988. Therefore, they may not lawfully be reproduced without the prior written consent of the Controller of HMSO. However, Government policy is not to authorise the copying of completed certificates without permission except in limited circumstances, such as by government departments and local government for the purposes of public administration, in judicial proceedings, in respect of certain genealogical research etc.

In 1999, HMSO issued guidance on the copying of birth, death and marriage certificates. On the death of an account holder solicitors had experienced technical problems when trying to administer the deceased person's estate. If, for example, a solicitor required information from a building society regarding the deceased person's account, the society would normally ask for a certified copy of the death certificate.

The full HMSO guidance (updated in May 2005, eg to incorporate civil partnership certificates) can be accessed through the following link -

www.opsi.gov.uk/advice/crown-copyright/copyright-guidance/copying-of-birth-death-and-marriage-certificates-and-marriage-registers.htm

The Association, along with the British Bankers' Association and the Association of British Insurers worked on a draft protocol for some months. The BSA Legal Panel also viewed the documentation associated with the protocol. The protocol gives solicitors the opportunity to verify death without the provision of a copy of the death certificate. The protocol is in operation in England and Wales. HMSO has contacted the Law Society of Scotland has been contacted and plans a similar protocol in Scotland.

The protocol letter and associated form with guidance notes was agreed by the above trade associations and the Law Society and is available for appropriate use in dealing with estates. The letter is provided as a model and will be adapted by solicitors to individual

circumstances. The form is an agreed standard. Similar forms will be used by insurers and pension providers in respect of birth and marriage certificates.

The Law Society announced the new protocol in the Law Society Gazette. To see a copy of the relevant article click on the following link www.lawgazette.co.uk/news/solicitors-give-last-rites-ban-1

The copy of the model letter, death certificate verification form can be obtained at –

www.bsa.org.uk/docs/policy/practice_briefs/misc_3.pdf

www.bsa.org.uk/docs/policy/practice_briefs/misc_4.pdf.

- **Direct payment of Inheritance Tax**

In 2002, the Inland Revenue (now HM Revenue & Customs - HMRC) developed a scheme to allow institutions to join a scheme for paying initial Inheritance Tax direct by electronic transfer from a deceased customer's account to the Inland Revenue.

The Secretariat consulted the BSA Legal Panel about this project and notified societies of it through BSA *Members' Bulletin* No 134, 13 September 2002 and the, now deleted, BSA *Investment Manual*. The scheme was implemented from 31 March 2003.

The scheme is voluntary. Institutions deciding to take part are not obliged to register the fact, but HMRC would find it useful to monitor the number of firms taking part.

In summary, the Scheme –

- Is designed to facilitate the secure payment of Inheritance Tax by allowing intending personal representatives access to money in the deceased's bank account, before grant of representation is issued.
- The scheme applies only to money in an account or accounts held in a deceased's sole name.
- Each building society or bank participating in the Scheme may establish its own requirements as to the extent of proof required (this would help building societies that, for example, may want to ensure that they preserve the protection in Schedule 7 to the Building Societies Act 1986 – see above).
- The intending personal representative, rather than the institution, will calculate the amount of tax to be paid and will use a specific Inland Revenue form (D20) as evidence of the amount to be transferred.

You can find further details on the HMRC website by clicking the following link –

www.hmrc.gov.uk/inheritancetax/

2. Settlement of Disputes

Section 85 introduces *Schedule 14*, which deals with settlement of disputes between a building society and a member (or a member's representative) or other complainant. The following arrangements now exist –

(i) The Financial Ombudsman Service

The Ombudsman provisions that the 1986 Act first included in building society legislation (*sections 83-84 and Schedule 12*) were repealed by the arrangements for a Financial Ombudsman Service (FOS) under the Financial Services and Markets Act 2000. The relevant new provisions are –

- Part XVI (sections 225 – 234) of, and Schedule 17 to, the 2000 Act, and
- The FSA Handbook Dispute Resolution: Complaints (DISP) provisions

<http://fsahandbook.info/FSA/html/handbook/DISP>

For further information see pages 125 and 145 below. The BSA has a page in its members' website on FOS –

www.bsa.org.uk/members/policybrief/blog100007.htm

DISP contains rules and guidance about firms' complaints handling procedures and about the procedures of the FOS. The DISP Rules include –

- Treating Customers Fairly
- Complaint handling procedures for firms
- Jurisdiction of the FOS
- Complaint handling procedures for the FOS
- Standard terms
- FOS funding rules
- Handling endowment complaints.

If the FOS determines a complaint in favour of the consumer, it may make a money award for fair compensation (up to £100,000) to be paid for by the firm and/or a direction that the firm takes steps to rectify the matter complained of.

The Scheme has both a compulsory and a voluntary jurisdiction. Consumer credit was added to the FOS jurisdiction in 2006. For building society members or others who cannot, or do not want to, use the FOS, there are other provisions for the settlement of disputes, as set out below.

(ii) The Courts

Some disputes between a building society and a member must be settled by the High Court or, in Scotland, in the Court of Session (*Part I of Schedule 14* to the 1986 Act). The same applies to disputes being conducted by a representative of a member, but the 1986 Act does not define 'representative'. The relevant disputes are those –

- in respect of any rights or obligations arising from the rules of the society or any provision,
- where the member is acting in the capacity of member or the representative acting in the capacity of representative

(paragraph 1(2) of Schedule 14).

An example of a dispute where the member acts in the capacity of member would be a dispute about a share (membership) account, but not about a deposit (non-membership) account (*Futcher v Portman Building Society* [1952] Reg Rep 1).

Other cases must be referred to the FSA or to arbitration, but the court may nevertheless hear and determine certain of those cases (see below).

(iii) The FSA

The FSA, acting as arbitrator, must hear and determine disputes about –

- the rights of a member to access a building societies register of members (*paragraph 6(1) of Schedule 2*)
- the circulation of election (and revised election) addresses, resolutions and statements, where a party alleges that publicity would damage confidence in the society of investing members of the public

(paragraph 1(4)).

For further information about the above matters see *Constitution and Meetings* above.

The Court might be required to hear certain other disputes (see below).

(iv) Arbitration

A dispute must be referred to arbitration (arbitrator, in Scotland) if the society's rules provide for this and the dispute is about a refusal by the society to send its members copies of –

- an election (or revised election) address,
- a statement with respect to matters to be dealt with by a special meeting requisitioned by members, or
- a statement with respect to the matter referred to in a resolution proposed by members.

(paragraph 4(1)).

If the society's rules provide, arbitration will also apply to any dispute about a society's refusal to call a special meeting on members' requisition (*paragraph 4A*).

For further information about the above matters see *Constitution and Meetings* above.

However, if the grounds for refusal to circulate the document are either –

- that it would be likely to diminish substantially the confidence in the society of investing members of the public, or
- that the rights are being abused to seek needless publicity for defamatory matter,

then the court must hear and determine the dispute.

(v) Miscellaneous Points

Schedule 14 also contains provisions concerning –

- The FSA's right to notice of, and to be heard in, proceedings (*paragraph 3*)
- The procedure for arbitration (*paragraph 5*)

3. Company Law

Section 104 provides for HM Treasury to assimilate company law into the 1986 Act if the Treasury decides, on any modification of company law, that it is expedient to do so. This provision reflects Parliament's belief that certain aspects of building societies operations are broadly the same as companies.

The assimilation mechanism applies only to certain 'relevant provisions'; mainly management (including arrangements relating to directors), accounts and audit, and winding up (*see section 104(2)*). Many of the 1986 Act provisions concerning directors and accounts derived from company law.

A related provision is *section 104A*, which specifically allows the Secretary of State, with the concurrence of the Treasury, to apply to building societies certain companies' legislation concerning registration of charges.

4. Notice and Other Documents

Section 115 sets out provisions relating to the service of documents required or authorised by the 1986 Act or a society's rules. A document may be served on a person by delivery (including electronic delivery), by leaving it at the person's proper address, or by sending it by post to the person at that address. The provisions define –

- “**delivery**” (*section 115(2), (2A) and (3)*), and
- “**proper address**” (*section 115(4)*).

The provisions do not apply to service of notices on the FSA. The statutory provisions are subject to provisions in a society's rules, as far as notice or documents to be given or sent to members are concerned (*section 115(1)*).

Section 116 gives the FSA power to provide the form or contents of any document to be sent under the 1986 Act.

5. Receipts by Minors

Minors (those under 18) are subject to different laws from adults in relation to contractual commitments. Subject to certain exceptions, contracts are not binding on minors.

Despite a range of common law provisions and the Minors' Contracts Act 1987, there are still certain vagaries in the law relating to minors' contracts. The 1986 Act clarifies one point – that minors may give due receipt for moneys properly withdrawn from an account with a building society (*paragraph 5(3) of Schedule 2 and paragraph 2 of Schedule 7*). This means that a society can lawfully rely on a minors' receipt if the withdrawal was proper but not if, for example, it was made by a minor who was subject to duress or undue influence.

6. Exemption from Stamp Duty

Section 109 exempts from payment of stamp duty any instrument that the 1986 Act or a society's rules require (or authorise) to be given, issued, signed, made or produced. The section specifies certain instruments including copies of the rules, transfers of a share in a society etc.

7. Interpretation

Section 119 is the interpretation provision in the 1986 Act. Many of its specific provisions are dealt with, in context, in other parts of this Guide.

Please note that certain 1986 Act definitions are not in *section 119*, but are included in the relevant part of the Act; for example, *section 65(10)* defines certain terms relevant to restrictions on loans etc to directors (eg "outstanding", "subsidiary" etc), *section 70(2)* defines "connected person", etc.

8. Conveyancing

Parliament originally intended that regulations under the Courts and Legal Services Act 1990 would, among other things, amend the solicitors' legislation to allow certain bodies (including financial institutions such as banks and building societies) to provide conveyancing and probate services ('reserved services') to the public.

Section 124 introduced *Schedule 21*, which provided for conveyancing by building societies. However, after many years of consultation, the Government abandoned the project in 2004 and *section 124* and *Schedule 21* were repealed by the Statute Law (Repeals) Act 2004.

The Department of Consumer Affairs (DCA), among other things, revived the suggestion that the reserved services monopoly should be broken – see the DCA's publication *The Future of Legal Services*, 2005. For more information, visit the following links to Circulars 6326 and 6359.

www.bsa.org.uk/members/circular/101023.htm

www.bsa.org.uk/members/circular/101100.htm

In 2006 the Government published a draft Legal Services Bill, which became the Legal Services Act 2007 www.opsi.gov.uk/acts/acts2007/ukpga_20070029_en_1.

Certain elements of conveyancing (and probate) currently remain reserved to solicitors and certain other persons. However, the current plan is that, probably during 2010, such activities will be re-defined under the 2007 Act and opened up to various categories of authorised person. The BSA would press for building societies to be included.

9. Administrative Provisions

Like any large Act of Parliament, the 1986 Act contains a number of non-substantive, administrative provisions covering matters such as amendments, transitional provisions, jurisdictional aspects etc. They are as follows –

Section	Subject Matter
120	Amendments, repeals, revocations, transitional and savings provisions
121	Power of the Treasury to make transitional and savings provisions
122	Application to Northern Ireland
125	The 1986 Act's short title
126	Commencement
Schedule	
18	Amendments of enactments
19	Repeals and revocations
20	Transitional and savings provisions

10. Statutory Limits

The table below lists, for ease of reference, the various financial limits, thresholds and fines in the 1986 Act; see www.bsa.org.uk/docs/policy/prudentialandfinreg/changed_financial_limit_rev.pdf.

NB - The BSA's *Model Rules for Building Societies* (5th edition) contains an optional 'escalator' provision to cover changes to all amounts, percentages, lengths of time etc that may be changed by way of secondary legislation. Building societies that have adopted the escalator, and use the prescribed statutory maxima/minima (as applicable) do not need to change their rules to accommodate increases in financial limits etc. It is important to note the provisions in footnote 35 of the Model Rules.

1986 Act provision (section unless otherwise stated)	Item (more detailed summaries are set out in the footnotes below)	Limit/Threshold/Fine [F] = fine (f) = fee Note: Some of the fines are on a daily basis	Positive or Negative Resolution* (except fines and fees, which are subject to different arrangements)	Companies Act 2006 equivalent (if known and applicable **)
9A (2)(a); (3)(a)	Restrictions on certain transactions [1]	<ul style="list-style-type: none"> £100,000 £100,000 	P - section 9A(14)	
52 (10)(b)	Certain failures regarding accounts [2]	£200 [F]	n/a	Section 453
56 (11)	FSA Inspections - security for costs [3]	£5,000	N	Section 984(2)
60 (9);(15)(b)	Directors – shareholding [4]	<ul style="list-style-type: none"> £1,000 £40[F] 	N – section 60(16)(b) n/a	
61 (1)	Nomination of directors – society asset holdings [5]	£100million - £5,000 million (society's commercial assets)	N – section 61(5)(b)	
(2)(b)(c)	Maximum shareholding qualification [6]	<ul style="list-style-type: none"> £200 £200 	N – section 61(5)(b)	
3(a)	Maximum deposit for candidate [7]	£500	N – section 61(5)(b)	
64 (2)(a)(b)	Acquisition by directors of non-cash assets [8]	<ul style="list-style-type: none"> £200,000 £1,000,000 £2,000 	N – section 64(4)	Section 190
65 (2)(a)(c); (3)(a); 4(a); 6(b)	Restrictions on loans etc to directors etc [9]	<ul style="list-style-type: none"> £10,000 £200,000 £20,000 £10,000 £40,000 	N – section 65(9)	Various
68 (6);(7);(8)	Records of loans etc falling within section 65 [10]	<ul style="list-style-type: none"> £5 (f) £2,000 £10,000 	n/a N – section 66(10)	Various
69 (12);(15)	Disclosure and record of income of related business [11]	<ul style="list-style-type: none"> £10,000 £5 (f) 	N – section 69(16) n/a	
76 (10)(b); (11)(b)	Summary financial	<ul style="list-style-type: none"> £200 [F] £40 [F] 	n/a n/a	Section 426

	statement [12]			
81 (4)(b);5(b)	Laying and furnishing accounts, etc to FSA [13]	<ul style="list-style-type: none"> £200 [F] £40 [F] 	n/a n/a	Sections 437 - 440
87 (7)(b)	Dissolution by court [14]	£10 [F]	n/a	
91 (5)(b)	Power of court to declare dissolution void [15]	£40 [F]	n/a	
107 (11)	Restriction of use of certain names and descriptions [16]	£200 [F]	n/a	
114 (5)(b)	Records [17]	£100 [F]	n/a	
Schedule 2 Para 12(4)	Copies of rules etc [18]	£1 (f)	n/a	
Para 20A(7)	Deposit with requisition [19]	£50	N – para 20A(14)	
Para 31(2)(a)	Members' right to propose and circulate resolutions [20]	£100 million		
Para 36(1)	Prescribed amount [21]	£100	N – para 36(2)	
Schedule 7 Para 1(1)	Members or depositors dying [22]	£5,000	P – para 1(6)	n/a, but see Administration of Estates (Small Payments) Act 1965
Schedule 11 Para 3(2)(b); 6(3)	Appointment of auditors [23]	<ul style="list-style-type: none"> £40 [F] £40 [F] 	n/a n/a	

* This column denotes whether the amendment of the limit requires the relevant order to be approved by a resolution in each House of Parliament (P = 'Positive' resolution) or be subject to annulment in pursuance of a resolution in either House of parliament (N = 'Negative' resolution).

** Some of the equivalent matters are dealt with by a company's articles (eg election of directors) or by other legislation (eg insolvency).

The following footnotes are summaries of the relevant 1986 Act provisions and, as such, cannot be relied upon as being comprehensive – for full details see the relevant statutory provision.

[1] Building societies and their subsidiary undertakings are restricted by section 9A(1) from carrying on certain activities (eg acting as a market maker in securities), but certain transactions shall not be taken into account in respect of the restrictions if the amount or value of the consideration given by the society does not exceed the specified limit.

[2] This relates to the level of additional fine in respect of continuing offences in failing to comply with the requirements of section 52 concerning the furnishing of information or accountant's report etc to the FSA.

[3] This relates to the security for the payment of the costs of an investigation of a building society.

[4] The rules of a building society may impose a requirement that, to be or to remain a director, the director must hold shares in the society not less in value than the prescribed amount – section 60(9) states that the minimum holding required by the rules must not exceed £1,000. The £40 fine relates to failure of a director to notify a society that he is due to attain the normal retirement age.

[5]-[7] These provisions relate to the nomination of directors and, respectively, lay down maxima as to the number of members a society's rules may require to join in the nomination (which varies depending on the society's asset size); the nominating member's shareholding or mortgage debt (£200); and the amount of the candidate's deposit (£500).

[8] By section 64(1), a building society must not enter into certain arrangements with a director or a connected person concerning non-cash assets, unless the arrangement is first approved in general meeting, or the asset's value is less than £200,000 (or, if the society's reserves shown in the last balance sheet were less than £1,000,000, the asset's value is less than the higher of £2,000 or 10% of the reserves so shown).

[9] Section 65(1) restricts loans to directors. By section 65(2)(a), the restrictions do not apply to loans that (when aggregated with other loans) do not exceed £10,000, or do not exceed £200,000 if made towards purchase or improvement of an executive director's main residence on terms similar to those ordinarily made to employees. Certain restrictions do not apply to leasing or hiring of property the value of which does not exceed £20,000 or to payments of no more than £10,000 repayable within a maximum of two months. Section 65(6) restricts provision of funds to a director to meet expenditure in respect of society business, but the restriction does not apply to matters given prior approval in general meeting or to amounts that (when aggregated) do not exceed £40,000.

[10] Section 68 concerns records of loans and other arrangements falling within section 65. Section 68(6) permits a society to charge a maximum £5 fee to a member for a copy of the statement of particulars of those transactions. Certain transactions are excepted from certain provisions of section 68 if their value does not exceed £2,000 (see section 68(7)) or £20,000 (see section 68(8)).

[11] Section 69 deals with disclosure and record of related business of building society directors. Section 69(12) excepts from the requirement to keep details (in the relevant register) related business where its volume does not exceed £10,000. Section 69(15) permits a society to charge a maximum £5 fee to a member for a copy of the statement of particulars of those transactions.

[12] These provisions are fines in respect of convictions for, respectively, failing to send a copy of the summary financial statement to members entitled to receive it and copies to the FSA, and failing to send copies of the auditors' report in certain circumstances.

[13] These provisions are fines in respect of convictions for, respectively, failing to lay the annual accounts at the AGM and send copies to the FSA, and failing to make available free of charge to members and depositors.

[14] This is a fine in respect of the conviction of trustees for failing to submit certain information to the FSA on the dissolution of a society.

[15] This is a fine in respect of the conviction of a person for failing to furnish the FSA with a copy of an order declaring the dissolution of a building society void.

[16] This is a fine in respect of the conviction of a person for contravening the prohibition, set out in section 107(1), on improperly holding himself out as being a building society or being connected with building society business.

[17] This is a fine in respect of the conviction of a building society for failures in relation to the keeping records in accordance with the section.

[18] This is the maximum amount chargeable by a building society to a non-member for provision of a copy of its statutory documents (rules etc).

[19] This is the maximum sum a society may require a person requisitioning a special meeting.

[20] By paragraph 31(1) of Schedule 2, a building society is under a duty to include a members' resolution the AGM notice (and circulate any related statement, up to a maximum of 500 words), provided the requisition is supported by a "requisite number" of qualified members. The requisite number is 500 if the aggregate of the society's liquid assets and fixed assets exceeds £100 million. Otherwise the requisite number is 100 or such lesser number as the society's rules specify.

[21] The £100 figure is the "prescribed amount" used for certain matters in Schedule 2, eg relating to the eligibility of members for certain purposes.

[22] Schedule 7 permits building societies, subject to certain requirements, to pay sums not exceeding £5,000 to persons claiming to be beneficially entitled on the death of a member or a depositor. Had the sum been increased in line with inflation, it would now (2005) be around £10,000.

[23] These are fines in relation to certain offences concerning failures in respect of the appointment of auditors.

Financial Services Regulation



FINANCIAL SERVICES AND MARKETS ACT 2000 (FSMA)

This sub-section provides a brief overview of the Financial Services and Markets Act 2000.

1. Introduction

The FSMA is the Act that sets out the law relating to the regulation of financial services and markets. It is a very large piece of legislation, extending to more than 300 pages, 433 sections and 22 Schedules.

“I have seen grown men weep at the size of this Bill”

Lord Saatchi

Opposition Lords Spokesman, during the passage of the FSM Bill

The FSMA covers –

- **The Regulator** (Parts I and X: sections 1 – 18, 138 – 164, and Schedule 1)
- **Regulated activities, authorisation and exemption, rules and guidance** (Part s II – V: sections 19 – 71, and Schedule 2)
- **Information gathering, investigations, control and discipline** (Parts XI - XIV: sections 165 – 211, and Schedules 15 and 16)
- **The Financial Services Compensation Scheme** (Part XV: sections 212 – 224)
- **The Ombudsman Scheme** (Part XVI: sections 225 – 234, and Schedule 17)
- **Other matters**, eg –
 - official listing
 - control of business transfers
 - penalties for market abuse
 - collective and open-ended investment schemes
 - recognised investment exchanges and clearing houses
 - competition scrutiny
 - mutual societies etc.

The text of the FSMA is at - www.opsi.gov.uk/acts/acts2000/ukpga_20000008_en_1.

Brief commentary on relevant aspects of the FSMA is also included in the *Building Societies Act 1986: a BSA Summary* – www.bsa.org.uk/consumer/factsheets/100003.htm.

The FSMA is heavily supplemented by the FSA's Handbook of Rules and Guidance (see below) <http://fsahandbook.info/FSA/html/handbook/>.

2. Regulated Activities, Authorised Persons and Approved Persons

(i) Regulated Activities

The FSMA prohibits an unauthorised person from carrying on a regulated activity in the UK. An authorised person may carry on in the UK only those regulated activities for which the FSA has given them permission.

So far as regulated activities are concerned, an Order under the FSMA - the Regulated Activities Order 2001 (SI No 544), as amended, specifies the activities that the FSA regulates, including accepting deposits, regulated mortgage contracts, various investment-related activities etc.

In its early days, FSA did not regulate the conduct of the particular type of business (except investment business), but prudentially regulated the authorised person carrying out the activity. However –

- the conduct of **residential mortgage business** has been FSA-regulated since October 2004 (for further guidance, see www.bsa.org.uk/members/policybrief/mortgage_regulation.htm),
- the conduct of **insurance mediation business** has been regulated since January 2005, and
- on 24 April 2009, the FSA announced that it will regulate banking, by implementing a Banking and Payment Services (BPS) conduct regime, covering all **retail banking services** within its remit, from 1 November 2009. BPS will comprise BCOBS and the Payment Services Regulations (for further guidance, see www.bsa.org.uk/members/policybrief/BCOB.htm).

(ii) Authorised Persons

‘Authorised person’ in this context means any body corporate (such as limited companies and building societies), individual, partnership or unincorporated association. A firm becomes an authorised person by application for permission under the FSMA.

The detailed requirements used to be set out in the FSA Handbook under AUTH, but are now mostly in COND, PERG, PRIN, SYSC etc – for a useful overview see - www.fsa.gov.uk/pubs/other/applying_authorisation.pdf.

Building societies, banks, insurance companies, investment businesses and others that *were already* authorised under the legislation that preceded the FSMA (such as the Building Societies Act 1986 or the Banking Act 1987) were deemed to be authorised under the FSMA - a process called ‘grandfathering’. Authorised persons must meet, on a continuing basis, certain ‘Threshold Conditions’ (set out in COND 2.1 – 2.5) to do with –

- **Legal status** (for instance, individuals may not accept deposits)
- **Location of offices** (head office and registered office must be in the UK)
- **Close links** (with other persons must not prevent effective supervision)
- **Adequate resources** (adequate resource to carry on the regulated activities)
- **Suitability** (the authorised person must be ‘fit and proper’).

(iii) Approved Persons

There are also requirements that the people, such as employees and office holders, who perform specified types of function for authorised persons (‘controlled functions’), also be approved by the FSA.

These people are known as ‘approved persons’, and should not be confused with authorised persons who, as explained above, are the organisations that they work for. The FSA

Handbook of Rules and Guidance uses 'firm' to mean 'authorised person' to help avoid any such confusion.

An authorised person must obtain the FSA's approval before allowing another individual to perform a controlled function. Such functions are specified in rules made by the FSA under the FSMA and must meet at least one of the following conditions –

- The function is likely to enable a person significantly to influence the conduct of the authorised person's affairs – for example, a director
- The function involves dealing with customers – for example, financial advisers
- The function involves dealing with customers' property – for example, a stockbroker.

(section 59(4) – (7) FSMA).

The Supervision Manual in the FSA's Handbook - SUP 10.4.5R - sets out specific controlled functions (see pages 144-145 below).

Building society directors (as approved persons) must be "fit and proper". This is a continuous requirement – not just at the time of appointment. The FSMA states what the FSA may have regard to, including qualification, training and competence of the candidate. The FSA has published criteria for assessing the fitness and propriety of approved persons in its Handbook - FIT. The main assessment criteria are –

- honesty, integrity and reputation
- competence and capability
- financial soundness.

For more information on FIT, see pages 138-139 below.

There are statements of principle and a code of practice for approved persons in the FSA Handbook of Rules and Guidance – APER, issued under section 64 of the FSMA (see pages 137-138). The Rules and guidance relating to senior management arrangements, systems and controls in the FSA's Handbook are also relevant - SYSC (see pages 136-137).

3. The Financial Services Compensation Scheme

The FSMA requires the FSA to establish a company to manage the Financial Services Compensation Scheme and sets requirements as to the company's constitution. The detailed statutory provisions are in sections 212 – 224.

The Scheme www.fscs.org.uk compensates customers who suffer loss in various circumstances where the authorised person is unable to meet its liabilities. The Scheme does not compensate customers for regulatory breach (such as mis-selling of investments), where the liability remains with the firm.

The Scheme protects –

- **deposits** (which includes building society ordinary share accounts)
- **life and general insurance firms**
- **investment business** (on or after 28 August 1988)
- **home finance** (eg mortgage) advice and arranging (on or after 31 October 2004)

- **general insurance** policies advice and arranging (on or after 14 January 2005), including connected travel insurance where the policy is sold alongside a holiday or other related travel eg by travel firms and holiday providers (for business on or after 1 January 2009).

The current compensation limit for deposit claims is £50,000 (100% of the first £50,000). The limit applies per depositor per institution and covers deposits made in all currencies. Each depositor is entitled to compensation up to this amount, whether the deposits are in sole or joint accounts.

Until the failure of Northern Rock in 2007, there was little focus on the Scheme in respect of mortgages and savings. However, since then there have been a number of significant developments. The BSA has a policy page on its Members' Website concerning the Scheme, which goes into more detail – www.bsa.org.uk/members/policybrief/fscs.htm. Also see the FSA Handbook COMP (pages 145-146 below).

The FSA increased the limit to £50,000 with effect from 7 October 2008. For claims against deposit-taking firms declared in default between 1 October 2007 and 6 October 2008, the maximum level of compensation is £35,000 (100% of the first £35,000). For claims against deposit-taking firms declared in default before 1 October 2007, the maximum level of compensation is £31,700 (100% of the first £2,000 and 90% of the next £33,000).

4. The Ombudsman Scheme

The FSMA requires the FSA to establish a single, compulsory ombudsman scheme for the speedy and informal resolution of disputes between members of the public and authorised persons. The detailed statutory provisions are in sections 225 – 234 and Schedule 17.

It also confers certain powers on the operator of the scheme and provides for the ombudsman to adjudicate certain types of dispute on a voluntary basis. The compulsory jurisdiction covers all FSA regulated activities and certain other specified activities conducted in, or from, the UK. See the FSA Handbook DISP: page 145 below.

The Financial Ombudsman Service www.financial-ombudsman.org.uk operates the Scheme. For further information see the BSA Members' Website at www.bsa.org.uk/members/policybrief/blog100007.htm.

5. Other Matters

Among the other matters covered by the FSMA are –

- Official Listing (including the obligations of issuers of listed securities)
- Control of business transfers (the provisions for transfer of a banking business in Part VII)
- Penalties for Market Abuse
- Information Gathering and Investigations by the FSA
- Requirements on those who propose to acquire control over authorised persons
- FSA Disciplinary Measures
- Competition Scrutiny
- Mutual Societies (covering mainly 'transitional' issues; for example, the transfer to the FSA of the functions of the previous regulatory bodies for building societies, friendly societies etc.

Also, the FSA holds a register of all mutual societies in the UK even if they are not involved in the provision of financial services)

- Auditors and Actuaries.

Part X of the FSMA confers powers on the FSA to set regulatory requirements for persons authorised under the Act. It provides for modification and waiver of rules by the FSA, contravention of rules, procedural provisions etc.

Part X gives the FSA power to issue guidance on requirements imposed under the FSMA. It also sets out procedures that the FSA must follow in exercising those powers. All the FSA's formal rules and guidance are set out in their single Handbook (see pages 131-151 below).

The Treasury conducted a review of the FSMA during 2004, but made no changes requiring amendments to the FSMA.

FINANCIAL SERVICES AUTHORITY

This sub-section covers the FSA's organisation, structure, accountability, objectives, functions, principles and supervisory methodology.

1. Organisation and Structure

(i) Constitution, Management and Funding

The FSA, a company limited by guarantee, is the body responsible for the regulation of deposit-taking, mortgage, insurance and investment business in the UK – www.fsa.gov.uk. It is independent and non-governmental, but has statutory powers under the FSMA. The FSA has been the regulator for building societies since it took over the functions of the former Building Societies Commission on 1 December 2001.

HM Treasury is the sole shareholder in the FSA. The Treasury appoints the FSA Board, which currently consists of a chairman, a chief executive, managing directors, and non-executive directors (including a lead non-executive member, the deputy chairman). The Board sets the FSA's overall policy, but day-to-day decisions and management of the staff are the responsibility of the executive.

The FSA is funded by levies on the financial businesses it regulates (see page 139 below). Fee-payers are grouped into 'fee blocks', with each block representing firms that offer broadly similar products and services. There is no cross-subsidy between fee blocks.

(ii) Recent Changes

Following the failure of Northern Rock in 2007 and the results of the FSA's internal audit report www.fsa.gov.uk/pubs/other/nr_report.pdf, the FSA conducted a 'supervisory enhancement' programme www.fsa.gov.uk/pubs/other/enhancement.pdf.

To cement the changes made as part of that programme, the FSA decided to change its internal structure, with effect from 1 October 2009. The main changes are –

- integration of retail and wholesale firm supervision into one Supervision business unit
- integration of risk identification, risk management and policy formulation into one Risk business unit
- expansion of the Financial Stability team to become a new division
- creation of a new International division
- integration of enforcement and financial crime to form one division
- the moving of the Financial Capability division from Retail business to become a stand-alone division.

The current FSA management structure can be accessed at - www.fsa.gov.uk/whos/orgchart.pdf

(iii) Accountability

The FSA is accountable to Treasury Ministers, and through them to Parliament (eg regularly appearing before the Treasury Select Committee). The FSA is subject to a number of specific accountability requirements. For example, it must establish and maintain a

Practitioner Panel and a Consumer Panel and consider any representations they make and, if it disagrees, give reasons. It also has a clearly set out governance structure, which includes a majority of non-executive directors on its Board. It also has the normal reporting mechanisms (such as an Annual Report and an open general meeting).

HM Treasury also has certain powers in respect of the FSA, including the appointment of an independent person to conduct a review. There are also arrangements for the independent investigation of complaints against the FSA – see COAF: page 146 below. Appeals against FSA decisions are possible through the Financial Services and Markets Tribunal.

In 2005, Legal and General (L&G) became the first large financial institution to challenge an enforcement decision by the FSA. The FSA argued that, based on a past business review, L&G had committed widespread mis-selling of with-profits endowment mortgage policies. In 2003, the FSA's Regulatory Decisions Committee (RDC) decided that L&G should be fined £1.1 million. L&G referred the FSA's decision to the Financial Services and Markets Tribunal.

The Tribunal upheld the FSA's argument that L&G's sales procedures were defective, but decided that the evidence from the past business review exercise did not prove mis-selling – the RDC was "in error in its approach to the mis-selling case and reached conclusions not justified by the material before it". The FSA reviewed its procedures following the case www.fsa.gov.uk/Pages/Library/Communication/PR/2005/004.shtml.

The FSA is subject to the Freedom of Information Act 2000, which gives the public a general right of access to all types of recorded information held by public authorities. The 2000 Act also sets out exemptions from that right of access and places a number of obligations on public authorities designated under the Act. The FSA is a designated public authority under the 2000 Act. For more information, see www.fsa.gov.uk/Pages/Information/Overview/index.shtml.

In August 2007 the Information Commissioner published two decisions under the Freedom of Information Act 2000 on cases where the FSA had refused to disclose information.

The [first case](#) concerned a review, carried out by the FSA in 2001, of the way in which firms set premiums for mortgage endowment policies. The [second case](#) related to a mystery shopping exercise, conducted in October 2004, designed to test firms' sales of equity release products.

In each case, the FSA sought to rely on statutory exemptions, but the Information Commissioner upheld the complaint that the information was wrongly withheld and directed the FSA to release it. For more information, see –

www.ico.gov.uk/upload/documents/decisionnotices/2007/fs_50075781.pdf
www.ico.gov.uk/upload/documents/decisionnotices/2007/fs_50094595.pdf

The FSA, generally speaking, is exempt from legal liability in damages (paragraph 19 of Schedule 1 FSMA). This exemption also applies to the FSA's members, officers and staff. The exemption does not apply in cases of 'bad faith' (ie an act or omission that no reasonable regulator would have made) and cases where the act of omission is incompatible with the Human Rights Act 1998. The FSA is subject to judicial review.

2. Objectives, Functions and Principles

Since October 2004 the FSA has been responsible for mortgage regulation and, since January 2005, for general insurance regulation (see pages 142-143 below). It will be responsible for banking conduct of business regulation from 1 November 2009.

The FSA regulates most financial services and firms, and provides support to consumers, by authorising and supervising firms, setting and enforcing standards, educating consumers, tackling financial crime, and dealing with crisis management.

The FSA maintains a public register of financial services firms, individuals and other bodies that fall under its regulatory jurisdiction. The register may be searched using the FSA website www.fsa.gov.uk/register. The FSA publishes its consultation papers, policy statements and other materials on its website www.fsa.gov.uk/pubs/

The FSA's **aim** is –

“To maintain efficient, orderly and clean financial markets and help consumers achieve a fair deal.”

Its objectives, functions, principles to which it must have regard, and accountability provisions are all set out in the FSMA.

The **regulatory objectives** are to –

- Maintain market confidence
- Promote public understanding of the financial system
- Protect consumers
- Reduce financial crime.

Its **general functions** are –

- Rule making
- Issuing Codes
- Giving general guidance
- Determining general policy.

The **principles** to which it must have regard in performing its functions are –

- Economic and efficient use of resources
- The responsibilities of senior management
- Proportionality (ie costs compared to benefits)
- The desirability of facilitating innovation
- The desirability of maintaining the UK's competitive position
- The need to minimise adverse effects on competition and the desirability of facilitating it.

The FSA's regulatory objectives, general functions and principles are all set out in section 2 of the FSMA www.opsi.gov.uk/acts/acts2000/ukpga_20000008_en_1.

3. Supervision of Firms

The FSA's supervision of firms is 'risk based'. The FSA has developed a common approach to risk assessment, irrespective of the nature of a firm's business. Details are provided in

the FSA's *Firm Risk Assessment Framework* and with its *Building the New Regulator* progress reports www.fsa.gov.uk/pages/About/What/Approach/index.shtml.

However, the fundamentals of the approach are for the FSA to examine the following groups of risks –

- **Business risk**
 - Strategy
 - Market, credit, insurance underwriting and operational risk
 - Financial soundness
 - Nature of customers and products/services

- **Control risk**
 - Treatment of customers
 - Organisation
 - Internal systems and controls
 - Board, management and staff
 - Business and compliance culture.

The FSA reviews risks within a firm, or a sector, by an '**ARROW**' (**A**dvanced **R**isk **R**esponse **O**perating frame**W**ork) assessment, which often involves visits to regulated firms. The visits usually include discussions with senior management and staff in controlled functions. For more details, see www.fsa.gov.uk/pubs/policy/bnr_firm-framework.pdf.

A Government white paper, *Reforming Financial Markets*, published in July 2009, proposes (among other things) new supervisory and enforcement powers for the FSA, including new powers to place higher capital requirements on firms that present greater risks to the system

www.hm-treasury.gov.uk/d/reforming_financial_markets080709.pdf

www.bsa.org.uk/members/circular/6937.htm

FSA HANDBOOK OF RULES AND GUIDANCE

This sub-section highlights the provisions of the FSA's Handbook of Rules and guidance that are most relevant to the building society sector.

1. Introduction

The following abbreviations are used in this section –

- “the FSA” – the Financial Services Authority
- “the FSMA” – the Financial Services and Markets Act 2000.
- “firm” – an authorised person under the FSMA (such as a building society)

The FSA's rule-making powers, and its powers to provide regulatory guidance, are prescribed by Part X of the FSMA. There are controls on the way in which the FSA makes rules and guidance eg under section 155 the FSMA must consult on the draft rules.

The FSA's rules and guidance are included in a single Handbook, the main substantive contents of which are as set out in the table overleaf. In terms of size, the FSA Handbook makes the FSMA look like a leaflet! Over time, the FSA has worked to improve the accessibility to and navigation around this massive document. The Handbook is available on the FSA Website - www.fsa.gov.uk/handbook/. It is very important that authorised persons use the latest issue, but there is a useful facility on the FSA website, allowing users to view the Handbook as it was on any specified date.

FSA Handbook Notices, which give notice of changes to the Handbook, are also published on the FSA website www.fsa.gov.uk/Pages/Library/Policy/Handbook/Notices/. The Handbook notices report changes made by the FSA Board under its legislative powers, and also contain information about other publications relating to the Handbook and, if appropriate, list minor corrections made to previous instruments made by the Board. The FSA gives advance warning of important publications that might affect the Handbook through a series of *Handbook Development Updates*.

Each Handbook module in the Manual is coded (eg 'PRIN', 'SYSC' – see overleaf) and divided into chapters; divided into sections; and each section is divided into paragraphs. Each paragraph has a regulatory status, the most common of which are as follows –

- **Rules – “R”** - In accordance with section 417(1) of the FSMA, Rules usually create binding obligations on authorised firms such as building societies, breach of which may lead to disciplinary measures.
- **Evidential Provisions – “E”** - An evidential provision is a rule, but not a binding one in its own right. It derives its authority by linking to another rule. An evidential provision has *evidential* weight, ie it may be relied on as “tending to establish” compliance or non-compliance with a rule to which it relates.
- **Guidance – “G”** - Guidance is not binding, and does not have evidential effect, but may be used to explain other provisions, indicate possible means of compliance, recommend a particular course of action etc.
- **Direction – “D”** - A binding requirement, similar to a rule.

Below each icon (**R**, **E**, **G** etc) appears the date when the paragraph came into force and the number of the Handbook release in which it first appeared.

FSA Handbook of Rules and Guidance: Main Provisions

High Level Standards	
Principles for Business	PRIN
Senior Management, Systems, Arrangements and Control	SYSC
Threshold Conditions	COND
Statements of Principle and Code of Practice for Approved Persons	APER
The Fit and Proper Test for Approved Persons	FIT
General Provisions	GEN
Fees Manual	FEES
Prudential Standards	
General Prudential sourcebook	GENPRU
Prudential sourcebook for Banks, Building Societies and Investment Firms	BIPRU
Prudential sourcebook for Insurers	INSPRU
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries	MIPRU
Prudential sourcebook for UCITS Firm	UPRU
Interim Prudential sourcebook for Banks	IPRU-BANK *
Interim Prudential sourcebook for Building Societies	IPRU-BSOC *
Interim Prudential sourcebook for Friendly Societies	IPRU-FSOC *
Interim Prudential sourcebook for Insurers	IPRU-INS *
Interim Prudential sourcebook for Investment Businesses	IPRU-INV *
Business Standards	
Conduct of Business sourcebook	COBS
Insurance: New Conduct of Business sourcebook	ICOBS
Mortgages and Home Finance: Conduct of Business sourcebook	MCOB
Client Assets	CASS
Market Conduct	MAR
Training and Competence	TC
Regulatory Processes	
Supervision	SUP
Decision Procedure and Penalties Manual	DEPP
Redress	
Dispute Resolution: Complaints	DISP
Compensation	COMP
Complaints against the FSA	COAF
Regulatory Guides	
The Building Societies Regulatory Guide	BSOG
The Collective Investment Scheme Guide	COLLG
The Enforcement Guide	EG
The Perimeter Guidance Manual	PERG
The Responsibilities of Providers and Distributors for the Fair Treatment of Customers –	RPPD
The Unfair Contract Terms Regulatory Guide	UNFCOG

As at 1 September 2009

(**ICOBS** will be introduced on 1 November 2009 - www.bsa.org.uk/members/policybrief/BCOB.htm)

* The Interim Prudential sourcebooks are being deleted and replaced by other FSA Handbook standards – in particular, there will be a specialist sourcebook for building societies www.fsa.gov.uk/pubs/cp/cp09_17.pdf

There are also –

- a number of FSA **Specialist Sourcebooks** (covering requirements applying to individual business sectors eg collective investment schemes, credit unions, regulated covered bonds etc; not to building societies' mainstream activities),
- various **Handbook Guides** (which give a basic overview of certain topics and point firms to Handbook material applicable to them eg energy market participants – again, these are not generally relevant to building societies), and
- rules on **Listing, Prospectus and Disclosure** (relevant to building societies with PIBS).

GEN 2.2 (see below) <http://fsahandbook.info/FSA/html/handbook/GEN/2/2> contains a useful guidance on interpreting the Handbook. There is also a glossary of terms used in the Handbook - <http://fsahandbook.info/FSA/html/handbook/Glossary>.

The FSA website also has a useful *Focus On...* feature designed to help users find key material on certain subjects (eg senior management arrangements, fees and levies, financial crime, record-keeping, quickly and easily - <http://fsahandbook.info/FSA/select-handbook/focus-on>).

A recent trend, following the FSA's move to principles-based regulation (PBR) – see page 152 below, and its desire to keep the Handbook manageable, has been for some modules (eg SYSC) to increase in size.

However, a number of other Handbook modules have ceased to be in force; for example, the integrated Prudential sourcebook (PRU) from the end of 2006, the Conduct of Business Sourcebook (COB) from 31 October 2007, Money Laundering (ML) from 30 August 2006, Authorisation (AUTH) from various dates, and the Enforcement Manual (ENF) from 27 August 2007.

For more on PBR, see –

www.fsa.gov.uk/pubs/other/principles.pdf

www.bsa.org.uk/members/practice_briefs/fair_play_guidance/principles_based_regulation.htm

A brief summary of the current Handbook modules follows. The summary concentrates on those parts of the Handbook that are likely to be particularly relevant to most building societies. At the end of the section there is a table highlighting, in an informal way, the sourcebooks and manuals in the Handbook that are most important to building societies, in respect of their mainstream businesses.

Some of the modules are relevant to all building societies (such as the High Level Standards), but the extent to which some of the others are relevant (eg COBS or MAR) will depend on the nature and scope of an individual society's business and operations. The summary is intended for ease of reference and does not replace the need to read the Handbook. The Schedules to the modules are important. For example, firms should ensure that they are aware of, and comply with, the reporting and record-keeping requirements (if any) in each module; usually schedules 1 and 2 respectively.

Breach of some of the rules in the Handbook may form the basis of an action for damages by a private person (section 150 FSMA). If so, the right will usually be specified in Schedule 5 of the relevant module. Schedules also cover such matters as a note of which rules, if any, can be waived.

2. High Level Standards

These standards apply to all firms and approved persons.

(i) Principles for Business - PRIN

PRIN comprises a set of Principles, and related rules and guidance, that apply to all businesses authorised by the FSA. The Principles for Businesses are general high-level statements of the fundamental obligations of firms under the regulatory system established by the FSMA, and underpin the detailed requirements set out elsewhere in the Handbook. The Principles derive their authority from the FSA's rule-making powers as set out in the FSMA and reflect the regulatory objectives in sections 2(2) and 3 to 6 of the FSMA. **PRIN is fully relevant to building societies.**

Nevertheless, the FSA has the power to enforce the high-level rules in PRIN. If in doubt about the application of a principle, a firm should analyse the matter in a reasoned way, taking advice where appropriate. A firm may also request the FSA to provide guidance. In building society terms, some of the Principles, in effect, superseded the previous criteria of prudent management that were set out in section 45(3) of the 1986 Act. There are 11 Principles for Businesses which appear in the form of a rule – PRIN 2.1.1 R, as follows –

PRIN

1 Integrity	A firm must conduct its business with integrity.
2 Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3 Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A firm must maintain adequate financial resources.
5 Market conduct	A firm must observe proper standards of market conduct.
6 Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7 Communications with clients	A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9 Customers: relationships of trust	A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10 Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11 Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

The Principles are largely self-explanatory, but a number are - in effect - elaborated in more detail elsewhere in the Handbook, for example –

- *3: Management and Control* – eg, SYSC, APER, TC, Prudential Standards
- *4: Financial Prudence* – eg, Prudential Standards
- *11: Relations with Regulators* – eg, SUP.

Broadly speaking, the Principles apply only to regulated firms and not, generally, to the unregulated business of firms. Principles 3 and 4 are exceptions because the FSA would judge the relevant matters by taking into account the operation of the firm as a whole including, for example, groups of which it is a member.

Some of the Principles focus on treating customers fairly (TCF); most notably, Principles 1, 2, 6, 7, 8, and 9. Therefore, a strong TCF exercise should help a firm reduce the risk of breaching much of PRIN – see www.bsa.org.uk/members/policy/consumerrelations/treatcustfairly.htm.

The guidance in PRIN 1.1.3G is potentially important in respect of accepting deposits –

“Principles apply with respect to regulated activities generally, but, in applying the Principles with respect to accepting deposits and issuing electronic money the FSA will proceed only in a prudential context. That is to say, in this context, the FSA would not expect to exercise the powers brought into play by a contravention of a Principle unless the contravention amounted to a serious or persistent violation which had implications for confidence in the financial system, or for the fitness and propriety of the firm or for the adequacy of the firm’s financial resources.”

However, this will change when the FSA begins regulating banking conduct of business, from 1 November 2009. From that date, deposit-taking will be fully ‘conduct of business’ regulated.

Principles 6 (*Customers’ interests*), 7 (*Communications with Clients*), 8 (*Conflicts of Interest*), 9 (*Customers: Relationships of Trust*) and 10 (*Clients’ Assets*) impose requirements on firms expressly in relation to their clients or customers. These requirements depend, in part, on the characteristics of the client or customer concerned. Therefore, PRIN 1.2 deals with categorisation of clients.

PRIN 3 contains a number of rules about application –

- PRIN 3.1 (*Who?*) covers the firms, like building societies, to which PRIN applies
- PRIN 3.2 (*What?*) sets out the activities to which it applies
- PRIN 3.3 (*Where?*) deals with the territorial application of the Principles, which varies considerably.
- PRIN 3.4 (*General*) among other things, makes it clear that a contravention of the rules in PRIN does not give rise to a right of action under section 150 of the FSMA (see above).

Recent Principle 3 Breaches

In July 2009, FSA fined three HSBC firms over £3 million for not having adequate systems and controls in place to protect their customers’ confidential details from being lost or stolen. These failings contributed to customer data being lost in the post on two occasions.

During its investigation into the firms’ data security systems and controls, the FSA found that large amounts of unencrypted customer details had been sent via post or courier to third parties. Confidential information about customers was also left on open shelves or in unlocked cabinets and could have been lost or stolen. In addition, staff were not given sufficient training on how to identify and manage risks like identity theft.

Despite increasing awareness of the need to protect people’s confidential details, all three firms failed to put in place adequate procedures to manage their financial crime risks.

www.fsa.gov.uk/pages/Library/Communication/PR/2009/099.shtml

(ii) Senior Management, Arrangements, Systems and Controls - SYSC

SYSC sets out the high level rules and guidance on senior management arrangements, systems and controls. The rules in SYSC cover the apportionment of significant responsibilities among directors and senior managers, and the establishment and maintenance of appropriate systems, controls and records. **Chapters 4 - 10 and 18 – 19* of SYSC are potentially relevant to building societies.**

*SYSC 19 stems from the FSA's remuneration code, published in August 2009 www.bsa.org.uk/members/policybrief/corpgovpolicybrief.htm. It directly affects only a very small number of building societies but sets out the FSA's thinking on good practice. The FSA is currently considering whether to extend the scope of the code to cover other FSA-authorized firms and plans to publish an update "around October" 2009.

For the avoidance of doubt, SYSC 2 does **not** apply to building societies www.fsa.gov.uk/Pages/Doing/Regulated/Approved/index.shtml. Therefore, for example, the requirement to allocate apportionment and oversight functions to one or more individuals ('CF8'), no longer applies to societies www.fsa.gov.uk/pubs/cp/cp07_16.pdf.

SYSC, which largely supports Principle 3 (*Management and Control*), has expanded rapidly since it was introduced. It has increased from four to 18 chapters, following the inclusion, in particular, of elements on systems and controls stemming from the Capital Requirements Directive 2006/48-49/EC (CRD) and the Markets in Financial Instruments Directive 2004/39/EC (MiFID).

CRD amended two existing Directives – the Banking Consolidation Directive and the Capital Adequacy Directive – for the prudential regulation of credit institutions (including building societies) and investment firms across the European Union. It introduced a modern prudential framework, aligning capital levels more closely to risks and providing institutions with incentives to move to higher standards of risk management www.bsa.org.uk/members/policybrief/capital_requirements.htm

MiFID replaced the Investment Services Directive, which governed the way a wide range of regulated investment business was conducted in EU member states and cross-border within the EU. Building societies are subject to MiFID for certain investment business, such as the sale of investment products that contain securities www.bsa.org.uk/members/policybrief/mifidpb?art_type=policy_brief&policy=4.4.

In CP 06/9, the FSA proposed a "common platform", ie a single set of rules and guidance to implement CRD and MiFID for firms subject to one or both Directives. The "common platform" proposals concerned the internal affairs of firms – management oversight and systems and controls. This approach was consistent with the European Commission's view that firms subject to both Directives should not have to comply with two sets of requirements. Such an approach, however, involved a degree of super-equivalence.

Consequently, in 2007, the FSA replaced the existing SYSC chapter 3 with seven new "common platform" chapters applicable to "common platform" firms (these include building societies); for details see - www.fsa.gov.uk/pubs/policy/ps06_13.pdf. SYSC chapters 4 – 10 are the "common platform" chapters. SYSC 18 (whistleblowing) is also applicable to building societies.

Certain other SYSC chapters are applicable only to other firms eg insurers. (For details of SYSC application, see SYSC 1.1A.1G and SYSC 1 Annex 1 <http://fsahandbook.info/FSA/html/handbook/SYSC/1/1A>). The chapters applicable to building societies are set out in the table below.

SYSC

SYSC 4	General organisational requirements
SYSC 5	Employees, agents and other relevant persons
SYSC 6	Compliance, internal audit and financial crime
SYSC 7	Risk control
SYSC 8	Outsourcing
SYSC 9	Record-keeping
SYSC 10	Conflicts of interest
SYSC 18	Guidance on Public Interest Disclosure Act: Whistleblowing
SYSC 19*	Remuneration Code (in force from 1 January 2010) Senior Management Arrangements, Systems and Controls (Remuneration Code) Instrument 2009

SYSC 5.1.1R requires a firm to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them. This requirement is elaborated in TC (see page 144 below).

(iii) Threshold Conditions – COND

COND sets out the minimum standards for becoming and remaining authorised. **All but one aspect of COND relevant to building societies.**

In order to carry on a regulated activity in the UK, or to purport to do so, a firm must be an authorised person (or exempted under certain provisions) – the “general prohibition” (section 19 FSMA). It is a criminal offence to breach the general prohibition (section 23 FSMA).

Authorised persons must meet, on a continuing basis, certain ‘Threshold Conditions’ set out in Schedule 6 to the FSMA, and repeated in COND. The threshold conditions relate to –

- **Legal status** - eg, individuals may not accept deposits (building societies will, of course, satisfy this condition).
- **Location of offices** - head office and registered office must be in the UK (in any case, section 5(1) of the 1986 Act requires this for a building society).
- **Close links** - with other persons must not prevent effective supervision (the details are set out in detail in COND 2.3.1) <http://fsahandbook.info/FSA/html/handbook/COND/2/3>
- **Adequate resources**
- **Suitability** - the authorised person must be ‘fit and proper’.

An additional condition (appointment of claims representatives) – concerns motor insurance, so is unlikely to be relevant to building societies.

COND 3, which is new (in effect from 6 September 2009) applies in the case of a failing bank, building society etc and explains how the FSA would assess the meeting of the conditions by such firms – Threshold Conditions (Banking Act 2009) Instrument 2009 (FSA 2009/39) http://fsahandbook.info/FSA/handbook/LI/2009/2009_39.pdf.

(iv) Statements of Principle and Code of Practice for Approved Persons – APER

APER consists of high-level standards applying to all individuals who are approved persons. **APER is relevant to approved persons within building societies.**

The statements of principle (APER 2) are set out in the table overleaf. Statements of principle 1, 2, 3 and 4 apply to all approved persons and 5, 6 and 7 apply to those approved to perform significant influence functions (see pages 134-135 above).

The statements of principle are supplemented by a code of practice (APER 3 and 4), which helps to determine whether or not an approved person's conduct complies with a statement of principle.

Statements of Principle

<p>1 - Integrity An approved person must act with integrity in carrying out his controlled function.</p>
<p>2 - Skill, Care and Diligence An approved person must act with due skill, care and diligence in carrying out his controlled function.</p>
<p>3 - Market Conduct An approved person must observe proper standards of market conduct in carrying out his controlled function.</p>
<p>4 - Co-operation with Regulators An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.</p>
<p>5 - Control of Business An approved person performing a <i>significant influence function</i> must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.</p>
<p>6 - Skill, Care and Diligence (in significant influence function) An approved person performing a <i>significant influence function</i> must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.</p>
<p>7 - Regulatory Requirements and Standards An approved person performing a <i>significant influence function</i> must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.</p>

(v) The Fit and Proper Test for Approved Persons – FIT

FIT sets out and describes the criteria that the FSA will consider when assessing the fitness and propriety of a candidate for a controlled function. The criteria are also relevant in assessing the continuing fitness and propriety of approved persons. **FIT is relevant to people applying to take up controlled functions within building societies, and to approved persons in building societies.**

The main assessment criteria are set out in FIT 2 and, as noted above, relate to –

- honesty, integrity and reputation
- competence and capability
- financial soundness.

In assessing fitness and propriety, the FSA will also take into account the purpose among other things, of the firm for which the approved person's function is, or is to be, performed. If

a matter comes to the FSA's attention which suggests that the person might not be fit and proper, the FSA will take into account how relevant and how important it is.

The FIT Guidance also makes it clear that, during the application process, the FSA may discuss the assessment of the candidate's fitness and propriety informally with the firm, and retain any notes of these discussions.

The FIT Guidance sets out in more detail the specific matters to which the FSA will have regard in determining a person's honesty, integrity, reputation, competence, capability, and financial soundness. There is an obligation for an approved person to notify the FSA of any factors suggesting that he or she is no longer fit and proper.

The FSA will not consider applications for pre-approval of candidates for the election to the governing body of a mutual society. Therefore, the FSA will not 'pre-vet' candidates at building society elections. An individual would not be able to carry on the director function until he or she had been successful in the election and the FSA has granted approval.

(vi) General Provisions - GEN

As the title suggests, GEN contains miscellaneous provisions. **All of GEN applies to building societies.**

GEN covers the following –

- restrictions on firm's referring to the extent to which the FSA has approved aspects of their business (this provision is intended) to help prevent consumers being misled (GEN 1.2)
- failure to comply with FSA rules because of emergencies (GEN 1.3)
- interpretation of the Handbook (GEN 2)
- statutory status disclosure (GEN 4), which sets out when a firm must – and when it need not – disclose its authorised status
- use by firms of FSA logos (GEN 5)
- prohibition of insurance policies to indemnify those who are subject to FSA penalties (GEN 6).

(vii) Fees Manual - FEES

FEES consolidates all the FSA Handbook provisions relating to fees **and is fully relevant to building societies.**

As well as certain general provisions, covering such matters as late payments and recovery of fees, FEES covers FSA fees (including 'one-off' and periodic fees), fees to FOS and fees to the Financial Service Compensation Fund.

It is uncertain why an administrative matter, like fees, is included under 'High Level Standards'.

3. Prudential Standards

The Prudential Standards Block sets out the prudential requirements for firms.

Note: building societies and certain other firms, eg banks and investment firms, that are within the scope of the CRD (see page 136 above), are subject to the FSA's prudential regime under GENPRU and BIPRU.

On 1 January 2007, GENPRU and BIPRU replaced IPRU(Bank), IPRU(BSoc) and IPRU(Inv) text for firms within the scope of the CRD. The replacement text in most of GENPRU and BIPRU is, in the majority of cases, substantially different from the text it replaces.

The GENPRU and BIPRU rules and guidance seek to ensure that firms hold adequate capital, maintain adequate liquidity, and control large exposures.

(i) General Prudential Sourcebook - GENPRU

GENPRU contains prudential requirements common to building societies, banks, insurers and investment firms, relating to capital adequacy. There is no overall application statement for GENPRU - each chapter or section has its own, **but much of GENPRU is relevant to building societies (see below).**

GENRU, among other things, sets out the requirements to which a building society's internal capital adequacy assessment process ('ICAAP') must comply (see GENPRU 1.2). (This is part of the firm-specific, and more subjective, capital requirements known as "Pillar 2", which add to the quantitative formula-based capital requirements known as "Pillar 1".)

GENPRU divides capital into tier 1, upper and lower tier 2, and tier 3 (GENPRU 2.2.8G to 2.2.12G). GENPRU 2.2.9G states that tier 1 capital typically has the following characteristics; it –

- is able to absorb losses
- is permanent
- ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities, and
- has no fixed costs, ie there is no inescapable obligation to pay dividends or interest.

The table in GENPRU 2, Annex 3 sets out capital resources for a building society <http://fsahandbook.info/FSA/html/handbook/GENPRU/2/Annex3>.

Subject to certain specific requirements, tier 1 capital for a building society comprises a society's profit and loss account (taking into account interim net losses), other reserves, externally verified interim net profits, PIBS, and innovative tier 1 capital (certain instruments other than PIBS – see GENPRU 2.2.114R)

Tier 2 capital for a society would include perpetual subordinated debt, perpetual subordinated securities, revaluation reserves, general/collective provisions, and surplus provisions upper tier 2), and long-term subordinated debt, and fixed term subordinated securities (see GENPRU 159R to 180R).

Upper tier 3 is short term subordinated debt, and lower tier 3 is net interim trading book profit and loss – neither relevant for societies as tier 3 can be used only for very limited purposes.

(ii) Prudential Sourcebook for Banks, Building Societies and Investment Firms - BIPRU

BIPRU contains prudential requirements for banking and investment firms, additional to those in GENPRU (above). Like GENPRU, BIPRU has no overall application statement, **but much of BIPRU is relevant to building societies.**

BIPRU covers, among other things, detailed capital requirements for credit risk, credit risk mitigation, operational risk, market risk, group risk, and securitisation. The FSA plans to introduce new liquidity requirements through BIPRU during late 2009 and early 2010 – for details, see www.bsa.org.uk/members/circular/6805.htm.

(iii) Interim Prudential Sourcebook for Building Societies – IPRU - BSOC

As noted above, the Interim Prudential sourcebooks (including IPRU-BSOC) are being deleted and replaced by other FSA Handbook standards – in particular, there will be a specialist sourcebook for building societies www.fsa.gov.uk/pubs/cp/cp09_17.pdf. **Obviously, this will be important for all building societies.**

Chapters 4 and 5 of IPRU BSOC still in force and likely to be until 2010.

In summary, the new sourcebook will take the five tier approach to financial risk management already familiar to societies from IPRU (BSOC) and develop it to blend in with the revised liquidity policy. It will separately introduce a simpler three tier approach to lending. Societies will be required to self-classify, against the published guidance for each tier, and supervisors will review these choices.

However, there are very serious concerns within the building society sector about the practicability, and restrictive nature, of the FSA's proposals, and about the apparent lack of co-ordination with the mortgage market review - www.bsa.org.uk/members/circular/6911.htm.

The consultation on BSOCs closes on 5 September 2009. The FSA plans publish feedback on the responses in a Policy Statement in the Q4 2009, with a view to implementing the proposals, if confirmed, in early 2010. **NOTE: BSOCs will remain separate from BSOG.**

4. Business Standards

These are the detailed requirements relating to firms' day-to-day business.

In *Better Regulation Action Plan* (December 2005), the FSA announced plans to move further towards a principles-based approach. Chapter 2 of FSA consultation paper CP 06/19 explained the FSA's general approach to reforming its Conduct of Business sourcebook to support a more principles-based approach to regulation (PBR) www.fsa.gov.uk/pubs/cp/cp06_19.pdf. Also see page 152 below.

(i) Conduct of Business Sourcebook – COBS

COBS is a residual sourcebook covering regulated activities not dealt with by MCOB (regulation of mortgage lending and administration) and ICOB (non-investment insurance regulation) *and, from 1 November 2009, BCOBS (banking regulation)*. Most of COBS relates to the investment advice process regarding “designated investment business” eg securities, derivatives and investment-related insurance. **Therefore, COBS is not relevant to most building societies' mainstream business, but –**

- **this will depend on the nature and scope of an individual society's business and operations, and**

- **COBS will, in any case, be relevant to most societies' treasury operations.**

(ii) Insurance Conduct of Business Sourcebook – ICOBS

ICOBS deals with non-investment insurance business **and is relevant to building societies that engage in such business.**

ICOBS covers –

- client categorisation, communications to clients, inducements - ICOBS 2
- distance communications – ICOBS 3
- information about the firm, its services and remuneration – ICOBS 4
- identifying client needs and advising – ICOBS 5
- product information – ICOBS 6
- cancellation – ICOBS 7
- complaints handling – ICOBS 8.

(iii) Mortgage and Home Finance: Conduct of Business Sourcebook – MCOB

MCOB covers the activities of mortgage lending and administration, and advising on and arranging mortgage lending. **Because mortgage lending is a core building society activity, most of MCOB is relevant to most building societies (see below).**

The provisions of the most direct relevance to building societies are those relating to lenders/providers and to regulated mortgage contracts ie a contract that, at the time it was entered into, was subject to the following conditions –

- a lender provides credit to an individual or to trustees (the 'borrower'), and
- the obligation of the borrower to repay is secured by a first legal mortgage on land (other than timeshare accommodation)
- at least 40% of which is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a relation of the borrower.

The main individual MCOB provisions likely to be relevant to all societies are –

- **General**
 - Application and Purpose (MCOB 1)
- **Standards**
 - General Conduct of Business Standards (MCOB 2)
 - Advising and Selling Standards (MCOB 4)
- **Disclosure**
 - Pre-application Disclosure (MCOB 5)
 - Disclosure at the Offer Stage (MCOB 6)
 - Disclosure at the Start of a Contract and After Sale (MCOB 7)

- **Miscellaneous**
 - Other Provisions (MCOB 10 -13).

For detailed information, see –

www.bsa.org.uk/members/policybrief/mortgage_regulation.htm and pages 67 – 86 of the *BSA Guide to Residential Mortgage Law and Regulation 2009* - www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf

The FSA plans to publish a discussion paper in September 2009 that will examine how the mortgage market is regulated and particularly how regulation of the mortgage market should change in the future. The Review, which is likely to affect MCOB, is expected to focus on -

- Responsible lending
 - Income verification and self certification
 - Affordability assessments
 - Lender and broker responsibility for verifying affordability
 - Lending thresholds
 - Product design
- Suitable advice, charging and distribution
 - Advised and non advised sales
 - Suitable advice
 - Fair charges
 - Disclosure
 - Approved persons regime
- Arrears and possessions
 - Fit for purpose rules
- Non conduct of business issues
 - Supervision and enforcement
 - Financial crime
 - Equity release
- Other issues
 - Regulation of BTL and second charge lending by the FSA

For more details, see www.bsa.org.uk/members/policybrief/mortgage_market_review.htm.

(iv) Client Assets - CASS

CASS deals with designated investment business and the activities of non-investment insurance firms **and is not relevant to mainstream building society activities.**

(v) Market Conduct - MAR

MAR helps to determine whether certain types of conduct amounts to market abuse under the provisions in the FSMA. **MAR is not relevant to mainstream building society activities (except certain treasury operations) and whether it has any relevance will depend on the nature and scope of an individual society's business and operations.**

For example, a building society “dealing as principal” in securities or derivatives is subject to the Inter-Professional Conduct provisions in MAR 3.

MAR also includes a Code of Market Conduct and covers price stabilising rules, multi-lateral trading facilities etc. A building society, or its employees, using the relevant market would need to be familiar with the Code.

(vi) Training and Competence - TC

TC sets out rules for training and competence of employees carrying out any of the activities set out in TC App 1.1. These are a range of retail activities, including regulated mortgage activities, equity release transactions etc, **and will be fully relevant to building societies in relation to their employees who carry out the listed activities.**

TC stems from the overarching 'competent employees rule' in SYSC (see page 136 above). Much of TC was removed, from 1 November 2007, in order to give firms greater flexibility. The key provision is now TC 2.1, which covers assessment of competence, supervision, examination requirements, training needs, and maintaining competence.

(vii) Money Laundering

Until August 2006, the FSA Handbook contained a Money Laundering sourcebook. However, the FSA deleted this sourcebook and it was replaced by –

- high-level requirements in SYSC (see SYSC 6.3)
- more detailed systems and procedural requirements set out in the Money Laundering Regulations 2007 (SI No 2157), concerning verification of customer identity, internal reporting, record keeping, staff training etc.

These requirements are fully relevant to building societies.

For more details on anti-money laundering requirements, visit www.jmlsg.org.uk/bba/jsp/polopoly.jsp;jsessionid=aLRZUH_mnfo_?d=749.

5. Regulatory Processes

These manuals describe the operation of the FSA's authorisation, supervisory and disciplinary functions.

(i) Supervision – SUP

SUP sets out the relationship between the FSA and authorised firms such as building societies, and is also relevant to approved persons. It lays down supervisory provisions including those relating to auditors, waivers, individual guidance, notifications and reporting. Each chapter of SUP has its own application statement, **but much of it applies to building societies.**

As noted above, an authorised person must obtain the FSA's approval before allowing another individual to perform a controlled function.

SUP 10.4.5R sets out specific controlled functions most of them "significant influence functions" ie one which is likely to result in the person responsible for its performance exercising a significant influence on the conduct of a firm's affairs, so far as relating to a regulated activity of the firm. The following are (depending on a societies' size and operations) most likely to be relevant to building societies –

- **Governing functions**
 - Chief executive
 - Director
 - Non-executive director

- **Required functions**
 - Apportionment and oversight (normally the chief executive)
 - Compliance oversight
 - Money laundering reporting
- **Systems and control function**
- **Significant management function**
- **Customer functions** (this is not a significant influence function).

In July 2009, the Financial Services Authority (FSA) confirmed an extension of the approved persons regime for those that perform a 'significant influence' function at firms www.fsa.gov.uk/pages/Library/Communication/PR/2009/104.shtml.

(ii) **Decision Procedure and Penalties Manual – DEPP**

DEPP contains a description of the FSA's procedures for taking statutory notice decisions, and the FSA's policy on the imposition and amount of penalties. It should be read in conjunction with EG (see page 147 below). **DEPP is potentially relevant to all firms and approved persons, including building societies.**

6. **Redress**

This part of the Handbook deals with the processes for handling complaints and compensation.

(i) **Dispute Resolution: Complaints – DISP**

DISP sets out the detailed requirements for handling complaints and the Financial Ombudsman Service arrangements **and is fully relevant to building societies.**

DISP is very extensive, but key aspects relevant to building societies are –

- the treating customers fairly rules in DISP 1, which cover how firms should deal promptly and fairly with complaints, and include rules requiring proper procedures for handling complaints and resolving disputes, time limits, returns to the FSA etc
- the jurisdiction of the Financial Ombudsman service (FOS) in DISP 2, and
- FOS procedures in DISP 3, including determinations, awards to successful complainants etc.

For more information on the Financial Ombudsman Service, see page 125 above and –

www.bsa.org.uk/members/policybrief/blog100007.htm

www.financial-ombudsman.org.uk/

(ii) **Compensation – COMP**

COMP sets out the rules governing eligibility under, and levies for, the Financial Services Compensation Scheme (FSCS) **and is potentially fully relevant to all firms, including building societies.**

Like DISP, COMP is very extensive and covers a wide range of matters including the qualifying conditions for compensation, eligible claimants, protected claims, 'default' giving rise to a claim, payment of compensation, time limits, FSCS funding etc.

As noted above, until the failure of Northern Rock in 2007, there was little focus on the FSCS in respect of mortgages and savings. However, since then there have been a number of

significant developments. The BSA has a policy page on its Members' Website concerning the Scheme, which goes into more detail – www.bsa.org.uk/members/policybrief/fscs.htm.

The FSA introduced temporary rules, at the end of 2008 and at the beginning of 2009, allowing separate compensation cover for customers with deposits in two merging building societies. In June 2009, the FSA announced that it proposed to extend the rules beyond their original expiry date of 30 September 2009, to 31 December 2010.

www.fsa.gov.uk/pages/Library/Communication/PR/2009/072.shtml

For more information on the FSCS, see pages 124-125 above and www.fscs.org.uk.

(iii) Complaints Against the FSA - COAF

COAF contains details of the scheme for handling complaints against the FSA arising in connection with the exercise of, or failure to exercise, any of its functions. **It is potentially relevant to any firm, including a building society.**

The FSA is required to appoint an independent person as Complaints Commissioner, responsible for the conduct of investigations in accordance with the complaints scheme. Anyone directly affected by the way in which the FSA has carried out its functions, or anyone acting directly on such a person's behalf, may bring a complaint (COAF 1.2.1G).

The complaints scheme covers complaints about the way in which the FSA has acted or omitted to act, including complaints alleging mistakes and lack of care; unreasonable delay; unprofessional behaviour; bias; or lack of integrity (COAF 1.4.1G).

The complaints scheme provides that there may be two distinct stages for each complaint. At the first stage, the FSA will investigate any complaint that meets the requirements of the scheme (see COAF 1.4) and take whatever action to resolve the matter it thinks appropriate.

A complaint will normally proceed to the second stage only if the complainant is dissatisfied with the FSA's determination or how the FSA has handled the complaint. The second stage consists of investigation by the Complaints Commissioner, followed, if the Commissioner finds for the complainant, by a recommendation to the FSA on the form of redress, if any, that is appropriate in the circumstances.

For further information, visit www.fsa.gov.uk/Pages/About/complaints/procedure/index.shtml and www.fscs.gov.uk/.

6. Regulatory Guides

These are guides to specific aspects of FSA regulation.

(i) The Building Societies Regulatory Guide - BSOG

BSOG provides guidance on the Building Societies Act 1986 and on various constitutional and other provisions relating to building societies. **It is obviously fully relevant to building societies.**

BSOG covers -

- **Principal purpose of a building society and funding and lending limits**

BSOG 1.2 elaborates on the requirement in section 5 of the 1986 Act that a building society can only be or remain established if its purpose, or principal purpose, is

making loans which are secured on residential property and funded substantially by the society's members (the 'principal purpose test' – see page 9 above).

BSOG 1.2 covers matters that the FSA takes into account in assessing compliance, including that any programme of securitisation does not threaten compliance either with the principal purpose, or with the lending or funding nature limits (BSOG 1.2.6G).

- **Constitutional matters**

BSOG 1.3 deals with a range of constitutional matters, including fitness and propriety of directors, and a range of matters mostly underpinned by the 1986 Act, including dealings with directors.

- **Accounting records and reporting requirements**

BSOG 1.4, which reflects 1986 Act requirements, concerns accounting records and systems, and reporting requirements.

- **Electronic communications**

BSOG 1.5 briefly refers to the provisions of the The Building Societies Act 1986 (Electronic Communications) Order 2003 (SI 2003 No 404) – see pages 103-108 above.

(ii) **The Enforcement Guide - EG**

EG describes the FSA's approach to exercising the main enforcement powers given to it by the FSMA and by regulation 12 of the Unfair Terms in Consumer Contracts Regulations 1999 (SI No 2083) (also see UNFCOG below). **EG is potentially relevant to all regulated firms, including building societies.**

EG covers the FSA's approach to enforcement, and specific enforcement powers.

(iii) **The Perimeter Guidance Manual - PERG**

PERG gives guidance about the circumstances in which authorisation is required, or exempt person status is available, including guidance on the activities which are regulated under the Act and the exclusions which are available. **Aspects of PERG will be relevant to building societies.**

The guidance in PERG is issued under section 157 of the FSMA (Guidance). It represents the FSA's views and does not bind the courts.

For a useful overview on authorisation, see - www.fsa.gov.uk/pubs/other/applying_authorisation.pdf.

From 1 November 2009, PERG will include PERG 15 – guidance on the scope of the Payment Services Regulations 2009 (SI No 209) – see www.bsa.org.uk/members/policybrief/Payment_Services_Directive.htm.

(iv) **The Responsibilities of Providers and Distributors for the Fair Treatment of Customers - RPPD**

RPPD gives the FSA's guidance on what the combination of Principles for Businesses and detailed rules require respectively of providers and distributors in certain circumstances to

treat customers fairly. It is part of the FSA's wider treating customers fairly (TCF) project **and is relevant to building societies if they act as providers or distributors.**

For more information on TCF, see –

www.bsa.org.uk/members/policy/consumerrelations/treatcustfairly.htm and

www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml.

(v) The Unfair Contract Terms Regulatory Guide - UNFCOG

UNFCOG explains the FSA's policy on how it will use its powers under the Unfair Terms in Consumer Contracts Regulations 1999 (SI No 2083) **and much of it is relevant to building societies.**

For more information on unfair terms, see www.bsa.org.uk/members/policybrief/blog100003.htm.

The Handbook sourcebooks and manuals that are most important to building societies: informal summary

Notes in italics refer to certain expected changes

For a full list of the sourcebooks, manuals etc - <http://fsahandbook.info/FSA/html/handbook/>

Sourcebook or module	Description	Relevant to building societies?
High Level Standards [and supplementary material]		
PRIN	A set of Principles, and related rules and guidance, that apply to all businesses authorised by the FSA.	Fully relevant
SYSC	The high level rules and guidance on senior management arrangements, systems and controls.	Chapters 4 - 10 and 18 (but also see 19)
COND	Sets out the minimum standards for becoming and remaining authorised	All but one minor aspect
[PERG]	[Gives guidance about the circumstances in which authorisation is required, or exempt person status is available, including guidance on the activities which are regulated under the Act and the exclusions which are available]	[Certain provisions]
APER	High-level standards applying to all individuals who are approved persons.	Relevant to approved persons within building societies.
FIT	The criteria that the FSA will consider when assessing the fitness and propriety of a candidate for a controlled function	Relevant to people applying to take up controlled functions within building societies, and to approved persons in building societies
[SUP]	[relationship between the FSA and authorised persons and approved persons.]	[Certain provisions]
GEN	Miscellaneous provisions	Fully relevant
Prudential Standards		
GENPRU	Prudential requirements common to building societies, banks, insurers and investment firms, relating to capital adequacy	Certain provisions
BIPRU	Prudential requirements for banking and investment firms, additional to those in GENPRU <i>Note: The FSA plans to introduce new liquidity requirements through BIPRU during late 2009 and</i>	Certain provisions <i>Will probably be fully</i>

	<i>early 2010</i>	<i>relevant</i>
IPRU – BSOC BSOCS	Being deleted and replaced <i>Note: A specialist sourcebook for building societies' approach to financial risk management is likely to be implemented in early 2010</i>	Fully relevant <i>Will be fully relevant</i>
Business Standards		
<i>Note: From 1 November 2009, new FSA regulations (BCOBS) will replace the Banking Code and will be relevant to building societies</i>		
MCOB	The activities of mortgage lending and administration, and advising on and arranging mortgage lending <i>Note: The FSA plans to publish a mortgage market review discussion paper in September 2009, which will probably impact significantly on MCOB</i>	Largely relevant
ICOBS	Non-investment insurance business	Largely relevant to building societies engaged in that business
TC	Training and competence of employees carrying out specified regulated activities	Fully relevant in respect of such staff
Discipline, Redress, Complaints and Compensation		
DEPP	The FSA's procedures for taking statutory notice decisions, and the FSA's policy on the imposition and amount of penalties	Potentially relevant
EG	The FSA's approach to exercising its main statutory enforcement powers	Potentially relevant
DISP	The detailed arrangements for handling customer complaints, and FOS arrangements and procedures	Fully relevant
COMP	The rules governing eligibility under, and levies for, the FSCS	Potentially relevant
COAF	The scheme for handling complaints against the FSA	Potentially relevant
Miscellaneous Guides etc		
FEES	Provisions about regulatory fees (Situated in High Level Standards but in fact a set of administrative provisions)	Fully relevant
BSOG	Guidance on certain aspects of the 1986 Act	Fully relevant

RPPD	Guidance on what the combination of Principles for Businesses and detailed rules require respectively of providers and distributors in certain circumstances to treat customers fairly	Relevant where a building society acts as a provider or distributor
UNFCOG	The FSA's policy on how it will use its powers regarding unfair contract terms	Largely potentially relevant

7. Notification and Reporting Requirements

The FSA has wide powers to demand documents a range of routine returns must be made to the FSA. Firms must deal with the FSA in an open and co-operative way and disclose anything the FSA would reasonably expect notice of (see Principle 11, page 134).

There are many notification and reporting requirements in the FSA's Handbook of Rules and Guidance, which usually appear in a schedule to each module or chapter. Note that the Handbook changes regularly and the current version is available at - <http://fsahandbook.info/FSA/html/handbook/>.

Key requirements likely to be relevant to building societies include –

- **SUP 15 -17** – contains a wide range of notification and reporting requirements, and transaction reporting requirements, material to the FSA's supervision, many of which are relevant to building societies.

SUP 15.3 contains general **notification requirements** relating to –

- matters having serious regulatory impact (eg failure to meet a threshold condition or any matter which could have a significant adverse impact on the firm's reputation)
- matters of which the FSA would reasonably expect notice (eg any proposed restructuring, reorganisation or business expansion which could have a significant impact on the firm's risk profile or resources)
- breaches of rules and other requirements in, or under, the FSMA (eg the breach of a rule in the FSA Handbook; the breach of a provision in the FSMA; the bringing of a prosecution for, or a conviction of, any offence under the FSMA)
- civil, criminal or disciplinary proceedings against the firm
- fraud, errors and other irregularities (eg fraud by an employee against a customer or against the firm)
- various events concerning, or preparatory to, insolvency, bankruptcy or winding up (eg the calling of a meeting, or presentation of a petition, to consider a resolution for winding up the firm)

SUP 15.5 relates to notification of 'core' information (eg change of name or address of the firm)

SUP 15.7 deals with the form and method of notification. Generally, a notification required from a firm under any notification rule must be given in writing, and in English, and must be submitted on the form specified for that notification rule (see SUP 15.7.5R), or if no form is specified, on the form in SUP 15 Ann 3 RR (notification form).

SUP 15.8 sets notification requirements concerning certain specific products and services (eg If a firm begins or ceases to hold itself out as acting as a Child Trust Fund provider, it must notify the FSA as soon as reasonably practicable that it has done so).

SUP 16.3.9R sets out the required methods of **submission of reports**. The required reports include the annual 'close links' report (see COND, page 137 above), the appointed representatives' annual report etc. Not all are relevant to building societies – for details see SUP 16.

- **GENPRU and BIPRU Schedules 2** – contain various reporting requirements relating to financial matters, such as capital adequacy and risk.
- **DISP Schedule 2.1** – contains various requirements; notably, the requirement for a firm, twice a year, to provide the FSA with a complete report (in a specified format)

concerning complaints received from eligible complainants.

- **APER 2.1.2R** – requires notice of any information of which the FSA would reasonably expect notice.
- **GEN 1.3.2R** - requires notice of an emergency that makes it impracticable for a firm to comply with a particular rule.
- **Anti-money laundering suspicious activity reporting** is covered outside the FSA Handbook by chapter 6 of the *JMLSG Prevention of Money Laundering/Combating Terrorist Financing* guidance notes
[www.jmlsg.org.uk/content/1/c6/01/14/56/Part I - HMT approved.pdf](http://www.jmlsg.org.uk/content/1/c6/01/14/56/Part_I_-_HMT_approved.pdf).

Naturally, the FSA also has power to gather information on its own initiative (see SUP 2), including the use of 'skilled persons' (eg independent experts) under section 166 FSMA (see SUP 5). SUP also deals with reports to the FSA by auditors and actuaries (SUP 3 and 4).

8. 'Principles-based' Regulation

Firms, including building societies, are used to regulation based on specific, detailed rules, such as the MCOB and ICOB Rules. However, the FSA is moving towards greater use of principles-based regulation (PBR). The BSA has provided substantial information on the nature of, and advantages and disadvantages of this development -
www.bsa.org.uk/members/practice_briefs/fair_play_guidance/principles_based_regulation.htm

PBR does not mean that FSA rules disappear, but does mean that – beneath the overarching fairness principles in PRIN (see pages 134-135 above), there should be fewer prescriptive rules in future in the Handbook.

Treating customers fairly is the first, main example of PBR – see
www.bsa.org.uk/members/policy/consumerrelations/treatcustfairly.htm for practical guidance from the BSA and www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml.

Further PBR-based exercises, particularly relevant to building societies, include BCOBS and the mortgage market review (see page 143 above).

9. 'Quasi' Regulation

Another recent development is what might be termed 'quasi regulation'. This amounts to views expressed by a regulator which, despite not being delivered by a formal regulatory mechanism, have a potentially regulatory effect.

A theoretical example is 'regulation by speech'. For instance, the views expressed in speech by a FSA official are not binding on firms, but may be taken into account in enforcement procedures (see ENF paragraphs 2.23-2.25
<http://fsahandbook.info/FSA/extra/5149.pdf>.)

A further – practical - example is the FSA's interpretation of the Payment Services Regulations 2009 (SI No 209) -
www.bsa.org.uk/members/policybrief/Payment_Services_Directive.htm.

This development is worrying because, whilst draft FSA rules and guidance are subject to proper statutory control (Part X of the FSMA), quasi regulation is not.

OFFICE OF FAIR TRADING

This sub-section briefly identifies the aspects of the OFT's remit that are relevant to the building society sector or to individual societies.

1. Organisation, Structure and Objectives

The OFT is the UK's consumer and competition authority with an objective of making markets work well for consumers - www.offt.gov.uk/. It is a non-ministerial Government department established by the Fair Trading Act in 1973. The OFT's key activities are the enforcement of –

- consumer protection laws, such as those relating to consumer credit, unfair contract terms and unfair commercial practices, and
- competition laws, under the Competition Act 1998 and the Enterprise Act 2002.

In addition, based on expanded powers granted under the Enterprise Act 2002, the OFT has power to explore how different market sectors operate. For example, it has an ongoing study in the personal current accounts market -

www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/personal/pca/

The OFT works under a structure that is arranged by markets, rather than legislation, eg services, goods, consumer, cartels and criminal enforcement etc.

2. Relevance to Building Societies

The FSA is the main financial services regulator in the UK (see above) but the OFT is also potentially important to building societies in a number of ways; for example –

- The Consumer Credit Act 1974 Act requires all traders who make regulated agreements or exercise rights under a regulated agreement to obtain a consumer credit licence from the OFT. This applies to building societies that engage in consumer credit lending. For more details, see www.bsa.org.uk/members/policybrief/consumer_credit.htm.
- As noted above, the OFT is primarily responsible for the enforcement of a number of consumer protection regulations that apply to building societies, including their core savings and mortgages businesses, but in some cases arrangements are in place for the FSA to have direct responsibility in respect of compliance by FSA-regulated firms - eg unfair terms, see www.bsa.org.uk/members/policybrief/blog100003.htm.
- Some OFT activities (eg the 'test case' process on unauthorised overdraft charges and the PCA market study) will have direct implications for building societies that offer current accounts and, longer-term, could have legal ramifications regarding terms and conditions on a wider range of products.
- Like any other businesses, building societies are subject to competition legislation.

3. OFT's Relationship to FSA

The FSA was designed to be the single regulator for financial services industry, but this objective has not entirely been realised because, as noted above, responsibility for retail banking regulation is split between –

- the FSA (covering deposit taking under the Financial Services and Markets Act 2000) and
- the OFT (covering, for example, credit products under the Consumer Credit Act 1974).

This division of responsibilities means, for instance, that if credit is sold with payment protection insurance, the FSA will be the regulator for the PPI but the OFT will be the regulator for the credit.

The OFT and the FSA have arrangements for co-ordination of their respective regulatory activities www.fsa.gov.uk/pubs/other/OFT_FSA_Actionplan.pdf. The joint FSA/OFT publication *Delivering better regulatory outcomes – May 2008 update*, reported joint regulatory work on all of the following topics –

- personal bank account pricing
- credit card interest calculation
- credit advertising
- the retail distribution review
- PPI
- with-profits funds
- communications with consumers
- the Consumer Credit Act 2006
- mortgage arrears
- sale and rent back
- the Unfair Commercial Practices Directive
- anti-money laundering responsibilities
- the Payment Services Directive.

www.of.gov.uk/shared_of/about_of/oft998.pdf

While, on the one hand, this degree of co-ordination is laudable, the need for such a high-level of co-ordinated activity gives rise, on the other hand, to further questions about the FSA's single financial regulator status. For further commentary, see www.bsa.org.uk/docs/policy/prudentialandfinreg/consumerlawreview_response.pdf.

LENDING STANDARDS BOARD

The Banking Code Standards Board (BCSB – from 1 November 2009, the Lending Standards Board: see below) was formed in 1999 to monitor and enforce compliance with the Banking and Business Banking Codes and take disciplinary action for material breaches www.bankingcode.org.uk/home.htm.

However, from 1 November 2009, new FSA regulations (BCOBS) will replace the *Banking Code* – see www.bsa.org.uk/members/policybrief/BCOB.htm.

From that date, a 'slimmed down' BCSB, renamed the Lending Standards Board, will monitor and enforce lending and credit standards. These standards, to be set out in a new code of practice, will be based on existing *Banking Code* provisions.

The BCSB expects that those code subscribers that do not provide unsecured lending products, will resign from the BCSB from the end of October 2009.

The BSA has a policy brief on its Members' website concerning the *Banking Code* and the arrangements to replace it - www.bsa.org.uk/members/policybrief/blog100008.htm.

It remains to be seen how the new arrangements will co-exist with the OFT's powers once the *Banking Code* has been abolished (see above). The *Banking Code* held these matters together and there is a concern that the abolition of the Code will lead to certain problems, including confusion.

THE FUTURE OF UK FINANCIAL SERVICES REGULATION

The events of the last two years have called into question the future of financial services regulation in the UK. At the time of writing (late August 2009), we do not know what the outcome will be.

The BSA has kept members informed about recent Select Committee reports, speeches by the tripartite authorities, the Opposition Treasury spokesmen (both Conservative and Liberal Democrat), and others on the general subject of financial regulation and banking reform.

The Turner Review *A Regulatory Response to the Global Banking Crisis* was published in March 2009 www.bsa.org.uk/docs/policy/prudentialandfinreg/turner_review.pdf

The Review concluded that the FSA should complete the implementation of its supervisory enhancement program which entails a major shift in its supervisory approach (see page 127 above). The Government's policy on financial services regulation is broadly consistent with the Turner Review, ie one of enhancing and strengthening the current arrangements.

Under Conservative proposals, the Bank of England would be responsible not only for macro-prudential regulation, and micro-prudential supervision of individual banks, building societies and other significant firms like insurance companies. The FSA would be revamped as a new Consumer Protection Agency with a more conduct of business-focused remit. It would pick up regulation of consumer credit from OFT and still handle the supervision of small intermediary-type firms.

The Liberal Democrat Treasury spokesman Vince Cable has spoken on the matter. He has not called for the dismantling of the tripartite, which he sees as potentially disruptive. He has discussed the approach of breaking up the existing big banks so that large scale systemic risk is removed; ie banks become small enough to fail and more competition is restored.

For further information, see -

www.bsa.org.uk/members/policybrief/turner_review.htm

www.bsa.org.uk/members/circular/6934.htm

Building Society Constitutions



NATURE OF A BUILDING SOCIETY

This sub-section examines the nature of a building society as a mutual organisation.

1. Constitutions and Corporate Governance

Building society constitutions and the corporate governance of building societies are related subjects, but the latter is outside the scope of this Guide. Nevertheless, although societies are not publicly quoted, they should have regard to the Combined Code when they establish and review their corporate governance arrangements. (BSOG1.3.2G). We refer to the Combined Code below, where it is relevant to constitutional matters.

For more detail on corporate governance and the Combined Code as it affects building societies, see www.bsa.org.uk/members/policybrief/corpgovpolicybrief.htm.

2. What is a Building Society?

A building society is a mutually owned financial institution that offers savings accounts and mortgages as its main business.

The statutory principal purpose of a building society is that of “making loans which are secured on residential property and are funded substantially by its members” (*section 5(1)* Building Societies Act 1986). However, many societies have diversified and now offer a wide range of personal financial services. Building societies are incorporated under the Building Societies Act 1986.

A building society is a mutual institution. This means that most customers who have a savings account, or mortgage, are members and have certain rights to vote and receive information, as well as to attend and speak at meetings. Each member has one vote, regardless of how much money they have invested (subject only to a ‘qualifying shareholding’ – usually £100) or borrowed, or how many accounts they have. Each building society has a board of directors who directs the affairs of the society and who are responsible for setting its strategy.

Building societies are different from banks, which are companies (often listed on the stock market) and are therefore owned by, and run for, their shareholders. A building society cannot be owned or controlled by an outside institution or major shareholder. Societies have no external shareholders requiring dividends and are not companies. This normally enables them to run on lower costs and offer cheaper mortgages, and offer better rates of interest on savings, than their competitors.

3. Recent Constitutional Developments

(i) Mutual Societies’ Transfers

As noted above, the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (the “Butterfill Act”) enabled, for the first time, the transfer of the business of a mutual society to a subsidiary of another mutual society. The legislative provisions are considered in pages 100-101 above.

At its AGM on 29 April 2009, the members of the Britannia Building Society supported the Board’s recommendation to merge with The Co-operative Financial Services, under the Butterfill provisions. On 23 July 2009, the Financial Services Authority (FSA) announced that it had confirmed the transfer

www.fsa.gov.uk/pubs/final/disc_notice_britannia.pdf. The merger completed on 1 August 2009
www.britannia.co.uk/home/site/microsite/merger/index.html.

(ii) Profit-participating Deferred Shares

On 12 June 2009, the FSA announced that a new variety of permanent capital instrument for building societies – profit-participating deferred shares (PPDS) – could be recognised as core tier 1 capital - www.bsa.org.uk/members/circular/6917.htm. Since PPDS are a deferred share, like PIBS (and, in effect, treated as a sub-category of PIBS), the holders become members and have one vote regardless of size of holding.

At the same time, the West Bromwich Building Society announced that it had issued PPDS in exchange for existing holdings of subordinated debt, thereby upgrading its capital, and is the first society to take advantage of this new instrument .

The question arises whether or not PPDSs compromise mutuality. The BSA has published an article on the matter, which states –

“The issuance of the new capital has provoked a healthy debate within the building society sector about the extent to which the traditional mutual model has been compromised by the new form of capital. After all, up to 25% of the profit of a society can now be allocated to PPDS holders; this group of investors share some characteristics of ordinary share investors in a plc.

Arguably, a society issuing such deferred shares now has to generate profits to meet the expectations of these investors, compromising the traditional ability of a society to concentrate solely on the needs of its members – its savers and borrowers. Moreover, opponents of the change point out that the markets for existing forms of marketable capital - sub-ordinated debt and PIBS - have been damaged by the change.

Those supporting the change point out that there are also substantial advantages for members of a society which is issuing PPDS. Firstly, the core tier one capital ratio of the institution is strengthened. This means that members' funds are more secure and are backed by more loss-absorbing capital than was the case before the issue of the PPDS. In today's febrile financial world, this is an important advantage.

Members are also better off, it is argued, in that in the short to medium term the payments to be made to the new PPDS holders are likely to be lower than the interest payments payable to those same people in their former guise as holders of subordinated debt. Furthermore, each holder of PPDS has only one vote, as a member, irrespective of the value or number of PPDS held – a clear contrast with the plc sector, where institutions can buy voting power in the market.”

For the full article, visit www.bsa.org.uk/feature/ppds.htm.

MEMORANDUM, RULES AND OTHER CONSTITUTIONAL DOCUMENTS

This sub-section covers a building society's constitutional documents; notably, the memorandum and rules.

1. Introduction

(i) Nature of Constitutional Documents

Constitutional documents are those that define the nature of an organisation, regulate the organisation's structure, or control of the organisation and its members. The key constitutional documents of a building society are its –

- memorandum, which sets out the society's powers, and
- rules, which deal with its internal regulation and constitutional arrangements.

A range of other documents are 'constitutional' (eg Board and committee terms of reference or standing orders) or have a constitutional flavour (eg the annual report, policy documents). Those other documents with a statutory standing or dealt with by regulation are discussed below: see pages 171-172 below.

(ii) Notice and Service

The 1986 Act sets out provisions relating to the service of documents required or authorised by the 1986 Act or a society's rules (see *Building Society Law* above).

A society must comply, on demand, with a request for a copy of its "statutory documents" ie its rules (with a copy of the certificate of incorporation annexed) and its memorandum. A member is entitled free of charge to a copy of documents not previously given to that member. The society may require any other applicant to pay a fee not exceeding the prescribed amount (currently £1). It is a criminal offence for a society not to comply. For statutory provisions.

A society is exempt from any obligation imposed by the 1986 Act, or by its rules, to give or send notices or other documents to members, if the society has reason to believe that communications sent to the member at his registered address are unlikely to be received by him.

However, where the requirement relates to a notice of a meeting or a postal or electronic ballot, the society must instead comply with the advertising requirements set out in the 1986 Act.

2. Memorandum

(i) General

Every building society is required to have a memorandum (*section 5(5)* Building Societies Act 1986). The concept of a memorandum (long familiar to companies) was introduced by the 1986 Act. The legislative provisions are covered in detail on pages 10-17 above.

As noted above, since the Building Societies Act 1997 introduced the 'permissive' powers regime, a building society may carry on any activities allowed by its memorandum, subject to certain specific statutory restrictions.

(ii) The BSA Model Memorandum

- **Methodology and contents**

The BSA model memorandum contains a definitions section (paragraph 7), which is intended to be helpful to societies, members and third parties. The model highlights the defined terms in the text. A copy of the model is on pages 167-169 below.

The model gives the word "person" its usual legal meaning; namely, any individual or body corporate. The singular includes the plural and vice versa. Therefore, not only individuals but also groups of individuals (such as clubs, most partnerships etc) are included within "person", and any association of persons regarded in law as a corporate body with an identity separate from those making up the association; eg, companies, local authorities and other building societies.

Paragraphs 1 and 2 of the model memorandum, respectively, set out the society's name and the address of its principal office, in compliance with *paragraph 2(2) of Schedule 2*. (In accordance with *section 5*, a society's principal office must be in the United Kingdom.)

Paragraph 3 of the model specifies the society's purposes and paragraph 4 sets out the society's powers, to reflect the other requirements of *paragraph 2(2) of Schedule 2* (to specify the society's purposes and powers). In very broad terms, it might be helpful to think of a "purpose" as what a society does and a "power" as how the society does it. This approach also overcomes the difficulty, in long-form company objects clauses, of distinguishing between objects and powers.

Paragraphs 3(a) and (b) contain what are likely to be a society's main activities other than mortgage lending funded substantially by members (which is, of course, the principal purpose). These include investment and financial services and the provision of housing or other accommodation, which includes house construction and the sale and letting of residential properties.

The rest of paragraph 3 sets out other purposes that would probably not come within the core areas unless they were ancillary to them.

- Paragraphs (c) and (d) set out possible future activities in such fields as information technology and retailing and advisory services.
- Paragraph (e) covers the ownership of shares in other undertakings and is intended to permit ownership of subsidiaries that carry on group activities, and investment in other companies.
- Paragraph (f) permits the society to promote and support community and charitable purposes.
- Finally, paragraph (g) provides a "sweeper" provision that is included to permit anything that is connected with the other purposes and also to take advantage of or protect property or income or manage the risks of the society or a connected undertaking.

The phrase "in the opinion of the directors" is important because it is designed to bring within the provision any activity that the board honestly believes to be within the society's powers.

Paragraph 4(a) contains the main power to do anything that the board considers necessary or useful to help the society to achieve its purposes. The other powers are intended to allow any activity that might not fall within 4(a). For example, paragraph 4(c) avoids the need to argue that a pension for a dependant of a former employee can assist the society to achieve any of its purposes.

It is important to note that the model does not specify purposes or powers that are already covered by the general purposes or powers. This is preferable to a long form approach and running the risk of indicating an exclusion of other areas of activity. Examples would be specific purposes or powers to -

(a) **engage in securitisation** - this is covered by paragraph 3(g) (an activity which, is carried on for taking advantage of any of the property of the society – ie deriving value from the mortgages which arise from its making loans secured on residential property),

(b) **issue both share and deposit accounts** - there is no express reference to share and deposit accounts because these are implicitly covered by paragraph 3(a) ie the businesses of banking and the provision of financial services and facilities.

(See also *section 8(5)* and *(6)* which describes a building society's power to raise funds by the issue of shares and item 2 in *paragraph 3(4)* of *Schedule 2* which lists the manner in which the funds of a society are to be raised among the matters to be covered by the rules),

(c) **engage in unsecured or commercial lending** - this is covered by paragraph 3(a) since these activities fall within the term "banking",

(d) **hold land** - the earlier provisions in the 1986 Act expressly empowering societies to hold land were repealed by the 1997 Act. The power now comes within paragraph 4(a) and by virtue of the fact that there are references to holding "property" (which is expressly defined as including real property), and

(f) **enforce mortgages** - there is no express reference to the society's powers in respect of arrears and possessions; again, this falls within paragraph 4(a).

Paragraph 5 makes it clear that anything that the society may do may be done in any part of the world, subject only to the requirement that its principal office be situated in the United Kingdom (section 5(1)(a)).

The paragraph also expressly states that such activities may be carried out either alone or in partnership, association or joint venture with others.

One of the major benefits of the permissive regime introduced in 1997 was that doubts that had arisen from time to time about whether societies could act jointly with other societies (for example, in building society groups) were removed.

Provided the societies in question observed the restrictions in the 1986 Act and abided by the FSA's prudential control, there is no reason in building societies legislation why they should not engage in joint ventures, group undertakings etc with other building societies or other organisations.

Paragraph 5 also states that, in carrying out its purposes or powers, the society may act as agent for another person. Finally, the paragraph deals with rights to dispose of the society's property or business and covers mergers etc.

Paragraph 6 explains how the purposes and powers set out in paragraphs 3 and 4 are to be interpreted.

- **Amendments or variations**

Most societies adopt the BSA model. The Association strongly suggests that any society considering tailoring the model or using a different one should take legal advice, because careful drafting of the memorandum is crucial under the new permissive regime.

As noted above, it is particularly important not to include a specific purpose or power with the unintended consequence of excluding other areas of activity. The BSA model, introduced at the time of the 1997 Act, has stood the test of time well, but we encourage societies to contact us if they have any difficulties or queries.

- **Restrictions**

The restrictions on societies' powers under the 1986 Act (as amended by the 1997 Act) are set out in detail above (pages 14-17). The BSA takes the view that there is no need to refer to these in the model memorandum because a society's memorandum will be required to state the powers of the society, but not the restrictions that are specified in the 1986 Act.

In addition, there is a legal reason for this omission. *Sections 6, 7, 8, 9A and 92A* (but not *section 9B*) each state that any failure to comply with their provisions shall not invalidate any transaction or other act.

If the restrictions were included in the memorandum, non-observance would lead to breach of the memorandum as well as the 1986 Act. This in turn could have adverse legal consequences for the society and (unless the safe harbour provisions in the 1986 Act were available to it) for any third party dealing with the society.

The safe harbour provisions are not entirely free from doubt (because of, for example, the absence of clear judicial authority on the good faith requirement). If the restrictions are included in the memorandum, third parties may - before entering into a transaction with a society that could fall within the scope of those sections - require detailed evidence that the transaction would not breach a restriction.

It could be a tiresome and cumbersome process to provide such evidence and it might result in the society producing information that, for competitive reasons, it may not wish to make available.

The view of the FSA's predecessor (the Central Office of the Registry of Friendly Societies) was that, given the broad powers set out in the proposed memorandum, a society should provide a warning, to anyone referring to it, as to the restrictions on the operations of societies imposed by new sections such as *8, 9A and 9B* of the 1986 Act.

The Central Office suggested a form of wording that a society could include in its memorandum, if it wished, as a separate paragraph or sub-paragraph in relation to purposes and powers -

"that the purposes and powers of the society are limited by any restriction in the Statutes".

A definition of statutes following that in the *BSA Model Rules for Building Societies* (see below) would then need to be added to the memorandum in the appropriate place. As with other possible amendments to the model memorandum, it is strongly suggested that societies take legal advice before including the provision. By Rule 1 (fifth edition) "Statutes"

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"means the Building Societies Act 1986, or other Act or Acts, or statutory instruments or other statutory provisions from time to time in force relating to building societies, and any reference in these Rules to the provisions of any particular statute shall be construed as if the Rules were an enactment to which section 7(2) of the Interpretation Act 1978 applies."

The model memorandum does in fact include references to the prohibition on floating charges in *section 9B* (see paragraphs 4(a) and 7 (the definition of "dispose")), but this does not cause a problem as *section 9B* makes the creation of floating charges by a building society absolutely void (ie not subject to the safe harbour provisions), except when granted to the Bank of England in connection with relevant financial assistance (the Building Societies Financial Assistance Order 2008 (SI 2008 No 860)).

However, *section 9A* does not require a building society to include in the memorandum of association of each of its subsidiary undertakings, a restriction on the subsidiary undertaking doing anything that a building society is prohibited by *section 9A* from doing.

Furthermore, to restrict a subsidiary undertaking from doing anything that a society was restricted from doing would prevent it from granting a floating charge - *section 9B* does not apply to subsidiary undertakings.

In addition, to restrict the powers of a subsidiary undertaking (or of its directors) to anything within the powers of a society would not seem to be appropriate as the society is not restricted by its own memorandum of association (assuming that it has adopted the model form) from doing anything in *section 9A* - the society is merely under a statutory obligation not to do the various activities prohibited by *section 9A*.

BSA MODEL MEMORANDUM FOR BUILDING SOCIETIES

MEMORANDUM OF BUILDING SOCIETY

Words in italics are explained in paragraph 7 of this Memorandum.

1. The Society's name is "..... Building Society".
2. The principal office of the Society is
3. The Society's principal purpose is making loans which are secured on *residential property* and are funded substantially by its *members*. The other purposes of the Society are:
 - (a) to carry on the businesses of banking, investment, insurance and the *provision* of financial services and facilities;
 - (b) to carry on any businesses connected with the *provision* of housing or other accommodation or the *provision* of any services relating to housing or other accommodation;
 - (c) to carry on any businesses in the fields of information technology, data processing and communications;
 - (d) to carry on any businesses involving the *provision* of goods or other services (whether for consumers or others) or *dealing* in any *property*;
 - (e) to act as a *parent undertaking* and investment body and to assist and co-ordinate the activities of any undertakings in which it holds an interest;
 - (f) to promote and support community and charitable purposes;
 - (g) to carry on or participate in any business or other activity which, in the opinion of the Board of Directors or any duly authorised officer or employee of the Society, may conveniently be carried on in connection with any other activity of the Society or for developing, taking advantage of or protecting any of the *property* or income of the Society or any *connected undertaking* of the Society or managing any risks associated with the activities of the Society or any *connected undertaking* of the Society.
4. The powers of the Society are set out below. These may be exercised in connection with any of the Society's purposes.
 - (a) To do all things which, in the opinion of the Board of Directors or any duly authorised officer or employee of the Society, are necessary or may help the Society

to achieve any of its purposes (including, for example, raising capital and other funds in any manner, whether or not involving the issue of *securities* other than by the creation of a floating charge);

(b) to guarantee or enter into any indemnity or other arrangement relating to the discharge of any other *person's* obligations;

(c) to *provide* for pensions, insurance and benefits of any kind for individuals who are or at any time were officers or employees of the Society or a related undertaking and for any relatives or dependants of such individuals or for anyone having any relationship with such an individual. For this paragraph, any *connected undertaking* or former *connected undertaking* of the Society and any predecessor in business of any of them is a related undertaking. Also, insurance includes directors' and officers' liability insurance;

(d) to make donations and *provide* assistance of any kind to any *person* having any charitable, public or community purpose or object;

(e) to exercise any power of the Society for any consideration of any kind (including, for example, in the form of *securities* or obligations of another *person*) or for no consideration;

(f) to act as trustee, personal representative, custodian, director, receiver, manager, agent or intermediary of any kind and for any purpose.

5. Anything which the Society may do may be done by it in any part of the world (subject to the restriction as to principal office in the Building Societies Act 1986) and either alone or in partnership, association or joint venture with one or more other *persons* and either directly or indirectly. In carrying out any of its purposes or exercising any of its powers, the Society may act in any capacity and this includes acting as agent for another *person* and carrying out any functions for any other *person*. In addition, the Society has power to *dispose* of all or any part of its business or *property*. The Society also has power to take any lawful steps with a view to a merger with another entity, a transfer of all or part of its business to another entity or a winding up of the Society or distribution of all or any of its *property*.

6. The purposes and powers set out in paragraphs 3, 4 and 5 above are to be interpreted by using the following principles:

(a) each sub-paragraph and each activity referred to in any sub-paragraph is to be interpreted in the broadest possible sense and any examples given are not to be interpreted as restricting the meaning of the purpose or power which they relate to; and

(b) each sub-paragraph and each activity referred to in any sub-paragraph is to be interpreted separately and (without qualifying the fact that the Society's principal purpose is making loans which are secured on *residential property* and are funded substantially by its *members*) none of the sub-paragraphs or activities is to be interpreted in a way which would make it subordinate or incidental to another sub-

paragraph or activity, unless the wording expressly requires this; and
(c) any words in the singular include the plural and vice versa.

7. The words in italics have the meanings set out against them below:

acquire (or acquiring) to acquire in any way, including purchasing, leasing, licensing, exchanging, borrowing, receiving or otherwise obtaining rights in respect of the *property* in question. The acquiring can be direct or indirect and on any terms and conditions and can be of all the rights in the *property* in question or of only an interest or share in it;

connected undertaking has the meaning set out in section 119 of the Building Societies Act 1986;

deal (or dealing) to *acquire, dispose of, issue, grant, negotiate, discount, guarantee, transfer, subscribe for, borrow or lend;*

dispose (or disposing) to dispose in any way, including selling, leasing, licensing, exchanging, lending, charging (except by way of floating charge) or otherwise granting rights in respect of the *property* in question. The disposing can be direct or indirect and on any terms and conditions and can be of all the rights in the *property* in question or of only an interest or share in it;

member a *person* who is a member under the Society's Rules;

parent undertaking has the meaning set out in section 258 of the Companies Act 1985;

person any individual or body corporate;

property (save where used any real or personal property (including *securities*, in the expression intellectual property and money) of any kind and any

residential property) interest or rights in such property;

provide (or provision) provide or supply or make arrangements for another *person* to provide or supply. This can be by any means and on any terms and conditions and may or may not involve any *property* being *disposed of*;

residential property has the meaning set out in section 5 of the Building Societies Act 1986;

securities any shares (or other participation rights), stocks, debentures, deposit receipts, bills, bonds, notes, warrants, options, instruments (whether negotiable or not) or any other right or obligation. These can be fully, partly or nil paid.

Any reference in this paragraph to any legislation includes that legislation as amended or re-enacted from time-to-time.

3. Rules

(i) General

The 1986 Act specifies the general areas that the rules must cover including basic matters such as the name of the society and the address of its principal office, but also arrangements relating to the election of directors, the powers and duties of the board, the calling and holding of general meetings etc

The legislative provisions on building society rules, including the minimum content prescribed by the 1986 Act, are covered on pages 18-19 above.

(ii) The BSA Model Rules and Other Materials

Since 1961, the Association has produced *Model Rules for Building Societies* for use or adaptation by societies. The current, fifth, edition (published in November 1997) was produced primarily to comply with the changes made to the 1986 Act by the Building Societies Act 1997 www.bsa.org.uk/docs/policy/model_rules.pdf.

However, significant other changes were also made, both as a result of various suggestions made by societies over the years, and also in the light of the Unfair Terms in Consumer Contracts Regulations 1994 (now 1999 – SI No 2083).

The unfair terms Regulations meant that a number of "contractual" rules from the fourth edition were removed from the main body of the rules into the "*Additional Rules*" included at the back of the fifth edition. In 1998, the Association prepared suggested terms and conditions to replace the additional rules. Because these were included in societies' wider terms and conditions, the Association has left it to societies to update them as part of their reviews of the contractual terms.

The *Model Rules* constitute a complete set of rules containing not only those that are compulsory but also rules of operational convenience. Whether or not to adopt the *Model Rules* either as a whole or in part remains entirely a matter for each society. In accordance with usual practice at the time, the *Model Rules* were registered with the Office of Fair Trading (registration number 125000015). They were also approved by the Registry of Friendly Societies as registrable under the 1986 Act. Any future, revised versions would need to be approved as registrable by the FSA.

Work was carried out during the early 2000s to put the *Model Rules* into plain language. However, while this has been achieved by at least one individual society, it proved a very difficult task in respect of a wide body of technical rules, intended for use by many societies, including numerous optional provisions. The exercise was aborted and there are no current plans to re-write them in plain English. However, subject to other priorities, we plan to review them during late 2009-2010.

The BSA issued a Circular relating to rule change in the light of the Dormant Bank and Building Societies Act 2008, which received Royal Assent in November 2008 - www.bsa.org.uk/members/circular/6829.htm.

Because of the changes made to the 1986 Act by the 1997 Act, all societies needed to adopt new rules, and a new memorandum, in order to comply with the statutory requirements.

An Order made in 2003 enabled building societies to communicate electronically with their members on constitutional matters, such as summary financial statements, notice of meetings, voting etc. As noted above, nothing in the rules of a society prevent a society

from such electronic communication, so there is no general need to amend rules in the light of the Order (*see paragraph 3 of Schedule 2* and The Building Societies Act 1986 (Electronic Communications) Order 2003 (SI 2003 No 404).

In view of the changes made by the 1997 Act, the Association prepared a *Meetings Pack* for societies, which included a specimen notice of AGM and voting forms, together with guidance notes. The first pack was issued in 1998 and slightly revised in 2000 and 2001. See www.bsa.org.uk/members/circular/100503.htm.

4. Other Constitutional Documents

(i) Annual Report

The statutory requirements on the key components of a society's annual report (eg the annual business statement, directors' report, accounts etc) are dealt with on pages 85-89 above.

The Combined Code, whilst not binding on building societies, is of interest – see www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf. Among the provisions in the Code are the following (some of which might be utilised by building societies); that the annual report should include –

- a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the Board and which are to be delegated to management (A.1.1)
- the names of the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the nomination, audit and remuneration committees (A.1.2)
- the number of meetings of the board and those committees and individual attendance by directors (A.1.2)
- the names of the non-executive directors whom the Board determines to be independent, with reasons where necessary (A.3.1);
- the other significant commitments of the chairman and any changes to them during the year (A.4.3)
- information on how performance evaluation of the Board, its committees and its directors has been conducted (A.6.1)
- a separate section describing the work of the nomination committee, including the process it has used in relation to Board appointments and an explanation if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director (A.4.6)
- a description of the work of the remuneration committee, where an executive director serves as a non-executive director elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (B.1.4)
- an explanation from the directors of their responsibility for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.1)
- a statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary (C.1.2)
- a report that the Board has conducted a review of the effectiveness of the group's system of internal controls (C.2.1)

- a separate section describing the work of the audit committee in discharging its responsibilities (C.3.3)
- where there is no internal audit function, the reasons for the absence of such a function (C.3.5)
- where the Board does not accept the audit committee's recommendation on the appointment, reappointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and the reasons why the board has taken a different position (C.3.6), and
- an explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded (C.3.7).

(ii) Register of Members

Every building society must maintain a register of members showing the name and postal address of each member and whether each member is a shareholding or borrowing member or both Members. A member may make a written application to the FSA for the right to obtain names and addresses from the society's register.

For the legislative and regulatory provisions, see pages 22-23 above.

(iii) Register of Transactions

The 1986 Act requires a society to maintain a register of transactions involving directors and persons connected with them (see pages 78-80 above).

(iv) Register of Related Businesses

The 1986 Act also requires a society to maintain a register of particulars of related businesses of directors and other officers. For full details see pages 83-84 above.

BUILDING SOCIETY DIRECTORS AND OTHER OFFICERS

This sub-section covers building societies officers – chief executives, directors, secretaries, managers, and the Board. It also covers directors' appointment, induction and duties.

1. Officers of a Building Society

(i) General

An officer of a building society is defined as any director, chief executive, secretary or manager of the society (*section 119* 1986 Act).

An officer must be a fit and proper person to hold the office (see the FSA's approved persons regime, pages 138-139 above).

In relation to offences under the 1986 Act, the term 'officer' includes someone who "purports to be" an officer of the society (*section 119*). Therefore, it is possible for someone who is not technically an officer to put themselves in the position of one if their actions or statements hold him or her out to be an officer.

Under previous legislation, a society's auditors were also officers unless the society's rules provided to the contrary. It was an open question whether other senior people, such as solicitors or members of a local board, were officers by virtue of their position. However, the current definition is explicit about who is an officer.

A building society will, generally speaking, be liable for all authorised acts carried out by its officers in their relevant capacity. There are a number of old legal judgments holding that a society was liable for work ordered by an officer, even though it was not authorised by the board.

The positions of director, chief executive, secretary and manager are considered below, followed by a consideration of the collective responsibilities of the Board.

(ii) Managers

A manager of a building society is a person (other than the chief executive) employed by the society who, under the immediate authority of a director or the chief executive of the society exercises managerial functions or is responsible for maintaining accounts or other records of the society (*section 119* 1986 Act).

The key point about this definition is that it specifies who is a 'manager' and, therefore, an 'officer' of a society. This is important because officers, especially directors, have certain statutory duties and liabilities (see below).

(iii) Directors

There is no adequate statutory definition of a director. Obviously, a director is a person charged with the direction of a corporate body (such as a company or a building society), but whether or not a person is a director is determined mainly by what he or she does rather than by his or her title.

There is no definition of a director in the building societies legislation and the definition in companies legislation – 'any person occupying the position of director, by whatever name called' – is not very helpful.

Because a corporate body, such as a limited company or a building society, is an artificial legal 'person', and cannot of course act for itself, it needs human beings to be responsible for managing its affairs. A person can still be a director even if his or her title is something different (such as 'governor') – what matters is whether the person is carrying out a director's function.

However, a director is not a trustee (*Re Smith & Fawcett Ltd* [1942] 1 All ER 542), but is a paid 'confidential agent' with wide powers to manage the society's affairs.

A corporate body's constitution will usually give general management powers to the board, but these are often delegated to the chief executive/managing director.

The Building Societies Act 1986 defines an 'officer' as "any director, chief executive, secretary or manager of the society." Therefore, directors of building societies are also officers. The Act requires a society to have at least two directors (see page 60 above).

- **Executive and non-executive**

There are two basic types of director – executive and non-executive.

An executive director is a director responsible for the day-to-day direction and running of the organisation. Usually, executive directors will have a title set out in their contract of employment with the organisation, that reflects their executive function – such as 'chief executive', 'finance director', 'marketing director', 'operations director' etc.

The Building Societies Act 1986 defines an 'executive', in relation to a director, as a person who holds office as a director, and also chief executive, secretary or manager.

A non-executive director is an 'independent' director who receives a fee from the organisation. There has been a long-running debate about what 'independence' means in the context of non-executive directors. A common view (expressed in the Cadbury Report, for example) is that it means that, apart from their fees and any shareholding, they should be independent from the management and free of any business or other relationship that could interfere with their independent judgment.

BSOG 1.3.9G states –

"Given the mutual status of building societies, a clear majority of directors on a society's board should be non-executive. Non-executive directors should not be given the expectation that they will remain on the board until retirement. They should serve for a fixed term, both initially and for any subsequent term. The appropriate ratio of non-executives to executives will vary with the scale, nature and complexity of the society's business."

Legislation, including the Building Societies Act 1986, does not draw a distinction between executive and non-executive directors, but they are often treated differently eg by the courts and the Combined Code.

The Combined Code (A.1) states that non-executive directors should –

- constructively challenge and help develop proposals on strategy
- scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance
- satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible

- determine appropriate levels of remuneration of executive directors
- have a prime role in appointing, and where necessary removing, executive directors, and in succession planning.

There is also guidance on the liability of non-executive directors in the Combined Code (Schedule B). For more detail, see www.bsa.org.uk/publications/industrypublications/100667.htm.

The courts recognise that –

- non-executive directors’ functions are different
- they would not be expected to display a standard of care and skill beyond what is reasonable to expect given their knowledge and experience – this will normally be less than the executives, and
- they have less time to spend on the businesses’ affair than executive directors.

(*Re City Equitable* [1925] 1Ch 407).

Guidance in SYSC states –

“Where a non-executive director is an approved person, for example where the firm is a body corporate, his responsibility and therefore liability will be limited by the role that he undertakes. Provided that he has personally taken due care in his role, a non-executive director would not be held disciplinarily liable either for the failings of the firm or for those of individuals within the firm. The non-executive director function, for the purposes of the approved persons regime, is described in SUP 10” (SYSC 2.1.2G).

- **Shadow director**

A shadow director is someone who, although not appointed as a director, gives instructions to the directors that they are accustomed to acting upon. Professional advisors would not usually be regarded as shadow directors. Certain statutory provisions and liabilities apply to shadow, as well as actual, directors especially with regard to insolvency. The concept applies to building societies in relation to insolvency.

***Secretary of Trade for Trade and Industry v Deverell* [2001] Ch 340 133**

The Court held that the definition of a ‘shadow director’ included anyone, other than professional advisers, with real influence in the corporate affairs of the company.

In this case a tour operating company’s board had been accustomed to act in accordance with the directions and suggestions of two people, who were described as “consultants”. The court held that they were therefore shadow directors.

The Court said that their influence did not have to be across the whole range of the company’s activities, and the court had to consider all the evidence in order to decide whether a communication amounted to a direction.

Morrill LJ stated –

“Thus to describe the board as the cat’s paw, puppet or dancer to the tune of the shadow director implies a degree of control both of quality and extent over the corporate field in excess of what the statutory definition requires. What is needed is that the board is accustomed to act on the directions or instructions of the shadow director. As I have already indicated such directions and instructions do not have to extend over all or most of the corporate activities of the company; nor is it necessary to demonstrate a degree of compulsion in excess of that implicit in the fact that the board are accustomed to act in accordance with them.”

Information on the duties of directors is provided later in this Guide (from page 184 below).

(iv) Chairman

The chairman, as head of the board of directors, has the fundamental responsibility of running the Board (also see *Preparation and Conduct of General Meetings*, below).

The chairman's role is "pivotal in creating the conditions for overall Board and individual director effectiveness, both inside and outside the boardroom" (Combined Code on Corporate Governance - www.bsa.org.uk/members/policybrief/corpgovpolicybrief.htm).

The Building Societies Act 1986 requires one of the directors to be appointed chairman of the board. The FSA Handbook of Rules and Guidance requires a non-executive director (including a chairman) to be an approved person and BSOG 1.3.6G (see pages 146-147 above) states that the chairman should not have any executive post in the society, because this helps separate strategic direction - a chairman role - from the day to day running of the business - a chief executive function.

Section A.2 of the Combined Code lists a chairman's main responsibilities –

- leadership of the board running and setting its agenda
- ensuring that Board members receive accurate, timely and clear information
- ensuring its effectiveness on all aspects of its role
- ensuring effective communication with members; and
- facilitating the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

Section A.1.3 of the Combined Code states that the chairman should hold meetings with the non-executive directors without the executives present.

More specifically, it states that, led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate. The BSA commentary on the Combined Code discusses the degree to which the concept of a 'senior independent director' might be relevant to building societies www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf.

(v) Chief Executive

The chief executive has executive responsibility for running an organisation's business. The appointment of a chief executive is mandatory under the Building Societies Act 1986.

In a building society, the office of chief executive has certain features -

- as an officer of the society, the chief executive will be subject to the statutory provisions relating to building society officers generally.
- the chief executive must be employed by the society and appointed by its directors (section 59 Building Societies Act 1986 – see page 58 above).
- the FSA's guidance is that a chief executive should be a member of the Board (BSOG 1.3.7G – see pages 146-147above)

- in accordance with the normal rules of agency, he or she may also be an agent of the society and, so far as authorised to do so, may create contractual obligations between the society and third parties
- the chief executive is the person on whom the FSA must serve any prohibition order (section 36A(8) 1986 Act).

Section 59(5) of the 1986 Act requires the directors to take all reasonable steps to secure that the person appointed as chief executive has the requisite knowledge and experience to discharge the chief executive's functions.

The summary financial statement and the balance sheet must both be signed by the chief executive, as well as two directors (*sections 76(7) and 80(1)* 1986 Act).

The Building Societies Commission used to disapprove of joint chief executives because it interpreted the building societies' legislation as disallowing more than one chief executive at a society. The Commission also believed that having joint chief executives could obscure management responsibilities. It is not known that the Financial Services Authority (which took over the Commission's role) would take the same view, but it might because it has emphasised the importance of having clear management responsibilities.

A few building societies give different titles to their chief executive ('managing director' or 'general manager'), but 'chief executive' is much more common.

(vi) Secretary

The secretary is an organisation's chief administrative officer and is appointed by the Board.

Like the chief executive, a building society secretary is an officer of the society, and *section 59(3)* of the 1986 Act specifies that the chief executive and the secretary may be the same person. But the Building Societies Commission took the same view about joint secretaries as it did about joint chief executives (see above).

The directors must take all reasonable steps to secure that the person appointed as secretary has requisite knowledge and experience (*section 59(5)* 1986 Act).

The secretary may become an agent of the society, so as to bind it, with regard to certain aspects of its business (*Cross v Fisher* [1892] 1 QB 467).

Each individual society has broad discretion to decide for itself the extent to which the secretary's functions, powers and duties are set out in its rules or determined in some other way (see BSA Model Rule 22(3): pages 170-171 above). The scope of the duties are likely to vary considerably depending on the size of a society. However, the secretary (as such) is, in practice, usually responsible for –

- **the organisation's record keeping** (eg the secretary may certify a printed document as a true copy of the rules or memorandum – section 115(1) and (3)(a); the secretary must deal with records of alteration where a society has altered its powers or rules – *paragraph 4(2) of Schedule 2* to the 1986 Act etc),
- **receipt of certain statutory notices** (eg any notice, direction or document required by the 1986 Act may be served on the secretary (*section paragraph 4(2) of Schedule 2*); receipt, from the FSA, of copies of the rules and memorandum on an amalgamation of two societies etc)
- **filing of statutory returns** (see page 152 above),

- **administration of Board meetings,**
- **ensuring that Board procedures are followed and regularly reviewed** (BSOG 1.3.14G), and
- **providing guidance on the Board's responsibilities and how they should be discharged** (BSOG 1.3.14G).

(vi) The Board

- **Functions and powers**

The first principle in the Combined Code is –

“Every company should be headed by an effective board, which is collectively responsible for the success of the company” (A.1)

www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf.

The rules of a building society will set out the functions and powers of the Board, and delegation of those powers, as well as board procedures and related matters. Typically, a Board is authorised to conduct and manage the affairs of the society according to its discretion, but within the law and the society's memorandum.

The Combined Code goes on to state, at a high-level, that the Board should –

- set the company's strategic aims,
- ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance
- set the company's values and standards and
- ensure that its obligations to its shareholders and others are understood and met.

The **BSA's Model Rules for Building Societies**, which most societies use -

- put the business of the society under the direction of the Board
- authorise the Board to exercise all the society's powers that are not required to be exercised in general meeting
- provide that no rule (or rule change) will invalidate an earlier act of the Board
- give a range of specific powers to the Board, including the right to delegate their powers to one or more directors, committees or one or more officers or employees.

www.bsa.org.uk/docs/policy/model_rules.pdf

FSA guidance states that Board should have an appropriate range of skills and experience to control and direct the society's activities effectively. The FSA also states that the composition of the Board should be reviewed at regular intervals to ensure that its management and other resources are at least adequate for the society's current business and the business it proposes to undertake (BSOG 1.3.11).

The directors can deal with any affairs of the society at any Board meeting, whether or not previous notice of the particular business had been given (but the society's rules might

require notice to be given of a particular item of business, for example a resolution that a director shall vacate office). A clear majority of a society's Board should be non-executive (BSOG 1.3.9G).

A key principle in the Combined Code is that the Board should include a balance of executive and non-executive directors so that no individual or small group of individuals could dominate the Board's decision taking (A.3).

A supporting principle in the Code is that the Board should not be so large as to be unwieldy, but should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the Board's composition can be managed without undue disruption.

The Combined Code also states the Board should meet sufficiently regularly to discharge its duties effectively and that there should be a formal schedule of matters specifically reserved for its decision (A.1.1).

No director can lawfully be excluded from a Board meeting. A director who merely votes for confirmation of the minutes of a previous board meeting that he or she did not attend does not, by doing so, become responsible for what was done at the meeting.

If the directors of a building society exceed their powers when dealing with a third party who was acting in good faith, the society will still be bound by what was agreed (*paragraph 17 of Schedule 2* to the 1986 Act). However, a member of the society may bring a legal action to restrain such an *ultra vires* (exceeding of powers) act, and the directors may still be held to be in breach of duty in such circumstances.

- **Board committees**

Directors, including non-executive directors, will often sit on Board committees. Which committees a society has will depend largely on its size and the nature of its business.

The Combined Code emphasises the value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committee.

Commonly established Board committees, depending on the society's size and structure, include the –

- **Audit committee**, which deals with matters such as the adequacy of the society's systems of business control, such as –
 - its arrangements for evaluating risk – credit risk, market risk, operational risk, liquidity risk, business risk, concentration risk etc;
 - the effectiveness of the society's internal audit function;
 - the integrity of financial statements the society makes etc.

The audit committee is a committee of non-executive directors.

- **Remuneration committee**, which develops a general policy, and makes recommendations, on the pay of executive directors. It should consist only of non-executive directors. Remuneration is dealt with in paragraph B.2 of the Combined Code.
- **Asset and liability committee (ALCO)**, which is responsible for managing a society's management and control of interest rate and currency exposures.

- **Nomination committee**, which identifies and nominates candidates for the Board. The Combined Code (A.4.1) states that there should be a nomination committee which should lead the process for board appointments and make recommendations to the board.
- **Other Committees** often include - audit/compliance committee, mortgage committee, savings committee, information technology committee, premises committee etc.

Each committee will usually have terms of reference covering matters such as –

- objectives
- membership
- meetings process – ie notice, frequency, quorum, attendance, minutes etc
- authority
- responsibilities
- reporting procedures, etc.

The Combined Code (A.3) states that “no one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee”.

For more information, see www.bsa.org.uk/members/policybrief/corpgovpolicybrief.htm and the Walker Review www.hm-treasury.gov.uk/walker_review_information.htm.

2. Directors – Appointment, Induction, Duties

(i) Appointment

- **Nominations**

The 1986 Act requirements concerning nomination and election of directors are covered on pages 60-64 above.

The Combined Code states that there should be “a formal, rigorous and transparent procedure for the appointment of new directors” (see paragraph A.4, including supporting principles).

Before the election, the Board should take reasonable steps to establish whether there are any facts or matters concerning the candidate's fitness and propriety that the members should be aware of. If there are, the Board should bring them to the members' attention before the election takes place.

The FSA will not vet candidates for election. Unless a Board applicant is subject to a FSA prohibition order, the Board must not refuse to accept a candidate's nomination because the Board does not regard that person as fit and proper (BSOG 1.3.3G).

During the carpetbagger period of the late 1990s/early 2000s, the BSA provided information for societies that were in receipt of applications to become non-executive directors - www.bsa.org.uk/members/circular/100446.htm. The need for such guidance has reduced over time, but points societies might like to bear in mind are as follows.

Steps should be taken to help ensure that applicants appreciate the seriousness and responsibilities of the role. Therefore, one approach is to write to the applicant with –

- a copy of the society's memorandum and rules (and referring to the rules regarding eligibility and election of directors, and the relevant procedures, including nomination and related matters)
- a note about the duties and responsibilities of the post (see pages 68-84 above and pages 184-187 below)
- copies of other relevant documents, eg the society's latest report and accounts, the latest FSA annual report etc.
- information about the relevant FSA approval process
www.fsa.gov.uk/pubs/other/factsheet_approved.pdf
www.fsa.gov.uk/Pages/Doing/Regulated/Approved/persons/process/index.shtml

It is appropriate to inform an applicant that, if elected -

- they are not allowed to exercise a controlled function unless the FSA gives its approval (see pages 138-139 above)
- the FSA will not approve a director unless satisfied that the director meets, and will continue to meet, the 'fit and proper test' for approved persons
- they will also have to comply with the requirements of the Statement of Principle and Code of Practice for Approved Persons sourcebook in the FSA's Handbook (see pages 137-138 above).
- **Contracts**

The FSA's guidance (BSOG 1.3.12) is that, when a director is to be appointed under a formal service contract, the Board should consider carefully the terms of the contract it offers. When it does so, it should take into account eg –

- the need to attract and retain directors with appropriate experience, knowledge and skill;
- the need to preserve the Board's freedom of action; the potential cost of the contract proposed;
- the period of notice the society will have to give, and
- the potential liability it will incur, if it terminates the contract other than for misconduct.

The FSA states that the objective should be for notice or contract periods of one year or less. Paragraph B.1.6 of the Combined Code states that notice or contract periods should be set at one year or less but, if it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period. BSA Circular No 6108 considers this matter in the context of our sector - www.bsa.org.uk/members/circular/100231.htm.

The Building Societies (Accounts and Related Provisions) (Amendment) Regulations 2007 (SI No 859) require a building society to give particulars of its directors' and chief executive's service contracts in its annual Report and Accounts. If there are no service contracts, the building society should say so (see BSOG 1.3.13G).

The Employment Equality (Age) Regulations 2006 (SI 2006 No 1031) (the 2006 Regulations) have implications in respect of directors' contracts
www.bsa.org.uk/members/circular/6449.htm.

If a society's rules set a retirement age at, or above, 65 then there is no special action to take unless a director does not have a contract of employment. Whatever age is set, a director without a contract of employment could potentially claim age discrimination if required to retire from their position because of age. Obviously, this is most likely to relate to non-executive directors who, the Secretariat understands, are usually appointed by letter of engagement.

In such a case a society might decide, as a precaution, to enter into a compromise agreement with the director in advance, or to establish objective justification (among other things, long length of service might be relevant).

(ii) Induction

- **Background**

This note that follows provides information on the induction of newly appointed building society directors. It is especially applicable to the induction of non-executive directors, but certain elements could also be relevant to new executive directors and, possibly, other senior staff members. Some of the information was gleaned during consultation by the BSA Secretariat, with practitioners from various societies, during the preparation of earlier guidance in 2004, and we have recently reviewed the guidance.

This note, and the table that follows (pages 188-190), are purely for information and may be useful to societies when reviewing their current induction arrangements.

It is important for new directors to become familiar with the society as soon as practicable and, as long ago as 1992, the Cadbury Report recognised the significance of induction. One of the suggestions for good practice made by the Higgs Report in 2003 was that "every company should develop its own comprehensive, formal induction programme that is tailored to the needs of the company and individual non-executive directors".

Although the comments were made in the context of companies, they were likely (broadly speaking) to be relevant to other forms of business organisation. He went on to suggest that the induction programme should build –

- an understanding of the nature of the company, its constitution, its business and the markets in which it operates,
- a link with the company's people, and
- an understanding of the company's main relationships including meeting with the auditors and developing a knowledge of, in particular, who are the main customers, suppliers and major shareholders.

Higgs also recommended that the induction should be delivered by a combination of selected written material (including an induction pack), as well as presentations and activities such as meetings and site visits.

Higgs warned that "care should be taken not to overload the new director with too much information". This point was taken up by the Institute of Chartered Secretaries and Administrators (ICSA) – "it has become apparent that some newly appointed directors have been completely overwhelmed with the sheer volume of documents and other papers provided by the well meaning company secretary to such an extent that some have been completely put off by it"

ICSA recommended that, on appointment, a new director should be provided with certain key, essential information together with a comprehensive list of other information that will be made available later www.icsa.org.uk/assets/files/pdfs/guidance/030214.pdf.

- **The Walker Review**

Bringing thinking up-to-date, following the financial crisis that has developed since late 2007, *a review of corporate governance in UK banks and other financial industry entities* (the Walker Review) was published in July 2009; see the BSA policy brief - www.bsa.org.uk/members/policybrief/corpgovpolicybrief.htm. Some of the focus of the Walker Review is on the induction of directors.

The Walker Review reports that, despite much guidance over the years on the importance of director induction, “Practice and experience in respect of induction and training programmes appears to be quite variable” (paragraph 3.13), and it describes this situation as “palpably unsatisfactory”.

It recommends that it should be a “clear priority” for the Boards of UK banks and other financial industry entities (BOFIs) to ensure that fully adequate and substantive induction and continuing business awareness programmes are in place for non-executive directors.

Walker discusses the suggestion that non-executive directors should be expected to make regular use of advice from sources outside the organisation. Walker notes -

“such external involvement would be unlikely to provide more continuously dependable support than that provided by the company secretariat (or some other dedicated internal capability) and could risk generating needless friction with the executive.”

Walker suggests that the exception to this proposition is in the governance of financial risk and suggests that the normal expectation would be for a risk committee to seek an external perspective to ensure that the Board has up-to-date access to perspectives on product, market and other developments relevant for the enterprise that may not be captured by individual business units within the company.

The following table highlights the Walker Review’s recommendations concerning induction of non-executive directors.

Walker Review – Recommendations regarding director inductions

Recommendation 1

“To ensure that NEDs have the knowledge and understanding of the business to enable them to contribute effectively, a BOFI board should provide thematic business awareness sessions on a regular basis and *each NED should be provided with a substantive personalised approach to induction, training and development to be reviewed annually with the chairman.*”

Recommendation 4

“The FSA’s ongoing supervisory process should give closer attention to both the overall balance of the board in relation to the risk strategy of the business *and take into account not only the relevant experience and other qualities of individual directors but also their access to an induction and development programme to provide an appropriate level of knowledge and understanding as required to equip them to engage proactively in board deliberation, above all on risk strategy.*”

Even where the NED complement on the board is well balanced as between financial industry experience and deep experience from elsewhere, *the effectiveness of the overall NED contribution will be enhanced by a combination of appropriate induction and training programmes*, and dependable access for NEDs to support from within the company, for example from a dedicated capability in the company secretariat and greater time commitment.”

www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf

Beyond induction, the Combined Code states that the Board –

“should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.” (see paragraph A.5).

- **Building societies**

The suggestion in the Higgs Report that an induction should not merely comprise the provision of documentation, but should also include meetings with senior management, visits to sites other than headquarters, management strategy ‘awaydays’ etc, could also apply to building societies.

A building society, during the induction process, will in practice provide the new director with certain other information. Which package of items is provided, and when, is a matter for each society to decide, but the suggestions set out in the table overleaf might be considered, not necessarily as a package but, rather, as a menu of options.

Some are essential and/or obvious, but others might not apply to an individual society or a society might not consider it necessary to supply them at the outset or at all. Indeed, a phased timetable for different elements of induction could help avert information ‘overload’. Some of the points are drawn from the Walker Review and from recent input from building societies.

(iii) Duties

This section deals with –

- directors duties generally
- duties on directors of FSA-regulated firms
- building society directors' duties
- duties under the Companies Act 2006.

The last topic is not directly relevant to directors of building societies, but the requirements of companies' legislation are, where applicable, sometimes included – over time – in the building societies' legislation. Therefore, it is useful to be aware of the provisions. Also, the 2006 requirements are relevant to the directors of building society subsidiary companies.

There are significant overlaps in the duties provided from these different sources. Some of a director's responsibilities are personal to that individual director. Others are 'collective responsibilities' owed in common with the other directors on the board.

The distinction between executive and non-executive directors is covered above (page 174).

- **Directors duties generally**

Under the general law, applicable to all directors of corporate bodies, the duties are classified thus –

1. Fiduciary Duties – these are fundamental legal duties of trust to the society, requiring directors to act in good faith, to exercise their powers for the proper purpose given to the directors, to avoid conflicts of interest with the society, not make secret profits, and not to bind future board decisions. There are many useful illustrations from case law, mainly concerning companies.

JJ Harrison (Properties) Ltd v Harrison [2001] EWCA Civ 1467

A company owned land that it wanted to develop but could not get planning permission. A director learned from an architect that the objections might be withdrawn if certain changes were made to the application. Later, the Board agreed to sell the land to the director, but he did not disclose the new information. Although there was no allegation of dishonesty, the court held that the director had breached his fiduciary duties and had to account to the company for the profits he made on his subsequent sale of the land.

CMS Dolphin v Simonet [2002] BCC 600

A director resigned from a company. He was subject to no contractual restrictions on his subsequent activities. He took staff with him, solicited some of the company's customers and appropriated a maturing business opportunity of the company. The court held that, (in the absence of contractual restrictions) he was entitled to compete with his former company after his resignation. However, in this case, he had exploited after his resignation a business opportunity that belonged to the company when he was a director – therefore, he was in breach of fiduciary duty and had to account for the profits he made.

Fassihi -v- Item Software (UK) Ltd [2005] 2 BCLC 91

A director had set up a separate business in competition to his company and attempted to secure a lucrative contract from an existing customer of the company. The court held that the director owed a duty to confess his own misconduct to the company. The court decided that he had acted in breach of his fiduciary duty to act in good faith by failing to disclose. He was ordered to account to the company for the profit that he had made.

2. Care and Skill – this is a duty to exercise such care and skill as is reasonable to expect given the director's knowledge and experience.

***Re Continental Assurance Company of London plc* [2001] BPIR 733**

In the insolvency of an assurance company, the liquidators argued that the directors were liable for wrongful trading (ie carrying on the business knowing that the company had no reasonable prospect of avoiding insolvent winding up) and should pay damages for resultant losses. The court held in favour of the directors and decided that the non-executive directors had asked relevant questions at various meetings, but had reasonably relied on others (the finance director and the auditors) who had greater financial expertise. More generally, the court decided that directors of companies are not expected to be experts in accounting.

***Re Bradcrown Ltd* [2001] 1 BCLC 547**

By contrast, in this Judgment the court held that a finance director (a long-service employee who had been promoted to the board) was liable to a company for approving transactions that he knew were removing most of the assets of the company for no substantial consideration. He argued that he relied on expert advice, but the court decided that “he asked no questions and sought no advice. He simply did what he was told, and abdicated all responsibility. In these circumstances he cannot seek refuge in the fact that professional advisers were involved in the transactions.”

***Re Stephenson Cობbold Ltd* [2001] 2 BCLC 614**

Disqualification proceedings were taken against a non-executive director who was a company cheque signatory. Although irregularities had occurred in relation to some of the cheques he signed, the court accepted that he had queried the payments and received financial information and assurances from the company’s auditors and book-keepers. The court held that the fact that he was a cheque signatory did not mean that he was expected to display the skills of a finance director and he was not disqualified.

Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company’s business to enable them properly to discharge their duties (Morritt LJ in *Re Barings plc No 5* [2000] 1 BCLC 523).

- **Duties on directors of FSA-regulated firms**

Directors’ duties deriving from the FSMA are as follows –

1. To meet the expected conduct of an Approved Person – The FSA has issued *Statements of Principle* for approved persons (APER). The Statements cover integrity, care and skill, standards of market conduct, co-operation with regulators etc. APER also contains a *Code of Practice* to help determine whether an approved person has complied with the Principles. Directors are approved persons and subject to the Principles. For more detail, see pages 137-138 above.

2. Compliance with the FSA’s prudential requirements – the Board is responsible for ensuring that the society complies with the FSA’s prudential requirements; among other things, with High Level standards in the FSA Handbook of Rules and Guidance – the Principles for Business (PRIN) and Senior Management Arrangements, Systems and Controls (SYSC). For more details about the FSA Handbook, see *FSA Handbook of Rules and Guidance* above.

- **Building society directors**

The detailed legislative provisions, under the Building Societies Act 1986, are covered above (see pages 68-84 above). Directors’ duties under the 1986 Act may be classified as –

1. Individual Duties under the 1986 Act – these require compliance with the ‘anti-conflicts of interest’ sections of the Act, which prohibit or restrict certain transactions and prescribe disclosure requirements (see pages 68-84 above).

2. Collective Responsibilities under the 1986 Act – these oblige the Board, as a whole, to direct the business of the society and to comply with a range of requirements in the 1986 Act, including compliance with –

- the society's 'principal purpose'
- the funding and lending limits
- the restrictions on powers
- the requirements concerning proper accounting records, and
- the provisions concerning the documentation that must be prepared and laid at AGMs or dispatched to members.

- **Duties under the Companies Act 2006.**

For the first time, there is a statutory statement of company directors' duties (set out in Chapter 2 of Part 10 of the 2006 Act). Most already exist at common law (including duties to exercise reasonable care, skill and diligence; to act within their powers; to declare certain interests; and to avoid conflicts of interest), although some have been revised. There is a new duty to promote the success of the company, replacing the previous duty to act in its best interests. The statutory duties are as follows –

section: 2006 Act	duty
171	to act within powers (ie the company's constitution)
172	to promote the success of the company
173	to exercise independent judgment
174	to exercise reasonable care, skill and diligence
175	to avoid conflicts of interest
176	not to accept benefits from third parties
177	to declare interest in proposed transaction or arrangement

Most of the sections codify, or re-state in a different way, existing common law duties. The new statement of duties has attracted considerable criticism, with some commentators suggesting that they are inflexible and impracticable. There are specific concerns that the new duty to promote the company's success (which replaces the common law duty to act in good faith in the company's interests) will lead to uncertainty and require judicial intervention.

Generally, there is a concern that the statement, by failing fully to codify directors' duties, might be an unhelpful half-way house. However, an alternative view is that the existence of a statutory statement will increase certainty.

A very helpful guide (intended primarily for company directors but of interest to directors of other entities, such as building societies) is *the ICSA Directors' Handbook* (2009) ICSA Publishing: ISBN 978-1-86072-402-2.

Induction programme for building society non-executive directors: menu of possible elements		
Aspect of induction	Possible element	Explanation/Elaboration
	with appropriately staged introduction to the different elements	
The induction process	A dedicated resource under the “group secretary” – which can also coordinate arrangements for induction and training ¹	Where the secretary/secretariat is the focal point for such support, adequate resourcing in terms of available time commitment and capability will be required
	Such programmes should be explicitly included in the governance evaluation statement ¹	In order to emphasise the importance of the process and make its status prominent
	Mentoring of a new NED board member over the initial period by a senior member of the executive and should provide personalised induction ¹	To help ensure focus and control of the process
	Provide a checklist of matters to be covered during induction (it might include an induction-fulfilment questionnaire, possibly on a self-appraisal basis)	To assist in focus, feedback and evaluation
The business	Meetings with individual executives and other senior management, including finance, risk etc	To ensure appropriately speedy learning about the business
	Visits to individual departments	Assists in above
	Visits to branches, call centres etc	Assists in above and gives a broader business perspective
	Information about the society – <ul style="list-style-type: none"> • its organisation and its business • a brief history • an organisation chart • background (and contact details where appropriate) of other directors, the society secretary, senior staff, advisers etc. • branches and subsidiaries • the society's business objectives/corporate plan, key performance indicators etc • key customers, markets, suppliers, contracts etc • other major local contacts eg local charities • relevant policy documents (including risk management strategy, anti- fraud and money laundering procedures, health and safety arrangements, information security, environmental, corporate social responsibility etc) • products and services 	A range of information to help the new director become acquainted with the society's business and risks

	<ul style="list-style-type: none"> • financial data • recent media coverage. • any recent, or impending, significant litigation 	
	Restrictions concerning conflicts of interest – eg in 1986 Act (sections 62-69) and individual society requirements.	Although this could be covered under 'legal duties of directors' below, it is a matter of considerable significance, and worth highlighting
The society's constitution	Meeting with society secretary	To help the new director understand the society's constitutional and governance arrangements
	<p>Information concerning the operation of the Board and the society's constitutional arrangements² –</p> <ul style="list-style-type: none"> • a copy of the Society's rules and memorandum • copies of recent annual reports and accounts • basic Board information, such as copies of any Board standing orders/procedure manual, information about succession planning etc • a description of the arrangements for Board meetings (such as timing, duration, timing for dispatch of agenda papers and minutes, etc). • a list of dates of future Board meetings and other relevant meetings (such as Board committees). • agendas of recent Board meetings and minutes of recent Board meetings and general meetings. • details of Board committees (terms of reference, responsibilities, members etc). • delegated responsibilities – ie which responsibilities the has the Board delegated to others • other Board arrangements (such as directors' indemnity insurance; matters dealt with exclusively by the Board and those delegated; regular reports to the Board and committees; any policies concerning the use of/access to professional advice; authorisations; directors' undertakings etc) • the BSA commentary on the Combined Code³ • information on domestic matters, such as head office lay-out, emergency arrangements (fire, first aid etc), expenses, lunch, car parking, internal contact lists, support services (if any) etc 	Fundamental information to supplement the above point

<p>Generic</p>	<p>Information about wider matters, such as –</p> <ul style="list-style-type: none"> • FSA approval • market information • regulation by the FSA, OFT etc • legal duties of directors • access to external advice (if any) • the significance of FOS • current industry issues. <p>The BSA, FSA and FOS websites are all useful sources of relevant information –</p> <ul style="list-style-type: none"> • www.bsa.org.uk/members/index.htm • www.fsa.gov.uk/ • www.financial-ombudsman.org.uk/ <p>The BSA organises seminars for newly appointed directors of building societies and other events of likely interest - www.bsa.org.uk/events/index.htm</p>	<p>Wider information important to a director's induction and development</p>
<p>FOOTNOTES</p> <p>1 - Walker Review</p> <p>2 - Certain items personal to the new director, such as terms and conditions of employment and details of the qualifying shareholding and any individual objectives, will usually have been provided earlier so would not ordinarily be part of the induction process itself.</p> <p>3 - www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf</p>		

PREPARATION AND CONDUCT OF GENERAL MEETINGS

This sub-section covers the planning, preparing and conducting building society general meetings.

1. Introduction


(i) This Guidance

This guidance was originally prompted by, and was in response to, increasing queries to the Building Societies Association (BSA), particularly from smaller societies, regarding the arrangement of, preparation for and the conduct of general meetings, especially the Annual General Meeting (AGM). The BSA commissioned Robert Mann, formerly Group Secretary and Director at Portman Building Society, to prepare the guidance, which was first issued to chief executives on 5 February 2001.

The guidance was reviewed and updated by the BSA Secretariat, in conjunction with the BSA Secretaries' Panel was included on the BSA Members' Website in May 2009 - www.bsa.org.uk/docs/policy/practice_briefs/building_society_general_meetings.pdf.

It is designed to focus on matters affecting -

- planning the meeting
- conducting the meeting
- addressing member initiatives.

 in the text signifies an action point, and these are cross-referred to the 'Secretaries' AGM checklist' at the end of this section.

Experienced secretaries will find much of the material obvious, but the guidance seeks to be of use to all society secretaries, including those new to the role. Equally, some of the guidance might be irrelevant depending, say, on the size of the meeting, so readers will no doubt choose the material relevant to the scale and nature of their own meeting. Some aspects of the guidance, especially towards the end, cover unlikely contingencies – but it is always better to be prepared. However, we hope that all secretaries will find something of use to them in the guidance.

Most of the general law regarding meetings concerns companies and public meetings, but most of the principles comfortably translate to building societies - with some specific variations, largely affecting the rights of members to put forward resolutions.

It should be noted that companies' legislation does not apply directly to building societies, but provisions stemming from companies' legislation are sometimes incorporated into building societies legislation at a later date. Certain provisions of the Companies Act 2006 relate to general meetings - www.bsa.org.uk/members/circular/6512.htm. Currently, we know of no plans to transpose those particular provisions into building society law (but see www.bsa.org.uk/members/circular/6671.htm).

A small number of *Combined Code* provisions are relevant to meetings - www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf.

The BSA has provided guidance on all aspects of the Building Societies Act 1986 (the 1986 Act) - www.bsa.org.uk/members/policy/buildsoclegislation/bs_act.htm, including the statutory

provisions about general meetings -

www.bsa.org.uk/members/practice_briefs/constitution_meeting/const_and_meet_1.htm.

The relevant information is reproduced in an earlier section of this Guide (pages 24-36).

All references to Rules relate to the BSA's 5th Edition of *Model Rules for Building Societies* -

www.bsa.org.uk/docs/policy/model_rules.pdf.

Further sources of information include -

- *Shackleton on the Law and Practice of Meetings* by Cordes, Pugh-Smith, Keene, Burton and Caulfield (11th Edition 2008 published by Sweet & Maxwell – ISBN 0421539100.) Chapters 3-7 in particular contain some useful and practical advice.
- *ICSA Guide to Best Practice for Annual General Meetings* (published in 1996 the Institute of Chartered Secretaries and Administrators 16 Park Crescent, London W1N 4AH). Although an old publication and focused on plcs, the Guide includes valuable practical advice. A free copy may be downloaded at www.icsa.org.uk/assets/files/pdfs/guidance/960913.pdf. Appendix A contains a useful summary guide to best practice. We understand that the ICSA is currently considering whether to produce a new edition.

(ii) AGM Trends

The significance of the Annual General Meeting is increasing. Recent impacts over the last dozen or so years have included -

- **statutory accountability under 1997 Act requiring -**
 - uncontested directors to be elected and re-elected by a *vote*
 - *mandatory* precirculation of a proxy voting form (or postal ballot paper)
- **more member initiatives and pressures including -**
 - members proposing resolutions
 - members directly standing for election as director
- **more media interest in AGM issues generally**
- **more awareness by members and greater voting turnouts** - assisted by more canvassing of the "silent majority". The latest turnout and voting statistics for the sector (source: BSA) are set out in the table that follows.

This increasing member awareness in turn led to greater interest by societies and members in more simplification of the full documentation, evolving user-friendly documents, including, for example, colour, pictures and cameo portraits of directors standing for election and re-election etc.

The BSA collates AGM statistics. By late August 2009, 46 out of the 53 building societies have submitted returns to the BSA about their 2009 AGMs. The table below gives the average result in each category, and also the highest and lowest figures. Comparative figures for the same societies last year are shown. Voting figures are presented as the percentage in favour, excluding abstentions.

Average turnout has decreased by 1.3% points compared to last year, and the voting results are lower than in 2008 in nearly all categories. The election of directors fell 1.2% points

compared to last year, and the reappointment of auditors fell 0.5% points. The approval of directors' remuneration fell 2.5% points compared to 2008.

Turnout and voting at building society AGMs		2009	2008	Change vs last year
AGM Turnout	Average	18.4%	19.7%	-1.3%
	Highest	31.1%	24.3%	6.8%
	Lowest	10.0%	10.1%	-0.2%
Approve annual	Average	98.8%	98.9%	0.0%
	Lowest	96.5%	0.0%	96.5%
Reappoint auditors	Average	97.6%	98.1%	-0.5%
	Lowest	89.4%	0.0%	89.4%
Approve directors' remuneration	Average	92.6%	95.2%	-2.5%
	Highest	99.4%	98.6%	0.7%
	Lowest	79.8%	0.0%	79.8%
Election of directors	Average	96.1%	97.3%	-1.2%
	Highest	99.8%	99.3%	0.5%
	Lowest	89.4%	0.0%	89.4%

* 100% results are from show of hands at AGM

Responses from 46 societies.

Percentages are weighted averages. Votes are percent in favour excluding abstentions.

For more information, see www.bsa.org.uk/members/circular/6957.htm.

2. Risks

The *Turnbull Report* in 1999 (with its emphasis on the identification, evaluation and management of significant risks by companies) and the development of the Financial Services Authority (FSA) regulatory regime required societies to assess the risks attached to the various aspects of their operations. Accordingly, it is desirable to identify the risks in this context. There are three main areas of risk -

- **Voting Risk.** This arises -
 - if not all eligible members are properly mailed
 - if there is a close vote so that accuracy of voting eligibility becomes critical
 - when there is, at least, the theoretical risk that a close result could be challenged by an aggrieved member. The accuracy of the voting database and the scrutineering are much more critical in a close result, as was demonstrated in the 2000 United States Presidential Election.
- **Regulatory and Prudential Risk**
 - there are some explicit statutory deadlines and requirements and it would not inspire confidence in the eyes of the regulator for these to overrun – see www.bsa.org.uk/members/practice_briefs/constitution_meeting/const_and_meet_1.htm
 - the Board's fiduciary responsibilities arise because directors have responsibilities to members, examples being contained in the *ICSA Best Practice Guide*.

- **Financial and Operational Risk**
 - clear inconvenience to society and its staff and to members
 - adjournment and/or re-mailing is time consuming and costly
 - adverse public relations implications of errors of content and procedure publicised in media.

The process is not now as straightforward as it used to be and, with single-interest group activity having increased in recent years (eg carpetbagger activists in the late 1990s, complaints managers in the 2000s etc), the message must be that it is vital to get it right first time.

3. Advance Planning




(i) Basic

Because of the increased complexity of computer systems and the mandatory requirement to pre-circulate proxy forms as well as more general member awareness, it is both desirable and prudent to allow as much time as possible for preparation by making full use of the 12 months between AGMs, and to start the planning for the next meeting as soon as the previous meeting is finished.

A full debrief soon after the AGM is over can also be very valuable, as there may be one or two lessons to be learnt that are fresh in the mind at that stage - and there will always be scope to do some things better.

(ii) Early Reservations

Dependent on the actual arrangements being made for the AGM, some early reservations are also desirable -

- **AGM Venue** . If using an external venue in a large town or city, there may be restricted availability due to annual contracts or because its managers are reluctant to release a room or suite for part of a day and forfeit a one or two day booking.
- **External Printers and Mailing House AGM Venue** . The bigger companies plan their work well in advance. To secure a slot that is critical for it, a society should ensure that its chosen printers and mailing house are booked early and build this in at an early stage in its and their timetables.
- **Scrutineers** . Similarly, if a society wishes to use independent scrutineers (and there has been a marked increase in the use of Electoral Reform Ballot Services by building societies) they may also have some restricted availability.

Even if a society is later forced to alter its intended arrangements, it will find that its chosen suppliers will appreciate the early reservation and the early intent, and will therefore be much more ready to accommodate any unforeseen changes that may be needed later.

(iii) Choice of Venue and Time of Meeting

This is very much a matter of individual choice and established practice. All members who wish to attend should be able to attend, and all members who do attend should be able to see and hear the Chairman and the other speakers (for more information on venue, see paragraphs 69-74 below).










Some societies hold AGMs in an appropriate function room at their Principal Office, while others use conference centres or hotel function rooms. One point to watch is that to change the established venue and timing may attract adverse comment from regular attendees (perhaps without any appreciation from those who can then attend).







Timings also vary with some societies holding morning meetings, some holding evening meetings and some holding midday meetings. Inevitably, the location and timing of the meeting may well affect the ability of members to attend. Holding evening meetings could help to maximise the scope for attendance on a crucial issue. There could be advantages to members in societies local to one another staggering their AGM dates so as not to clash.

The advantages of holding an AGM in a society's "heartland" or in the region of its Principal Office are -

- the convenience to a greater majority of local, and presumably loyal, members – but, with the increase in non-branch delivery channels, this might be a factor of decreasing significance in a number of societies
- the greater availability of head office staff to attend (and vote - assuming that most are members).

Other practical points to consider include –

- **car parking** arrangements, including disabled parking as necessary 
- clear **signage** – to the meeting room, to WCs etc 
- a **speakers' platform** of sufficient height or good visibility from the floor and sufficient seating for the speakers (although there has been press criticism of some platforms being too 'isolated' from the members); space for their papers, refreshments, name cards etc ; an adequate lectern etc. An obvious point also to consider carefully is the seating of directors so that those who might need to confer are adjacent 
- enough **seats** for the expected number of members, and some spare; also, consider the use of -
 - reserved seats for guests, auditors (and for the media if they are present) or whether seating is entirely a matter for member and guest choice
 - designated seats such as where there are a number of former (ejected) members (who hold proxies) present and they are there in the capacity of proxies rather than members 
- good two-way **audibility** – working, effective microphones if necessary (pre-tested well in advance, allowing time for any necessary adjustment) 
- **lighting** adequate for members to be able to read the AGM papers - do also be aware, if there are spotlights, that any dazzle can make it quite difficult for the Chairman to see the audience 
- sufficient **heating or ventilation** to ensure a comfortable meeting 
- all other **electronic equipment** (eg projectors, PA system etc) should also be checked well in advance 
- if necessary, nearby **separate rooms** for the Chairman, other Board members, external auditors, other speakers (if any) etc to have some privacy before the meeting, and for media representatives if any 

- catering for **members with disabilities** (see below) or likely to be accompanied by children (a crèche facility is provided at some very large AGMs) 
- **safety equipment** (eg fire, first aid), public liability insurance etc should be in place – such precautions are usually the responsibility of the owners of the venue, but the secretary will usually seek confirmation that they have been arranged 
- **record keeping** could be assisted by having a shorthand note-taker or by taping the meeting 
- **feedback forms** – some firms seek comments from attendees on the meeting arrangements, to check whether any improvements might be made the next year 
- it is important to ensure that there are appropriate **staff** on hand to deal with unforeseen events – this does not only mean stewards (see below) but also people who could deal with any of the many things that might interrupt the meeting, eg late arrivals or technical problems with microphones, lighting, powerpoint presentations or DVDs, videos etc. It would not be appropriate for the secretary to have to leave his or her AGM duties, which in itself could disturb the smooth running of the meeting, in order to try to deal with such matters 
- the secretary, or another trusted staff member, should attend the meeting room well before the meeting to **check that everything is in place and working properly** 

(iv) **Members with Disabilities**

To ensure the convenience of disabled members, societies should take reasonable steps to make meetings accessible to those with disabilities –

- it is worth asking members when sending out information whether, if they plan to attend the meeting, they have any particular disability or handicap that the society needs to cater for
- as a matter of best practice an external venue should be wheelchair accessible, as indeed most venues hiring themselves out will be
- consider the possibility of offering a sign language presenter for those who are hard of hearing, as this allows for –
 - seats on the front rows to be reserved for those needing a "signer" or
 - for the society to save money if no "signer" is needed
- consider offering documents in large print, on audio tape or in electronic format for people with voice software, or in braille etc
- some members might be accompanied by guide dogs and this would need to be provided for
- do not overlook elderly members who have poor hearing (and eyesight) and cannot follow sign language, compared with an induction loop serving microphones built into digital hearing aids.

However, do bear in mind that the society only needs to provide *reasonable* facilities, and the excessive cost necessary to cater for the needs of one member might not be in the interests of the majority of members.

(v) Attendance

Although voting turnout in building society AGMs has increased in recent years, physical attendance varies and in many cases is quite modest. It is prudent to allow for increases and, just in case of any last minute unforeseen surge in attendance, to find out what alternative contingency venues are available - a week or so before the meeting. It is also prudent to make contingency plans, if an adjournment of any part of the AGM is likely.

(vi) Alternative Dates

The timing of the AGM can be important. If controversial issues of general importance to societies are to be discussed, a decision needs to be taken whether to hold the AGM before/at the same time as/after the majority of societies. Thus, media pressure may have waned before a late AGM is held.

During those years (pre-1997) when societies had to adopt new powers at most AGMs, the established pattern was for societies to hold their AGMs right at the end of the statutory four month period - ie at the very end of April for December year-end societies. Now that is no longer the case, more societies are holding their AGMs earlier. However, it may well be prudent, when making an earlier AGM venue reservation, to stipulate some (later) alternative dates in case of unforeseen eventualities.

Certainly, depending on the speed with which the Annual Report and Accounts and consequently the Summary Financial Statement (SFS) are prepared and on whether there are any member activated resolutions, it is perfectly feasible to hold the AGM within three months - ie by the end of March in the case of December year-end societies.

(vii) Member Awareness

It is important now to view the AGM, and particularly the AGM mailing, as part of the society's relationship with its members. The AGM documentation is moving away from its former tedious aspects, eg annual adoption of powers, to a more user-friendly annual vote to elect directors (who represent a more human interest than adopting powers) and presents a valuable opportunity to develop member awareness.

Consider making the AGM and the AGM mailing part of a marketing and member awareness strategy. Make sure that they interrelate with other member communications by adopting a consistent message and phased timing.


(viii) Meeting Organisers

Societies' needs will vary according to the size of society, but the largest societies would now consider using professional firms to help stage the meeting, organise the sound system and microphones, record the proceedings and generally ensure a well-managed professional event. Requirements will vary with the expected attendance.

(ix) Preparation Timetables

It is important to plan at an early stage a detailed timetable that will allow for regular management meetings - supplemented by specific detailed timetables dealing with the drafting, the approval, the printing and the dispatch of the vital AGM documentation. Take careful note of printing deadlines and ensure that key amendments are agreed at an early stage - particularly if additional cost is to be averted.

Give careful thought also to ensuring that all relevant skills and disciplines - internal or external - are included, especially where external suppliers such as scrutineers and printers are involved.

Again, the scope of these meetings will depend on the size of society, but planning the AGM is no longer just a part time job for the society secretary - it is necessary to involve those responsible for IT systems, member records, dealing with member queries, branches, internal audit etc. The larger societies are likely to have regular project team meetings before the AGM. 

Be prepared for last minute amendments at the sign-off stage - which can clash with the printing timetable. Always get initial input early on.



(x) Rule Changes

Do not forget to obtain early approval in principle from the FSA in the event of any Rule changes - www.fsa.gov.uk/pubs/forms/MS_ alteration_rules.doc.

4. Notice of AGM and Proxy Form

(i) Basic

Arising from the increasing importance attached to the AGM, consequently increasing attention is being paid, particularly by larger societies, to the structure, formatting and presentation of the AGM documentation.

The initial decision is whether to consider separate documents or to create an integrated AGM/SFS booklet . More societies are now treating the statutory documentation as a marketing and communications opportunity and devoting considerable effort and attention to preparing an integrated presentation of the pack with the use of colour, pictures and highlights .

The required voting for the election and re-election of directors also now provides an opportunity for the inclusion of pictures and cameos of incorporating a human element into the documentation. A map showing the location of branches can also create member interest. In some cases this is a far cry from the black and white small print documents of the past.

But do remember that a copy of the SFS has to be supplied to each **new member** or *depositor* upon opening an account and that, if the integrated booklet arrangement is used, a society may simultaneously need to prepare some separate SFS leaflets. For members entitled to receive the SFS, and under which circumstances, see section 76 of the 1986 Act.

(ii) The AGM Pack

The pack, typically, comprises -

- the dispatch envelope
- the Notice of AGM and its accompanying notes,
- details of any resolutions and statements
- cameos of the directors seeking election
- Summary Financial Statement
- proxy voting form
- pre-paid return envelope
- possibly, other items, eg a Society newsletter, branch map, interest rate information etc .

The BSA has published Models with Guidance Notes of -

- *Notice of AGM*
- *Proxy Voting Form, and*
- *Meeting Voting Form.*

www.bsa.org.uk/members/circular/100503.htm

www.bsa.org.uk/members/circular/100446.htm.

We plan to review these documents in 2010.

(iii) Charitable Donations

It is quite common nowadays for a society to seek to encourage member participation by pledging to donate a certain sum of money to a specified charity or charities, or to the Society's charitable foundation, for each vote received. In order to encourage online voting, some societies pledge a larger donation for each vote received online – such votes do, of course, save on postage costs.

(iv) Dispatch and Return Envelopes

Do not overlook the opportunity to use the dispatch envelope - and not just for the undelivered return address. But, beware Data Protection Act requirements - if the envelope identifies the addressee as a member of the society - with words such as "vote now".

The provision of a pre-paid return envelope is strongly recommended and most societies now include one in their meetings pack. The better the voting turnout, the stronger the justification for any statements by the Board indicating member support for its policies.

(v) Annual Report and Accounts and Summary Financial Statement

Traditionally, some societies have produced sometimes quite glossy Annual Report and Accounts, whilst the SFS has been fairly standard and clinical. But in recent years, this has changed – with many SFSs displaying much higher production values than in the past.

Bear in mind that the SFS is mailed to the eligible membership, very few of whom ever receive or are aware of the full Annual Report and Accounts. More attention should be directed to enhancing the SFS - never losing sight of the fact that it is of course a *summary* of the Annual Report and Accounts, rather than just a stand alone document in its own right.

Do not neglect the scope to promote the Society (and the directors) for example through the use of photographs, which should be of similar quality both for independent candidates and for existing members of the Board. (Some societies include material – usually less extensive – about existing directors who are not standing at the current AGM).

(vi) Postal Ballot

You should note optional Model Rule 39 (and its optional provisions) permitting voting on certain resolutions and elections to be conducted by a postal ballot. This may be a particularly useful option in the case of a *contested* election of Directors - all the more so if there is any risk that a candidate might withdraw at a late stage, turning a *contested* election into an *uncontested* election with its different procedures.

The essence of **voting by proxy** at the AGM is that it takes place at the meeting and that proxies (individuals) are appointed by the member to cast the member's vote at that moment

(and not before). Thus, if the vote is invalidated due to the withdrawal of a candidate, the meeting (and the vote) has to be adjourned and reconvened with its attendant cost and inconvenience.


In the case of a **postal ballot**, the individual's vote occurs at the moment of dispatch/receipt and the result can be announced before or at the AGM, and the closing date for the ballot can be some time before the AGM. Whilst, in the event of a candidate's withdrawal, the postal ballot will have to be repeated, there may not be any need to reconvene the AGM. (See optional Rule 39(10), but note 1986 Act Section 61(12)).

(vii) Proxy Voting Form


This is another good example of a form that has evolved and where colour, presentation and highlighting can be and are used to facilitate voting and minimise queries. The proxy voting form now invariably contains the member's name and address and can double up as the address slip and, for ease of scrutineering, bar coding can be added. Where there are separate independent scrutineers, it is essential that there is complete and appropriate integration with their IT systems.

Note the requirement in Rule 37(2) for Board approval of the proxy voting form.

(viii) Display of Notice of AGM

Further, do not overlook the facility in Rule 48(3) to display a notice of the holding of the meeting (which could be a copy of the Notice of AGM itself) both at the Principal Office and also in all branch offices. Such a notice can also be used to inform eligible Members by what date they should have received it - and who to contact if they have not received it by such date .

Not only does this provide protection under the Rules if for any reason a Member's Notice of AGM goes astray, but it is also a very useful defence to an aggrieved member, namely that details of the Notice were openly displayed.

Note the additional requirements of Rule 48(3)(b)(i) and (ii), eg state where copies of the Notice containing the resolutions and other documents, e.g. Proxy Voting Form, can be obtained .

(ix) Mailing Dispatch Sequence

Finally, do give careful thought to the dispatch sequence and whether -

- the whole mailing should go by first class post
- the whole mailing by second class post or
- whether there should be a combination of first and second class with the earliest batch of envelopes going second class (with more time) followed by -
- the final mailing sent by first class post to ensure due delivery.

Mailsort and similar bulk posting arrangements may offer price discounts and should be considered. Note "deemed delivery" *regardless of class of post* in Rule 48(2).

Further, a society may wish to take steps to improve the voting turnout among groups traditionally under-represented in voting at society general meetings. So, a follow up mailing to heartland members may be appropriate, where heartland members have traditionally

been under-represented in such voting, and the purpose of such a mailing is to correct the imbalance¹⁵.

But, although there are no problems over using follow-up mailings to improve turn-out among traditionally under-represented groups, considerable caution and advice is needed before using them just to target groups sympathetic to the Board's stance. Thus, there are a number of significant issues to be addressed here - in addition to the drafting of the key documents.

(x) Electronic Voting ¹⁵

In 2008, nearly half of the 56 societies replying to the BSA's AGM questionnaire (see table after paragraph 12 above) confirmed that they offered members the option to vote online on all resolutions – up from 37% in 2007.

There is no need for societies' rules specifically to authorise electronic voting. Paragraph 3(5) of Schedule 2 to the 1986 Act states -

"Nothing in the rules of a society shall prevent the service of a notice or other document by the society -

(a) by sending it electronically to an electronic address notified for the purpose in accordance with express provision made by this Act; or

(b) by its publication on a web site in accordance with any such provision."

The BSA has provided guidance on electronic communications with members - www.bsa.org.uk/members/practice_briefs/electronic_comms/elec_comms.htm.

5. Pre-Meeting Issues

This section deals with those issues where preparation is needed to -

- organise the mail-out
- handle responses
- set up the venue.

(i) Member Issues

Obviously, the proper identification of eligible voting members for the mail-out is essential and, if there is any prospect of a close vote, the accuracy of the membership records is absolutely vital. The inclusion in the 1997 Act of borrowers' entitlement to receive the Notice of AGM and to vote increased the importance of the membership register for these purposes¹⁶.

Note the helpful optional Model Rules 4(c), 4(d), 4(e), 5(a), 5(b) and 5(c) placing the onus on the member to ensure that accurate information is given to the society where he or she holds a number of accounts.

Obviously for account-based systems, there must be effective deduplication and a clear understanding of the implications of the IT system is needed. Care is also needed if the address list for the AGM is not extracted at the end of the previous financial year - to allow for changes of address up to the dispatch of documentation and for account closures or account openings between the year end and the extraction of the dispatch address list.

It is important also to prepare for handling members' response to the AGM mailing¹⁶, including -

- **returned envelopes** from "gone-aways" and "not known at this address"
- **returned proxy forms.** Model Rule 37(3) says that the proxy form "shall be deposited at the Principal Office not less than two clear days before the meeting and in default shall not be valid". "Deposited at" does not mean quite the same as "dispatched to". Rules could add "or at such other address as shall be specified in the notice of meeting" to allow proxy voting forms to be returned direct to scrutineers at their (external) address - with the added public relations benefit of demonstrably being outside the influence of the society. A society might consider a facility to provide for deposit of proxy forms up to 7 days before the date of the meeting if the rules contain an appropriate provision
- **telephone calls, visits to branches, and related queries.** Be ready to deal with members' queries; and those societies having or using a call centre should ensure that key staff are carefully briefed. Also ensure that there is a suitable interval between the AGM mailing and the annual mailings of mortgage statements and investment statements. In the past, some societies combined their investment statement mailings with Notice of AGM but this would be more difficult now and possibly not feasible.
- **Queries direct to Scrutineers.** If independent scrutineers are being used, the society should ensure that it is familiar with and comfortable with the timing and format of their reports - invariably addressed to the Chairman - and that there are appropriate procedures for any general membership queries that may be addressed to the scrutineers but which then need to be passed to the Society.

Further, members who write to the scrutineers should receive replies - particularly if they affect voting entitlements or request information to enable the member to vote.

Early warning of a borderline vote is essential to allow time for any follow-up procedures.

(ii) In Branch Voting¹⁶

Some societies provide an in-branch voting facility - which is particularly helpful to societies with large branch networks or who depend very much on contact with members through the branch. Branches can also make available to those members visiting branches additional voting forms.

Whilst this is a service generally appreciated by those members who use it, the overall numbers using it may not be large, and there is an increased risk of duplicated votes to be weeded out by the scrutineers. It may well be advisable to be consistent and not just to provide this service where there is a contest for the Board.

Further, particularly where there is a contentious Members' Resolution or a contested election of directors, there is an increased risk of allegations of undue influence against branch staff. Society procedures should be robust enough to defend any such challenges - in particular, there should be separate and sealed ballot boxes in the public area of the branch - to which the branch staff must not have access (eg keys) except perhaps for genuine emergency.

There should also be separate and secure arrangements for collection of votes cast e.g. by a security company direct to any independent scrutineers - who should record such votes separately. It may also be necessary to close branch ballot boxes one or two days before closing date for receipt of proxies (or postal ballots) to enable the votes to be transported to

the scrutineers in time. A possibility would be for a society to set up an arrangement under which members could complete their forms and put them in sealed envelopes that were then deposited in the branch ballot box. Because of the security implicit in the sealed envelope, the scrutineers might be content for the forms merely to be forwarded or sent to them by the branches.


(iii) Venue


The venue must be large enough to allow all invitees who wish to attend the meeting to be present in person, to be able to put their points of view, and to understand clearly the debate and the business being conducted.

Do ensure that all arrangements for the venue and the staging are in place and cover how the society will deal with members and vetting their eligibility to attend, customer queries and so forth.

Be prepared for any surge in attendance -

- through the *reservation* on a contingency basis of -
 - an alternative venue with much greater capacity or
 - an overflow venue with a comprehensive CCTV link, *or*
- at least be *aware* of suitable back-up venues.
- However, do appreciate that a large or prestige venue will be in demand, and its managers anxious for income. Thus, there may well be pressure to relinquish the contingency sooner than a society would wish, eg 3 months before the AGM – and even before the mailing - particularly if it is not the main venue but an alternative location. Try, if possible, to incorporate the contingency arrangements as part of the main booking.
- Whilst use can be made of audio/video links to overspill facilities within the same venue, do not forget the public safety/fire authority requirements which might limit the number of people permitted access. Also, make sure that everyone can get out in an emergency.

Consider also whether to record the AGM on video/DVD - for future use, or perhaps to broadcast through webcasts on the Internet - as several societies have done already. Also consider if this sets a helpful precedent. Video extracts can be used for staff communications (and any member presentations) throughout the year .

Be prepared also to make contingency arrangements in the event that an adjournment is necessary, eg if a director candidate withdraws in a *contested* election and turns it into an *uncontested* election with its different procedures - as happened to Britannia Building Society at its 1999 AGM .

Particular care is needed if a CCTV link is to be used - a plc AGM was challenged in the High Court in 1989 (*Byng v London Life Association Ltd*) – see overleaf.

Byng v London Life Association Ltd [1989] 1 AER 560; [1990] Ch 170

In 1988, an assurance company held an extraordinary general meeting in a cinema auditorium in central London. The room turned out to be too small to accommodate all those who arrived. The members unable to enter the auditorium were directed to overflow rooms, connected to the auditorium by audio-visual link. Unfortunately, the link did not work properly.

Therefore, the Chairman adjourned the meeting to the same afternoon, to be held at a restaurant elsewhere in central London. The meeting took place at that venue and the resolution was passed, after a vote and a poll. A member challenged the validity of the meeting and the vote.

The Court held that the Chairman had acted in good faith, but that the power in the articles for the chairman to adjourn could not be validly exercised when – as in this case – it was not possible to ascertain the views of the majority present.

The Court acknowledged that the Chairman had a separate, residual, common law power to adjourn, but decided that he had failed to take account of the fact that the matter was not urgent enough to require a decision that day, and also failed to take account of the fact that some members – who were not able to attend the re-arranged meeting – would not be able to speak or vote.

Therefore, the Court declared the subsequent meeting, and the resolution passed at it, to be invalid.

(iv) Security

It is important also to address security issues, if only because nowadays people expect adequate security and factors such as the following are relevant -

- many people are prepared for bags, handbags and brief cases to be checked, but personal searches are probably excessive (but the more recent terrorist bombings have added a new dimension to security and the general situation at the time, and police advice, will be relevant)
- the visible presence at the meeting of official security guards can be both reassuring and a deterrent to unruly behaviour.

Consider whether to provide external or internal support. It may well be that the managers of the venue know of security firms who are familiar with the venue and its layout.

A word of advice if, for any reason, external security guards/stewards are used. Do ensure that they are properly briefed and know when to act and also when **not** to act. However, if there is any reason to expect serious disruption, do consult the police. They appreciate being consulted in advance and, even if it is a false alarm, it may well be that a patrolling police officer or a squad car will be around or available at the crucial time. Often, their visibility will be enough.

Bear in mind that police officers have special powers of arrest, but civilian stewards do not. However, it would be rare indeed for this to be an issue at a building society AGM.

(v) External Auditors

As they will be appointed or, as is much more usual, *reappointed* at the meeting, do ensure that they are available and briefed over the likely vote and that any non-routine queries raised about them are passed on to them.

(vi) Media and Press Releases

Consider whether any pre - or post - AGM press releases are to be issued and whether the press or media are to be invited to or admitted to the meeting. An AGM is a private meeting which the press have no legal right to attend - although they may attend at the Chairman's invitation. During the Spring of 2009, *the Mail on Sunday* is ran a series on building society AGMs attended by the journalist.

If for any reason any members are not admitted to the meeting - such as because they are not actually eligible to vote under Rule 38(1) - then do take considerable care over inviting external agencies to be present[Ⓜ].

Press releases can also be used to publicise the Chairman's speech, the voting figures and any other significant announcements[Ⓜ].

6. Admission Procedures

(i) Reception[Ⓜ]

It will be appropriate, as part of a society's strategy, to consider the means by which the society is *actively encouraging* the attendance of members; for example -

- Consider providing a **map** and/or opening times on the AGM booklet. It may not lead to an increase in numbers but it is member-friendly.
- Take care over the **queuing** arrangements. Be ready for and avoid last minute congestion - members queuing in the rain will not generate goodwill.
- Consider the provision of **refreshments** and whether before and or after the meeting. If members have had to travel any distance, refreshments will be appreciated and generate goodwill. If they are available before the meeting, they may encourage early arrivals and ease any last minute congestion. Do not overlook the provision of tables for empties. Remember to cater for vegetarians.

However, *withdrawal* of certain refreshments or facilities at the next year's AGM is unlikely to generate goodwill unless, of course, the general feedback on the item in question had been negative.

Consider separate tables for -

- **security checks** - handbags and briefcases
- **registration** - passbook/eligibility/identification
- **scrutineers** - so that they can check those external members who have been appointed proxies. If any external members hold proxies, they should be informed so that they can cast the proxy votes. Remember that those who are appointed as proxies may not know that is the case until they turn up, and also that, if they do not turn up, the proxy votes cannot be used.
- **customer queries** - these might be routine, eg about new products and opening accounts, but there might also be complaints. It is much easier to deal with complaints or lengthy, complicated enquiries away from registration and this eases queuing and congestion.

In larger AGMs, consider using "meet and greet" teams. Their responsibility is to approach and welcome members and it certainly helps if directors are also available and visible. In practice, directors simply might not have time to talk to large numbers of members.

Also consider the use of displays and presentations to attract members away from registration and reception into the meeting room and avoid the inevitable log-jam.

(ii) Identification

Ensure that the society and the scrutineers have agreed effective procedures - such as in relation to identification requirements. In addition to members, meeting voting forms must be given to correct and valid holders of proxies. Watch out for high profile proxy voters eg activists, and ensure that an executive or manager is available to talk to them, and reduce their scope to lobby and canvass other members.

But remember that customers of any subsidiary companies are not (in the absence of eligible society membership) members and are not entitled to attend the meeting.

Be prepared for a member who has already voted by proxy and who attends the meeting. If he or she wants to vote at the meeting instead, the proxy vote must be cancelled at registration by the issue of a meeting voting form. Normally a later vote revokes an earlier vote.

(iii) Joint Members

Note carefully Rule 38(1), under which joint or second named members have no right to attend the meeting. A society may still choose to admit them but, whatever the approach, it must be consistent. Traditionally, societies did not permit non-voting members to ask questions or join in the proceedings – but a society may do so if it chooses.

At larger AGMs, the issue of admission slips/voting forms/badges of different colours makes identification of different classes of attendees much easier. Members may well be accompanied by spouses, companions or family - particularly if they are infirm, elderly or disabled - and exclusion may generate ill-will.

7. Scrutineers

(i) Choice of

It is important to consider the basis on which scrutineers are appointed. Essentially, there are three alternatives -


- *Society* itself - usually internal audit.
- *External auditors* - but note that they will be standing for their **annual re-election** and so there is one vote in whose outcome they have an interest.
- *External specialists* - of which Electoral Reform Services are perhaps the most well known and who act for a number of societies, and have thus also developed a good understanding of building society Rules and procedures www.erbs.co.uk/.

Important factors to bear in mind are -

- **likely volume** - of proxy voting form response and, arising from a strategy actively to encourage voting, volumes should increase

- **independence** - this is virtually essential if there is a contested election for a director or a members' resolution
- **systems** - it is likely that external scrutineers will have developed systems that will enable voting patterns, geographically or in other ways, to be analysed
- **expertise and experience** - do not underestimate the expertise and experience that outside specialists can bring and the reassurance that it can provide.


(ii) Procedures

If external scrutineers are to be used then it is important to agree and understand mutual procedures for  -

- *proxy voting form design* - their systems may require "tick" boxes to be of adequate size.
- *secure collection of returned forms* - if it is not possible for proxy voting forms to be return mailed direct to the (external) scrutineers, suitable arrangements need to be made for secure collection of forms received by the society
- *report and running tally* (for the Chairman) before the AGM
- *admission arrangements* - for the meeting itself and the necessary documentation available at the meeting
- *adjournment and final count* - and reporting to the Chairman at the meeting if he is to announce the final result.

It is essential to give them the opportunity to be included in the appropriate internal AGM planning meetings.


(iii) "Spoilt" Proxies

Finally, a difficult problem can be that of what constitutes a "*spoilt*" proxy voting form. The basic presumption must be that by completing and returning the proxy voting form, the member intended to make his or her point and scrutineers should always lean in favour of allowing the vote to be counted, if at all possible .




Further, it is most unlikely that the inclusion or exclusion of spoilt voting forms will determine the final result and, in the unlikely event of challenge, it is easier and less risky later to disallow a vote counted in error than to add in later a vote that was excluded. However, if the member fills in *both* the "*for*" and "*against*" boxes, the voting form will obviously be invalid.

8. Secretarial Issues and Quorum



As noted above, the secretary, or another trusted staff member, should attend the meeting room well before the meeting to check that everything is in place and working properly. There are some responsibilities which are specifically those of the society secretary and where he or she will need to be prepared at the start of the meeting -

- **Quorum** . Note Rule 34(1)(a) and ensure that a quorum is present. The 1986 Act provides no guidance on which number should constitute a quorum. There is in fact no advantage for the Rules to require a large quorum for the AGM but not all (small) societies do in fact have a quorum even in single figures.

The Secretary should be familiar (one hopes, for emergency use only) with the procedures if a quorum is not present – see Rule 34. Some societies can require 100 members for a Board convened Special General Meeting which may be twice the size of the total staff. Note that the quorum needs to be present "at the time when the meeting proceeds to business", not later (Rule 34(1) – *Re Hartley Baird Ltd* [1955] Ch 143).

- **Reading the Notice of AGM** . Practice varies as there is no statutory requirement to read the Notice of AGM. However, if the starting time of the meeting has arrived whilst there is still a queue or backlog at registration, reading the Notice slowly is a way of getting the meeting started on time - whilst still allowing latecomers to enter the meeting but not to miss any substantive part of the meeting.
- **Minutes of the last AGM** . Again, practice varies (see '19. Minutes' below) but it is advisable to ensure that a sufficient number of copies are available at the meeting. They are usually approved at the Board meeting that follows the AGM but, strictly, the minutes should be approved at the subsequent AGM - being a meeting of the same character.
- **Minutes of the current AGM** . The Secretary should ensure that they are taken. Caution would suggest (whilst it may be excessive) both taking a written shorthand note using an experienced society secretary and also taping the minutes. This would be helpful in event of any unforeseen and unplanned issue or confrontation. However, if the meeting is being tape recorded, this should be announced at the start for the information of members.


Note Rule 17 - it is the Board's responsibility to take the minutes and in particular note Rule 35(7) whereby a Chairman's decision (eg on the outcome of a show of hands) is conclusive under the Rules if it is recorded in the minutes.

- **Availability of documents** . A simple point which it is so very easy to overlook is to ensure that *all* essential documents, particularly those in respect of which members may raise queries of the Chairman and the Board, are available on the Directors' table - notably the Rules and the Annual Report and Accounts. It would make sense to tag and label key sections, for ease of reference during the AGM.
- **Statutory Registers** . Another secretarial duty is to check that the Statements sent to the FSA relating to both the Section 68 and 69 Registers are available at the AGM - even if there are nil returns.

These are statutory requirements and, as members get better informed, you may find that there will be a request to inspect these Statements at the AGM. From time to time, members do ask to inspect particularly the Section 68 Statement (or the Register) (Director's Loans) at the AGM.

9. Impact of Society Rules

A significant number of Rules and their Sub-Rules are relevant to the AGM, and they appear throughout the Rule Book. Some members are increasingly familiar with the Rules and may wish to utilise them for their advantage.

It can be most embarrassing to be hunting for a particular Rule during the meeting. As suggested above, good advice is to work from a highlighted and tagged *master copy* at the meeting, and also to rely on a *single page summary index* which is invaluable in directing the secretary quickly to a vital rule needed at the meeting . The best advice and practice is to

re-read the key rules just before the AGM - especially Rule 30 on the *Annual General Meeting* and Rule 35 on the *Procedure at Meetings*.

The Rules support the Chairman's inherent authority to conduct the meeting, but the Rules do not address every eventuality. If members are going to become more interested in raising points of order or technicalities, there may well be scope for incorporating more detail as to their rights and responsibilities in the Rules - some of which are probably little changed for many years.

Some plcs do this. An example of one problem that some plcs faced was that, if the venue insisted on security checks, the member may strictly be entitled to refuse - without authority in the company's Articles of Association or a society's Rules.

Do also note Rule 36 on the *Entitlement to Vote* and Rule 37 on the *Appointment of Proxies*. It never does any harm and it is often very helpful to re-read carefully such other Rules in the light of what might happen at an AGM¹⁰.

Do particularly note the recommendations in the ICSA guide to AGMS (see above) - "*sufficient time should be allowed to enable members to ask questions about the society's performance past, present and future*" and "*seeking the consent of the meeting to allow proxies to speak*". The ICSA recommendation neatly addresses the issue which leaves discretion to the Chairman who can then consult the meeting.

10. The Chairman's Role at the Meeting

The Chairman's responsibilities are to –

- **preserve order**
- ensure **proper conduct of proceedings** according to the rules and the law - eg that the meeting starts and finishes on time, that the Chairman introduces items clearly and summarises decisions accurately, that speakers receive a fair hearing, that procedural questions are dealt with but that points of substance disguised as "points of order" are not allowed, to exercise any right to adjourn properly (see below)
- remain **impartial** – if he or she wishes to address the meeting, as part of formal debate, the Chairman should, technically speaking, leave the chair
- exercise his or her powers and discretions in **good faith**
- ensure that, as far as practicable, all shades of opinion are given a **fair hearing**
- ensure that the **sense of the meeting** is accurately ascertained and recorded – the Chairman's minute is prima facie evidence of the accuracy of the recording of the decision – *Wall v London and Northern Assets Corporation* [1898] 2 Ch 469. Rule 35(7) (see 97 above) broadly reflects this decision¹¹.


11. Conduct of the Meeting

It goes without saying that the Chairman's role is pivotal in achieving a successful meeting but there are three particular ingredients -


- *be firm but fair*
- *be patient and unprovocable, and*
- *have the ability to create and gauge the sense of the meeting.*


Do not forget that, although some members might have obviously come with a sense of grievance and/or a desire to make trouble, there will be a considerable number of loyal members who are fully supportive of the Board and the society. Members noticeably pursuing an unfair or unreasonable personal vendetta or grievance can lose the support of their fellow members and, if the Chairman is seen to have done his or her best, the meeting may well come to sympathise with him or her. Also, members anxious for their next meal or to get home may not welcome members stealing the limelight and prolonging the meeting unnecessarily.

It is also vital to ensure the Chairman, the Chief Executive and the Secretary are well briefed on -


- **AGM procedures and the Chairman's script** (but do watch page turning by all directors with copies)
- **Chairman's address** - its length and tone
- **sensitive issues** - internally and externally
- **presence of complaining members** (it is **very** effective if the Chairman or Chief Executive is able to say that so and so has already been in touch with the society on several occasions) .

Further, decide whether every director, eg through proposing or seconding, will have a chance to do or say something or whether the Chairman will personally deal with everything.

Do ensure that the admission procedures identify and pick up the presence of members who have been pursuing a complaint or particular grievance so the Chairman can be ready to address them .

Arising from that, it is obviously very wise to anticipate awkward questions or complaints. Although there will always be a risk of ambush by stray questions, in practice very few questions are asked that cannot be anticipated or prepared for. Obviously, it will be important to decide if the Chairman will deal with all **questions** himself or distribute them amongst the Board (or any executives in the room) .

The BSA has provided building society chief executives with a list of generic questions and answers, relating to market conditions, financial results etc. These Q&As could be useful in respect of questions at AGMs. The BSA also collects AGM feedback. If you require more information on these matters, please contact Rachel.LeBrocq@bsa.org.uk (020 7520 5905).

It is worth considering roving microphones or microphone points. Microphone stations are easier to control, as those who wish to ask questions have to move out of their seats to form a queue, and there is also less risk of them being overlooked .

If there are portable microphones, ensure that the staff or ushers responsible for those microphones are carefully briefed because providing and reclaiming microphones (and ensuring they are switched on) with those in the middle of rows can have its practical problems.

It can also be very valuable to know the location in the room of members who are likely to ask questions/make comments supportive of the society, so that the Chairman can address the balance of feeling in the meeting.

12. Chairman's Script and Address

It is obviously vital that the Chairman is fully briefed as to the order of business and as to the options open to him or her¹². Some societies put their Chairman through detailed briefing sessions beforehand and "*preparation - preparation - preparation*" pays off. Do not overlook the Vice-Chairman in case he or she is required to stand in at short notice - it can happen.

It is absolutely essential that the Chairman works to a detailed script and does not work off the cuff. In these sensitive and litigious times, it is particularly important to ensure that the script (and that of any other speakers) does not inadvertently contain material that could reasonably be –

- considered defamatory
- interpreted as offensive to any particular groups of members
- likely to cause adverse PR.

The Chairman's script should be available to the key players - Chairman, Vice-Chairman, chief executive, secretary, scrutineers, auditors and so forth. However, as has already been said, do watch out for communal page turning¹².

It is also important that the Chairman's script takes particular care with the procedures for putting resolutions and with the consequential voting -

- each resolution should be read out separately and then members asked to vote on it
- each director's name should be read out in turn and then members asked to vote
- it is advisable to vote on each resolution and each election or re-election separately (and not en bloc even if there is one voting form)
- the Chairman's script should also provide for any adjournment that is required to enable the votes to be counted before the result is finally given.

It is advisable to prepare for contingencies¹², so that in the event of a proposal –

- to elect a director at the meeting
- to put or amend a resolution at the meeting
- for an adjournment, or
- for a vote of no confidence in the Board

there is a separate script ready and the Chairman can seamlessly move to the additional text.

Although there is no specific legal requirement, it is the established practice for the Chairman to give an address to the meeting¹². The items to be dealt with in any address could include -

- changes to the Board and to executive management
- annual results, past performance and achievements (related to the SFS, Director's Report and the Annual Accounts)

- any key initiatives, any significant issues, (like TCF or market conditions)
- customer service, new branches and services
- anticipating possible difficult member questions
- important external factors and future developments eg FSA and regulation
- appreciation to members, colleagues, staff, and other stakeholders.

The content of the address is very much a matter for individual preference, but it is worth trying to make it interesting and avoid simply repeating statistical information contained in the SFS already sent to the members.

It can also be particularly helpful to address problem areas - such as the current market conditions, management of interest rates etc - in the address so that during questions the Chairman can respond by saying that a particular issue has already been dealt with in his or her address.

13. Questions


As noted above, the BSA has provided building society chief executives with a list of generic questions and answers, relating to market conditions, financial results etc. The ICSA Best Practice Guide recommends that -

- all Boards should allow adequate time for questions at AGMs
- members should be permitted by the Chairman to ask questions on any item of the society's past performance, its results and its intended future performance
- the Chairman should seek the consent of the meeting to proxies speaking and participating in the debate. You should check Rule 37(4) as proxies may not have the right to speak. On the last point, it is worth noting that, since October 2007, companies legislation has entitled a member of a company to appoint another person as his proxy to exercise all or any of his rights to attend and to speak and vote at a meeting of the company (section 324 (1) Companies Act 2006).

Success obviously depends on the Chairman's skill but some useful practical points are -

- ask each questioner to give their name and confirm their membership or show an admission card
- consider limiting one question per member (but this is a judgment call and likely to depend on the number of questions being asked)
- take all questions on one topic together
- allow members to ask questions first
- take questions from proxies at the end.

This is often much easier said than done - but these should be helpful pointers - and it may help for the Chairman to be working to a particular objective.

Pre-notified questions at registration  can help the Chairman to manage a balanced discussion, but they undermine spontaneity and can be construed as restrictive by members. Members can be asked to fill in a form at registration, indicating which resolution their

question relates to and whether they are "*for*" or "*against*" the resolution. Each speaker is then called up in turn to the microphone point, with the next speaker then being on notice.

Another possibility is to consider pre-registering questions with the society in advance of the meeting - particularly if a large number are expected¹³. This may give early warning of at least some of the key issues and thus gives even more opportunity to consider an appropriate response.

It is perfectly permissible (and also reasonable) to respond to detailed, technical or complex questions outside the meeting or to inform a member that a written response will be provided.

It will obviously be advantageous to have sufficient executives and managers present from the finance and operational areas of the business to enable sufficient replies to be given to basic questions at the meeting.

In any event, the answers to all likely questions should be thoroughly prepared in advance. There is no substitute for preparation (and prior input from those with a "hands on" involvement). It may even be advisable to start preparation soon after the year end. It is a matter of personal preference -

- whether the chairman personally responds to all the questions, or
- whether he distributes these amongst his fellow directors, or
- even to executives who may be present in the room.

Bearing in mind that the Chairman's role is to conduct the meeting even-handedly, it may be easier for him to "*stay above the debate*" by letting the Vice-Chairman or Chief Executive lead and respond on any particularly sensitive issues. As already noted, the BSA has provided chief executives with some generic Qs and As.

14. Voting By Show of Hands or Proxy¹³

A **show of hands** is the traditional method of voting called by the Chairman at an appropriate stage of the proceedings. It is separate from a **poll** which includes proxies. It is worth remembering that many members do not understand what is meant by a poll or proxies. Most people are familiar only with political elections and their (simple) ballot papers. Care is needed if -

- there are members present, but who have voted separately by proxy
- there are proxies present, when a show of hands is called - as it is only members (not proxies) who can vote on a show of hands.

A member (including the Chairman) has only one vote and cannot use proxies on a show of hands. Although very rarely used in practice, the Chairman does have a (second) casting vote in the event of a tie - see Rule 35(13).

Depending on the size of the meeting, it is important to be able to understand and manage the different constituencies in the room - for example, by using coloured admission cards, which are now quite common. This will provide protection against any aggrieved member alleging that the voting and any poll was not properly conducted.

Some important administrative preparations are therefore needed and it is wise to provide separate coloured meeting voting forms for members and for proxies (as well as for non-voting guests).

It is important particularly to note Rule 35(6) (which allows the Chairman or [a maximum of 10] members entitled to vote who are present in person, by proxy, by attorney, by representative ... to call for a poll) and to be clear whether it means 10 members or 10 proxies and whether one proxy holder holding 10 proxies counts as 10 members.

The best advice in the legal position is that this means that, if 10 eligible members have all appointed the same person as their proxy, that one individual will be able to demand a poll - without need the support of any other person at the meeting - whether a member or a proxy for a member. Thus, one determined individual, whether a member or a proxy holding 10 proxy votes, is able to demand a poll. Be prepared.

Remember Rule 35(5), which actually says "*every question to an AGM or an SGM is decided by a simple majority and such votes shall be taken in the first instance by a show of hands*". Case law has decided that this does not prevent a poll being called at the outset instead - because some societies have felt it necessary to call for a show of hands and then, on the outcome of that show of hands, to proceed to a poll which can appear cumbersome.

A show of hands is not always easy, particularly in a large meeting because not all hands go up at the same time, not all hands go up fully, and some hands come down too soon. Counting is impracticable if there are over 50 persons present. The advantage of a poll is that it does deliver a precise and certain result separately verified by the scrutineers.

In the event of a valid resolution to adjourn the meeting, the Chairman can use his proxy votes on a poll to defeat the adjournment. See Rule 35(2) (3) and (4). However, best practice indicates that he should use those votes in the appropriate proportions, depending on whether they are "yes" or "no" votes.

The ICSA has produced guidance notes on voting at general meetings, the Chairman's obligations regarding polls and proxies, and proxy votes – abstentions¹. These contain useful information, but it must be borne in mind that they are primarily concerned with company meetings and differences with building societies must be taken into account.

15. Voting on AGM Resolutions

Strictly, there is no voting until the Chairman calls for the vote at the meeting. Thus, in the event of a lengthy questions session, early leavers can be disadvantaged if they still wish to vote at the meeting - although they will have had an opportunity to vote by proxy up to the proxies return date. Consider the staff and scrutineers if there are any such aggrieved members.

Further, under Rule 35(8), a poll is now *mandatory* for Special Resolutions or in the election of directors or for contested auditors. In the case of election of directors, there is a *mandatory* requirement to pre-circulate a proxy voting form (or postal ballot paper).

In practice, it is simple to extend the proxy voting form also to include a poll vote on the receiving of the Annual Report and Accounts or on the annual appointment or re-appointment of the auditors. It is also, arguably, more democratic. There is no requirement for a vote on receiving the Annual Accounts but -

- it is simple to include it in the proxy voting form
- it invariably secures the largest pro-Board vote
- the result can reasonably be promoted as support for the Board's performance

- it averts the uncertainty of a show of hands, or a protest vote at the AGM.

The advantages of a Poll are as follows -

- providing for a poll on all resolutions means, above all, that the Chairman can be confident at the start of the meeting that, whatever may be said, he can win all AGM votes.
- any post-AGM press releases can be pre-drafted accordingly.

16. Procedural Motions

As already noted, all **substantive** resolutions must be pre-notified and pre-circulated - if only for the obvious reason that otherwise there is no way that those who are not present at the meeting can vote on them. Examples might be to amend a resolution or a vote of no confidence in the Board. It is difficult to imagine an amendment to a resolution which is not substantive but, if there is a typing or printing error, this could be dealt with at the meeting.

Concern existed in the late 1990s that hostile members such as activist carpetbaggers might have tried to cause disruption by putting forward *procedural* motions - ie those that affect the conduct of the meeting - during the course of the meeting of which examples might be a call for an adjournment or to appoint a different Chairman of the meeting. Such resolutions must be proposed by a member because, depending on Rule 37(4), proxies may have no right to speak, other than to demand or join in demanding a poll.

There is a right, acknowledged by the Rules, to require an adjournment of the meeting - which is essentially a delaying tactic. As already indicated, the Chairman can use his proxy votes to defeat it and the proxy votes that he or she holds are the authority.

The question of appointing a Chairman of the meeting only arises if, for any reason, the Chairman walks out or is taken ill but, if he or she stays at his post, the Rules provide authority for the Chairman to continue the meeting to the end.

It is important for societies and in particular for society secretaries to understand their own Rules, including in particular Rule 35 which deals with the Procedure at Meetings, because it contains a number of Sub-Rules that apply in particular circumstances. It is important to note the entitlement of members to call for a show of hands or a poll and the Chairman's right to require a poll. It is essential to ensure that the Chairman, the secretary and the chief executive, at least, are fully briefed on this.

It is also worth bearing in mind that a show of hands is quicker than an unforeseen poll. The Chairman may be unable to persuade a campaigning member to withdraw, eg by pointing out that his or her actions are only a delaying exercise because, with the Chairman's proxy votes, the Chairman will still win on any poll. The Chairman can proceed with a show of hands on the basis that it is much quicker than an unexpected poll and, even if a show of hands is taken and lost, the Chairman still has the right to call for a poll.

The crucial point is that societies should be prepared, and be able to provide "blank" voting forms before or during the AGM and to collect and count those forms. The whole exercise would be likely to add about 45 minutes to the meeting.

It is also prudent to prepare for the process to count hands if there is likely to be a close result on a show of hands. Note again that Rule 35(7) confirms the Chairman's declaration on a show of hands is conclusive as to the result.

17. Contingency Preparations

(i) General

During the carpetbagger activist period in the late 1990s, it became clear that every society needed to anticipate, and make contingency plans, to deal with activist surprises or 'ambushes' at the meeting. The carpetbagging phenomenon has disappeared and - in the light of the failure, disappearance or loss of independent status of every one of the building societies that converted to plc - is unlikely to re-emerge. However, more recent events in the market have strengthened the importance of being prepared even for unlikely eventualities.

Thus, because [10] members eligible to vote and present at the meeting can demand a poll, it is prudent to be prepared and

- **either** for the society already to have required a poll
- **or** for arrangements to be in place to conduct a poll at the meeting.

As part of the secretarial preparations, supplemental prepared contingency text - for the Chairman - should be available in case -

- an adjournment is proposed
- a poll is demanded.

In addition, such voting forms should also be available as a contingency, but remember again that as proxy voting forms are mandatory for the election of directors, the society can require a pre-meeting poll on every AGM resolution in advance so there is much less opportunity for ambush at the meeting.

It is obviously important to ensure that the Chairman is briefed as to the number of proxies he or she holds and as to the appropriate proportions, although, despite the overwhelming temptation, he should preferably avoid announcing the amount of proxy votes that he or she holds *before the vote has taken place*.

(ii) Substantive Resolutions Raised by Members

If a member proposes a substantive motion, eg a vote of no confidence in the Board, the Chairman should begin by attempting to allow the member to make his or her point and indicate that the Board has taken note of it. The Chairman should add that, if the members wish to express their confidence or otherwise in the Board, they should vote for or against the (resolution regarding) receiving Annual Report and Accounts. This will avoid wasting time considering superfluous resolutions.

If the member persists in requesting that a vote of no confidence in the Board be put to the members, the Chairman should indicate that, in accordance with the Society's Rule 33(3)(b), a resolution of this nature must be put to the society in accordance with this Rule, which requires that it should be delivered to the Society prior to the financial year end preceding the meeting.

This point is particularly important - because it allows those who could not attend the meeting to vote on it. If this has not been done, the resolution cannot therefore be put to the meeting and can be dismissed by the Chairman.

(iii) Procedural Resolutions Raised by Members

If members are attempting to adjourn the meeting, they will have to do so by proposing the adjournment, which should be seconded by another member at the meeting and voted upon, initially, by a show of hands. The Chairman can then call for a poll, or a member can demand a poll, provided he or she has been appointed proxy by 9 other members or alternatively is supported in his demanding a poll by 9 other members present at the meeting and entitled to vote - in accordance with the Society's Rule 35(6).

If [10] members validly call for a poll to adjourn the meeting, there must then be a poll of the members and proxies to determine whether a majority were in favour of adjournment.

(iv) Chairman's Proxies

Where the members validly call for a poll to adjourn the meeting, the Chairman who holds proxy votes should consider how his or her appointors, if asked, would vote on a resolution to adjourn the meeting. The appointors who wanted another resolution (eg reappointing the Auditors) to be passed may not want the meeting to be adjourned, while the appointors who opposed that resolution may be happy for the meeting to be adjourned.

Accordingly, the "yes" and *discretionary* proxy votes given to the Chairman should be used by the Chairman to vote against an adjournment motion, whereas the "no" proxy votes should be used by the Chairman to vote for an adjournment.

The basic principle applied in such circumstances is that of agency law, which requires that a person holding a proxy should vote in accordance with what he can ascertain to be the wishes of the appointor. The way in which the Chairman should exercise his *discretionary* votes may therefore depend upon the nature of the adjournment being proposed. This is not an easy matter and the BSA would be happy to consider it in more detail, should societies wish.

(v) Disruption

If the conduct of the meeting breaks down, the Chairman is required to exercise his or her duty at common law to preserve order and ensure the proper conduct of the meeting. The Chairman is entitled to ask a disruptive member to leave and, if necessary, have him or her expelled from the meeting.

The disruptive member should be given the opportunity to leave the meeting voluntarily and, only if he or she refuses, should the Chairman exercise his power of expulsion. If possible, the Chairman should gain the support of the meeting on a show of hands for the ejection of the disruptive member. Obviously, the minimum necessary force – "reasonable force" - should be used in expelling any member.

The Chairman has a common law rights to –

- exclude persons to maintain order (*Carruth v ICI* [1937] AC 707)
- adjourn the meeting in cases of disruption, preferably for a short time and with the consent of the meeting - *John v Rees and Others* [1969] 2 WLR 1294, in which Megarry J discussed the Chairman's powers in this respect ².

As noted elsewhere in this paper, if the society has been able to anticipate organised disruption, this should be prepared for, eg by –

- if possible, isolating the disruptive element
- having a carefully prepared Chairman's response, delivered calmly but authoritatively
- forewarning stewards, but using them only when necessary
- controlling the microphone, so that it may be switched off eg if a speaker with the mic is being abusive, defamatory etc.

Shackleton on the Law and Practice of Meetings (see above) provides a helpful piece of guidance –

"The chairman must combine fairness with tact. An element of humour may assist in avoiding matters getting out of hand – particularly if the disruption takes the form of an attempt to provoke an intemperate response. There can be a certain amount of disorder provided the business of the meeting can still be transacted and voting intentions are still clear."

18. Adjournment for Counting Votes

It is risky to vote before the Chairman's address and questions. There is a risk of challenge by members who wish to ask questions and hear the answers before casting their votes. On a time management basis, it would obviously be much easier to vote on entry to the meeting and then for the counting to take place during the Chairman's address and questions. A number of societies try to save time by leaving the completion of the voting slips (and their collection and counting) to a single point quite late in the meeting.

Depending on the numbers present at the meeting, voting and counting may take up to 20-30 minutes, and so it is practical to formally adjourn the meeting while the count lasts. See Rule 35(10) which refers to adjourning the meeting to announce the result of a poll.

Notwithstanding temptation and provocation, the Chairman should not announce the proxy numbers before the vote but, *after the vote*, the Chairman can announce the number of proxies *that he or she held and their implications for the result*.

In many cases, the votes at the meeting will not even influence the percentages of the result, if the proxy votes are so overwhelming. Alternatively, some Chairmen do announce the number of proxies that they hold earlier in the meeting, but this may carry an element of risk.

During the adjournment, there are different ways of occupying the natural break in proceedings. Some societies have a short comfort break, especially if it is only a few minutes, but practical examples used by societies to fill the gap include –

- some form of entertainment – eg, local choirs or regional entertainers
- a presentation by the chief executive – eg, an amusing address or an illustrated review of the business
- a presentation, possibly by someone else, on topic of general interest
- providing a glass of wine, tea, coffee, biscuits or other refreshments to the members
- playing background music
- showing a marketing video or DVD (or on some non-controversial matter of local interest)
- taking 'any other business' questions.

The Chairman should announce when the final result will be available -

- after the end of the adjournment
- by telephone to the society or at its call centre after a certain time
- on the society's website
- by notices displayed in branches
- even by an individual letter, if a member leaves his or her name and address.

In practice, most members will then leave at this stage if the likely result is made clear - but be aware of the possibility of members who remain to lobby directors with their personal questions and personal grievances during the adjournment - this can leave little time to talk to the loyal and supportive members.

19. Minutes

Rule 17 requires minutes to be taken of all meetings of the society, including AGMs. Normally, the AGM minutes will be signed at either the following Board meeting or at the next AGM. Typically, directors approve the minutes at the next Board meeting and the Chairman signs them. At the following year's AGM, the Chairman confirms to the membership that minutes of the previous AGM were so approved and asks the meeting to take them as read.

However, different approaches are adopted by different societies, eg –

- some have them approved by the Members present at the following year's AGM – this is, arguably, the 'purist' – or, even, 'purest' – method
- others make them available at the following AGM, but do not mention them
- some make a point in the AGM of confirming that the minutes were approved by the Board at its next meeting after the AGM and that the minutes are available for inspection should any member wish to see them at any time during the year
- once the minutes have been approved, they could be put on to the Society's website for anyone who wishes to access them to read
- in some cases, the AGM notification tells members that they can obtain copy minutes from the Principal Office or branches
- in other cases, minutes of the previous year's AGM are placed on each seat (along with the Report & Accounts) or on display. The Chairman, as part of the formal proceedings, refers to the minutes and asks the members present to agree them. They are then signed by the Chairman in the presence of the members.

Clearly, there are many different ways of dealing with this practical point!

20. Special General Meetings

(i) General

No paper on the subject of general meetings would be complete without specific reference to Special General Meetings (SGMs). Although they are rare, they can be called by the Board

to deal with a special issue such as a merger or a conversion. They can also be called by a group of members. 500 members can require the board to call an SGM.

It is important to note from Rule 31 that there are significant variations in practice to the requirements for the AGM. This is largely due to some statutory requirements which were introduced in the 1997 Act when, previously, SGM requirements were simply a matter for the Rules.

(ii) SGM After the AGM

You should note also that in the event of a SGM later in the financial year - *after* the AGM - that different voting eligibility criteria apply for Shareholding Members and Borrowing Members. See Rule 36(3)(c) and 4(c). In the case of Shareholding Members the £100 test applies at the end of the previous financial year, **but** the continuity test starts 56 days before the voting date and/or the meeting date.

Those members' requisitions must -

- state the objects of the meeting
- contain the full text of the resolution(s)
- *not* include the election of a director (*this is limited to the AGM only*)
- *nor* the removal of a director (*see the special notice requirements of Rule 33(2)(a) which only apply to an AGM*)
- where there is a series of individual requisitions, all must be lodged within 3 months of the first requisition.

The member must –

- state his or her *full* name and address
- identify the share or mortgage account on which he or she relies to justify eligibility.

A deposit at the rate of £50 per requisitioner - ie £25,000 in total - must be lodged with the society. The figure used to be £25, but this was increased in 2007 ³.

The Board has -

- **14 days** to object to the validity (*note there is no such limit to an AGM resolution*)
- **28 days** from the last requisition to **convene** an SGM to be held in 9 weeks (*note the time is very short*)
- the right to choose the date, time and venue (*a useful advantage*).

Familiarise yourself with the quorum requirements of Rule 34 -

- note the option for a larger quorum for an SGM - Rule 34(1)(d)
- if there is no quorum the Chairman dissolves the meeting - Rule 34(2).

Give some thought to what is a reasonable minimum quorum for an SGM convened by members at the society's, *ie other members'*, expense when they have the (free) opportunity to put resolutions to the AGM. Some societies require 100 members for the quorum for a

SGM which equated to the number formerly required to requisition a SGM - but this is now 500.

(iii) Timing - Note Rule 31(b)(ii)

Ignore the AGM period in calculating the "28 days" and the "9 weeks" - ie three months before and one month after the AGM.

In practice, the meeting must normally be **held** within 9 weeks (over 2 months) after the date the (last) requisition is lodged, although this may be extended by up to 4 months (approx 17 weeks) if this **Sub-Rule** applies.

21. Addressing Member Initiatives

No paper would be complete without reference to this matter. Member initiatives became commonplace during the carpetbagger period of the late 1990s, but the difficult market conditions of 2009 could, conceivably, lead to further initiatives at AGMs of financial services businesses. It is particularly important to understand fully the risks and implications in advance. The golden rule that applies is - preparation can ease many of the risks and much of the potential trouble.

There are essentially **three** main constitutional vehicles for initiatives, but it is vital to note that under the Model Rules *the criteria are not the same in each case*.

(i) **Requisitioning an SGM** - this statutory right with some interesting new criteria were introduced in 1997. It is possible to apply the statutory standard to other membership initiatives. It is important to appreciate that, if the failure rate is say 33% or a third, the nominators need 750 nominations to secure 500 valid requisitioners. The *correct* application of *valid* criteria gives societies a significant advantage.

(ii) **Nominating a director at the AGM** - it is important to check the key ingredients of **Rule 13** -

- **Rule 13(2)** - full name, address, age and occupation of the *candidate* and the **candidate's consent** is needed.
- The full names, account numbers and addresses of *nominating members* are needed.
- **Rule 13(3)** - the Board can require written evidence as to the qualifications, financial and managerial experience, creditworthiness, competence and character (only reasonable in a regulated industry) and require the candidate to complete in draft any form or questionnaire that he is required to submit to any regulatory authority. The FSA questionnaire is not an easy form to complete.
- **Rule 13(4)** - details of the requirements for nominators ie two year member holding shares or owing a mortgage debt. Note that a combination of both is one of the options provided for in the Model Rules.

(iii) Proposing a Resolution to the AGM - check **Rule 33** carefully and in particular -

- qualifying date for proposal is the date of the last requisition
- note the requirements for the notice
- note the Board's exemptions
- note also the different requirement for the quorum for convening an SGM.

Certain practical pointers are as follows -

- check the **validity** of the requisition, the resolution and the nomination
- check the **eligibility** of the nominator eg full name
- check the **signature records** and check for identical signatures
- commission an **independent "audit"** by eg Electoral Reform Ballot Services
- check **letter boxes** at the crucial hour - so assert with confidence if out of time
- **be familiar** with the requirements, the consequences and the implication well before the year end deadline
- allow for **contingency space** in the draft AGM brochure
- keep key **staff available** at all crucial times
- ensure that **two years' records** are readily available - beware archiving.

A separate matter, but one that could ultimately have general meeting consequences, is a hostile bid for a building society. This is a sensitive issue, and beyond the scope of this guidance, but one in which the BSA and the building society sector has experience www.bsa.org.uk/mediacentre/press/100160.htm. The BSA stands ready to help any society in the unlikely, but not inconceivable, event that is subject to a hostile bid from outside the sector.

22. Some Problem Areas

Some of the challenges that may emanate from members may involve rights under the general law and pointers include the following -

- there could be allegations that the Chairman is not neutral or independent – consider allowing the Vice-Chairman or the Chief Executive to present sensitive topics
- there could be barracking and disruption - use prepared text for any ejection.
- accommodate the members' right to ask questions up to a reasonable limit
- be prepared for the right to raise "points of order"
- note the requirements for calling for a show of hands
- note the requirements for the right to demand a poll
- note there is a right to prevent the close of the meeting

- In general, it is vital to be ready for knowledgeable members now seeking to raise technical points - anticipate them and be ready with the reasons to accept them or to declare them out of order.

23. Conclusion/Sanity Check

It should be apparent by now that, although the risks of challenge and disruption have decreased since the days of carpetbagger activism, it is always important to be prepared and there are practical steps that can be taken to minimise the risks and consequently any embarrassment. Key points are -

- detailed preparation and planning is essential
- anticipate problem areas and create contingency arrangements
- know the relevant Rules and legislation (eg **1986 Act Schedule 2**)
- be prepared for a "worst case" scenario (it will probably never happen, but it just *might*)
- in internal planning, **do** involve all relevant departments and scrutineers
- it is vital to ensure that the Chairman is fully briefed and supported by the internal team.

24. Table of Relevant Provisions

This table on the next page covers matters directly relevant to the AGM – indirectly related topics eg election of directors, contents of the annual report etc, are covered elsewhere – www.bsa.org.uk/members/policy/buildsoclegislation/bs_act.htm.

Topic	Main BS Act 1986 provision* : Schedule 2, paragraph -	Main Society Rule**	Combined Code ***
Holding the AGM / default / business at	20	30	-
Length of notice / to whom / default	21	32	<i>D.2.4</i>
Persons entitled to notice	22	32	-
Notice transmitted to electronic address	22A	-	-
Notice published on website	22B	-	-
Quorum	-	34	-
Procedure	-	35	-
Members' entitlement to vote	23	36	-
Proxies and joint members	24	37-8	-
Right to demand a poll	25	35(6)	-
Counting of votes	-	40	-
Auditors	see Schedule 11	41	-
Special resolutions	26-7	30(5)	-
Borrowing members' resolution	28-9	30(5)	-
Members' right to propose resolutions	31-2	33	-
Postal ballots	33	39	-
Electronic ballots	33A	-	-
Proxy / ballot declarations	34	37(2)	-
Advertising requirements in lieu of meetings	35	-	-
Special meeting requisitioned by members / default	20A-20B	31	-
Posting results	-	39(10)	<i>D.2.2</i>


* the Schedule 2 provisions about meetings are introduced by section 5(8)–(9)
www.bsa.org.uk/members/practice_briefs/constitution_meeting/const_and_meet_1.htm

** based on *BSA Model Rules for Building Societies* 5th edition
www.bsa.org.uk/docs/policy/model_rules.pdf. There is no need for societies' rules specifically to authorise electronic voting (3(5) of Schedule 2 to the 1986 Act)

*** www.bsa.org.uk/docs/corporategov/bsa_guidance_sept08.pdf

25. SECRETARIES' AGM CHECKLIST

- certain items will, or will not, apply depending on the size of the AGM, a society's own view and other variables – usually indicated with a question mark
- extra space is left for individual societies' special requirements, if any
- page numbers refer to pages in this guidance.

ITEM (if applicable) 	page	<input checked="" type="checkbox"/>	ITEM (if applicable) 	page	<input checked="" type="checkbox"/>
Advance Planning					
preparation timetable	197	<input type="checkbox"/>	charitable donations?	199	<input type="checkbox"/>
documentation timetable	197	<input type="checkbox"/>	dispatch sequence issues	200	<input type="checkbox"/>
co-ordination with colleagues	198	<input type="checkbox"/>	follow-up mailings?	200	<input type="checkbox"/>
project team meeting dates?	198	<input type="checkbox"/>	electronic voting?	201	<input type="checkbox"/>
decide date and time	195,		in-branch voting?	202	<input type="checkbox"/>
	197	<input type="checkbox"/>			
alternative date?	197	<input type="checkbox"/>			<input type="checkbox"/>
venue	194-5	<input type="checkbox"/>			<input type="checkbox"/>
reserve venue?	194	<input type="checkbox"/>			
book printers	194	<input type="checkbox"/>	Pre-Meeting Issues		
book mailing house?	194	<input type="checkbox"/>	members' queries	202	<input type="checkbox"/>
book scrutineers?	194	<input type="checkbox"/>	video AGM?	203	<input type="checkbox"/>
book meeting organisers?	197	<input type="checkbox"/>	contingency arrangements	203	<input type="checkbox"/>
			security	204	<input type="checkbox"/>
			presence of external auditors?	204	<input type="checkbox"/>
			attendance by externals?	205	<input type="checkbox"/>
			press release?	205	<input type="checkbox"/>
			reception issues	205	<input type="checkbox"/>
			identification issues	206	<input type="checkbox"/>
			admission procedures	206,	
				210	<input type="checkbox"/>
			joint member issues	206	<input type="checkbox"/>
			scrutineer issues	206	<input type="checkbox"/>
			scrutineer liaison	206	<input type="checkbox"/>
			spolit proxy procedure	207	<input type="checkbox"/>
			quorum	207	<input type="checkbox"/>
			reading AGM notice	208	<input type="checkbox"/>
			AGM minute approval	208,	
				219	<input type="checkbox"/>
			minute taking arrangements	208	<input type="checkbox"/>
			availability of documents	208	<input type="checkbox"/>
			availability of stat. registers	208	<input type="checkbox"/>
			'tagging' rules etc	208	<input type="checkbox"/>
			re-read rules etc	209	<input type="checkbox"/>

		<input type="checkbox"/>	briefing & notes to Chairman	210	<input type="checkbox"/>
			Chairman's script/address?	211	<input type="checkbox"/>
			questions preparation	210,	
				212	<input type="checkbox"/>
rule changes - FSA approval?	198	<input type="checkbox"/>	meeting contingencies	211,	
				216	<input type="checkbox"/>
identification - eligible members	201	<input type="checkbox"/>	pre-notified/registered questions?	212	<input type="checkbox"/>
AGM pack - contents	198	<input type="checkbox"/>	voting arrangements	213	<input type="checkbox"/>
AGM pack – marketing?	198	<input type="checkbox"/>	adjournment preparation	218	<input type="checkbox"/>
AGM pack – integrated SFS?	198	<input type="checkbox"/>	pre-meeting facilities check	195,	
				207	<input type="checkbox"/>
pre-paid envelope	199	<input type="checkbox"/>	'sanity check'	225	<input type="checkbox"/>
vote by proxy or postal ballot?	199	<input type="checkbox"/>			<input type="checkbox"/>
liaison/independent scrutineers?	206	<input type="checkbox"/>			<input type="checkbox"/>
display of AGM notice	200	<input type="checkbox"/>			<input type="checkbox"/>
obtaining copies of documents	200	<input type="checkbox"/>			<input type="checkbox"/>

FOOTNOTES

1 The ICSA guides may be downloaded as follows -

- *Voting at General Meetings*
www.icsa.org.uk/assets/files/pdfs/guidance/031219.pdf
- *The Chairman's obligations regarding polls & Proxies*
www.icsa.org.uk/assets/files/pdfs/guidance/020228.pdf
- *Proxy Voting – Abstentions*
www.icsa.org.uk/assets/files/pdfs/guidance/040831.pdf.

2 "It seems generally accepted that one of his functions is to preserve order: if despite his efforts serious disorder persists, and he is denied any power of adjournment, what is he to do? The disorder will almost by necessity make it impossible for the meeting to pass a resolution for adjournment. The first duty of the chairman of a meeting is to keep order if he can. If there is disorder, his duty, I think, is to make earnest and sustained efforts to restore order, and for this purpose to summon to his aid any officers or others whose assistance is available.

If all his efforts are in vain, he should endeavour to put into operation whatever provisions for adjournment there are in the rules, as by obtaining a resolution to adjourn. If this proves impossible, he should exercise his inherent power to adjourn the meeting for a short while, such as 15 minutes, taking due steps to ensure so far as possible that all present know of this adjournment. If instead of mere disorder there is violence, I think that he should take similar steps, save that the greater the violence the less prolonged should be his efforts to restore order before adjourning.

In my judgment, he has not merely a power but a duty to adjourn in this way, in the interests of those who fear for their safety. I am not suggesting that there is a power and a duty to adjourn if the violence consists of no more than a few technical assaults and batteries. Mere pushing and jostling is one thing; it is another when people are put in fear, where there is heavy punching, or the knives are out, so that blood may flow, and there are prospects, or more, of grievous bodily harm. In the latter case, the sooner the chairman adjourns the meeting the better. At meetings, as elsewhere, the Queen's Peace must be kept."

For further discussion, see -

<http://oxcheps.new.ox.ac.uk/new/casebook/cases/Cases%20Chapter%208/John%20v%20Reers.doc>.

3 The Building Societies Act 1986 (Substitution of Specified Amounts and Modification of the Funding Limit Calculation) Order 2007 (SI No 860) www.bsa.org.uk/members/circular/6548.htm.

DOCUMENT RETENTION TIMES

This sub-section provides guidance on retention times for building society documents.

1. Introduction

This guidance is designed to help building societies in making decisions about the retention times in respect of documents and records that they keep.

It deals primarily with retention times, but also briefly covers some broad topics concerning retention policies. The guidance was first issued by the Building Societies Association in December 2004 and has been revised and updated.

It is intended to be of help to societies when they review their policies and procedures and is *not* of a regulatory nature; it contains guidance rather than recommendations.

This guidance relates to the society's own documents. It should always be borne in mind that documents and records belonging to third parties must be disposed of only in accordance with any relevant agreement, legal authority or the owner's consent.

2. Factors Governing Document Retention Times

(i) General

Even in this electronic age, vast amounts of paper documents are generated each year. Any business, including a building society, will have limits to its storage capacity and may need to resort to off-site storage with all its costs. Nowadays, there are more opportunities to retain documents in electronic form, which reduces the problem as far as those documents are concerned.

Indeed, nowadays, increasingly documents or records are not created in paper form but are generated electronically and remain in that form. Whatever the nature of the storage, a society must decide *how long* to retain the documents. **So why retain documents in the first place?**

There are various reasons for retaining the documents and the specific reason has bearing on how long to retain the relevant document. Requirements arise from all of the following -

- Legislation
- FSA regulatory requirements
- Statutory limitation periods
- The society's constitution
- Business needs and costs
- Data protection.

The FSA has fined firms for failing in their duties with regard to record keeping.

For example, the failures by Royal Bank of Scotland, which resulted in a fine of £750,000 in 2002, included the failure to obtain, or to retain, sufficient 'know your customer' documentation.

In 2008, the FSA fined Thinc Group limited £900,000 for, among other things, failing to take reasonable care to ensure that it had records to prove that advice it gave to sub-prime mortgage customers was suitable.

(ii) Legislation

Certain legislation prescribes various records that must be kept by building societies and sometimes provide minimum periods for retention of such records, either by express requirement or indirectly - for instance, by empowering the relevant authorities to demand documents for a certain period of time.

The main legislation potentially relevant to building societies is set out below. **NB:** Much of this law has been amended, but amending legislation is referred to only if relevant to document retention times.

Building Societies Act 1986

www.bsa.org.uk/members/policy/buildsoclegislation/bs_act.htm

- **Schedule 2, paragraph 2(1)** requires a building society to have a memorandum stating its purpose of principal purpose and certain other matters specified in paragraph 2(2). It is implicit that a society must retain its memorandum and would customarily retain copies of past versions.
- **Schedule 2, paragraph 3(1)** requires a building society to have rules regarding its internal regulation. Although it is not statutorily prescribed, societies customarily retain copies of past editions of their rules.
- **Section 68(1)** requires every society to maintain a register of transactions or arrangements with directors etc, falling within section 65(1), to be kept (for the *current financial year or any of the preceding ten financial years*).
- **Section 69(11)** requires a society to keep a register of certain particulars supplied to it by directors etc of interests in "business associates" providing relevant services - conveyancing, surveying/valuing, accountancy and insurance intermediary services. (These are to be kept in respect of the last financial year and each of the *10 preceding financial years*)
- **Section 71** requires every society to keep accounting records which –
 - explain the society's transactions
 - disclose, with reasonable accuracy and promptness, the state of the business of the society at any time
 - enable the directors properly to discharge the duties imposed on them by or under the 1986 Act (and, where applicable, under the International Accounting Standards Regulation) and their functions of direction of the affairs of the society

- enable the society properly to discharge the duties imposed on it by or under the 1986 Act (and, where applicable, under the International Accounting Standards Regulation).

(Section 71(9) states that accounting records must be kept for *6 years* from the date on which they were made.)

(Also see the FSA Handbook, below)

- **Schedule 2, paragraph 13** requires a society to maintain a register of names and (postal) addresses of its members. (This is a continuing requirement).
- **Society Rules** usually make provision for custody of documents (eg documents of title, mortgage deeds etc) and the release of such documents.

Child Trust Funds Regulations 2004 (SI 2004 No 1450)

www.opsi.gov.uk/si/si2004/20041450.htm

Regulation 31(1) of these Regulations requires a Child Trust Fund account holder, at all times, to keep sufficient records to enable the requirements of the Regulations to be satisfied.

Specifically, Regulation 31(2) requires an account holder to produce, when required to do so by the Inland Revenue, any –

- applications
- vouchers
- annual statements
- transfer notices

or electronic copies, within the period of *3 years* from when it was made, issued or given (notwithstanding a transfer of the account).

Civil Evidence Act 1995

The Civil Evidence Act 1995 and the Civil Procedure Rules deal with the admissibility of documents as evidence in civil proceedings. A document retention policy needs to take into account the possibility of documents having to be disclosed in the course of litigation. This is relevant, for example, to the documentation used in possession proceedings by a lender, and to litigation between a building society and a third party eg over a contractual matter.

Competition Legislation

The UK's competition regime, supervised and enforced by the Office of Fair Trading, is set out in the Competition Act 1998 and the Enterprise Act 2002. The OFT is a non-ministerial Government department established by statute in 1973. The OFT has produced a series of guides on the competition regime, including the following –

www.offt.gov.uk/shared_offt/business_leaflets/ca98_mini_guides/oft447.pdf

www.offt.gov.uk/shared_offt/business_leaflets/ca98_mini_guides/oft424.pdf

www.offt.gov.uk/shared_offt/business_leaflets/general/oft911.pdf

The 1998 Act prohibits anti-competitive agreements between two or more undertakings and abuse of a dominant position in the market. It lays down powers of investigation and

financial penalties. The 2002 Act made the OFT a corporate body, created a new criminal offence and provided stronger enforcement arrangements, including the disqualification of directors where the firm had breached competition law.

The OFT has stringent powers to enter premises and require production of documentation. It is also a criminal offence to destroy relevant documentation. Although the legislation does not prescribe retention times for specific documents, original documents that could be required for an investigation should be retained, as part of a wider document retention policy.

The Dormant Bank and Building Societies Accounts Act 2008

The Dormant Bank and Building Society Act 2008 became law on 25 November 2008. It provides statutory cover for banks and building societies to transfer money in unclaimed accounts to charity while protecting the rights of account owners to reclaim their monies. For more details, see www.bsa.org.uk/members/policybrief/blog100012.htm and www.bsa.org.uk/members/circular/6829.htm.

Section 10 of the Act defines a dormant account, in essence, as one where there have been no customer-initiated transactions for 15 years or more. The clock for accounts with fixed term maturities starts ticking at the end of the fixed term period. Societies will have to ensure that they retain appropriate account records but they will already do so as a matter of normal practice.

Finance Act 1998

By Schedule 18 to the Finance Act 1998, documents and supporting documents (receipts, records, contracts, vouchers, accounts, books, contracts etc) for corporation tax returns must be retained for *6 years* from the end of the period for which there may be a requirement to deliver a tax return.

A building society is a body corporate and so is within the definition of a company for the purpose of the charge to corporation tax on the profits of companies - www.hmrc.gov.uk/ct/new-company/who-is-liaable.htm#1.

Health and Safety at Work Act 1974

Section 2(3) of the 1974 Act requires all employers to have a general policy (in written form unless the organisation employs fewer than 5 staff) with respect to the health and safety at work of employees and arrangements for carrying out that policy. There are a number of Regulations under this Act requiring the retention of documents for certain periods of time (see page 26 below).

Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990 No 2231)

(subsequently amended, most recently by - www.opsi.gov.uk/si/si2001/uksi_20010404_en.pdf)

These Regulations prescribe the cases in which a building society is required to deduct income tax from dividend or interest payments. Regulation 15B (inserted by SI 2001 No 404) provides for the inspection of copies of documents by, the Revenue and, accordingly, societies are required to retain the relevant copies of the records for these purposes. (Regulation 15B(2) requires societies to preserve every certificate of non-liability to tax (Forms R85) for *2 years* after it has otherwise ceased to be required under the Regulations.)

Income Tax (Pay As You Earn) (Amendment) Regulations 2009 (SI 2009 No 588)

www.opsi.gov.uk/si/si2009/uksi_20090588_en_1

Regulation 91 states that an employer must preserve (in any form or by any means) for not less than 3 years after the end of the tax year to which they relate all PAYE records which are not required to be sent to HMRC.

“PAYE records” means all wages sheets, deductions working sheets, documents completed under regulation 46 (Form P46) and other documents and records relating to –

- the calculation of the PAYE income of the employees,
- relevant payments to the employees, or
- the deduction of tax from, or accounting for tax in respect of, such payments, and
-

all documents relating to any information which an employer is required to provide to HMRC under regulation 85 (Forms P11D and P9D).

Individual Savings Accounts Regulations 1998 (SI 1998 No 1870)

These Regulations, and certain amending legislation, specify the records to be kept by ISA account managers. HMRC requires ISA managers to retain a record of ISA accounts they close or transfer to another manager for 3 years after the date of closure or transfer (chapter 17.14a of the ISA guidance see www.hmrc.gov.uk/isa/isa-guidance-notes-2008.pdf). Other records including ISA applications and ISA accounts transferred in must be kept for six years.

Management of Health and Safety at Work Regulations 1999 (SI 1999 No 3242) www.opsi.gov.uk/si/si1999/19993242.htm

These Regulations require pre-employment health screening questionnaires to be kept for 3 years after the employment ends. They also require occupational health records (health surveillance and medical records relating to risk assessments or incidents occurring at work) to be kept for 40 years - this long period is because of asbestosis and similar conditions.

Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996 No 1715) www.opsi.gov.uk/si/si1996/Uksi_19961715_en_1.htm

Pension trustees must keep financial records, details of transfers into and out of the scheme, records of their meetings, and details of insurance policies purchased to protect members' rights when the scheme is winding up for at least 6 years from the end of the scheme year to which they relate.

Occupational Pension Schemes (Disclosure of Information Regulations) 1996 (SI 1996 No 1655) www.opsi.gov.uk/si/si1996/uksi_19961655_en_1

These Regulations specify the type of information to be provided to various interested parties, including members and potential members of pension schemes, either automatically or on request, together with the timescales within which the information must be provided. Clearly, if the relevant administration records are incorrect, the required data may not be provided at all, or, if it is provided, it may be inaccurate or its provision may be outside the required timescale.

Regulatory Reform (Fire Safety) Order 2005
(SI 2005 No. 1541) www.opsi.gov.uk/si/si2005/20051541.htm

These Regulations, among other things, require employers of five or more staff to carry out a fire risk assessment and to retain a record of it until a further assessment has taken place that renders it obsolete. The Department for Communities and Local Government has published a guide - www.communities.gov.uk/fire/firesafety/firesafetylaw/aboutguides/.

Control of Noise at Work Regulations 2005
(SI 2005 No. 1643) www.opsi.gov.uk/si/si2005/20051643.htm

These Regulations require employers to prevent or reduce risks to health and safety from exposure to noise at work. Employers must undertake, and record, a noise risk assessment. The Health and Safety Executive has provided guidance - www.hse.gov.uk/pubns/indg362.pdf.

Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (SI 1995 No 3163) www.opsi.gov.uk/SI/si1995/Uksi_19953163_en_1.htm

These Regulations require accident books, and accident records and reports to be kept for 3 years after the date of the last entry.

Retirement Benefits Schemes (Information Powers) Regulations 1995 (SI 1995 No 3103)
www.opsi.gov.uk/SI/si1995/Uksi_19953103_en_1.htm

Participating employers must usually keep relevant documents for 6 years from the end of the relevant scheme year. These include all books, documents and other records in his possession or under his control relating to any –

- monies received or receivable by an approved scheme or a relevant statutory scheme or paid or payable out of funds held under such a scheme
- investments or other assets held by the scheme
- annuity contract by means of which benefits provided under the scheme have been secured, or
- a person who is, or has been, a controlling director of a company which is an employer in relation to the scheme.

Statutory Maternity Pay (General) Regulations 1986 (SI 1986 No 1960)
www.opsi.gov.uk/si/si2005/20050989.htm

These Regulations require statutory maternity pay records, calculations, certificates or other medical evidence to be kept for 3 years after the end of the tax year in which the maternity period ends.

Statutory Sick Pay (General) Regulations 1982 (SI 1982 No 894)

These Regulations require statutory sick pay records, calculations, certificates, and self-certificates to be kept for 3 years after the end of the tax year to which they relate.

Taxes Management Act 1970

This Act contains a wide range of requirements in relation to retention of certain documents, including the retention of payroll and wages records for *6 years* from the end of the financial year to which they relate

Value Added Tax Act 1994

Section 58 and Schedule 11, paragraph 6 of the 1994 Act require organisations registered for VAT to keep records of all operations which affect the amount of VAT a business has to pay or can reclaim (*6 years*). The requirement covers a wide range of documents, business records and VAT account records.

Working Time Regulations 1998

(SI 1998 No 183) www.opsi.gov.uk/si/si1998/19981833.htm

These Regulations require most employers to keep records including those showing compliance with the relevant weekly working time limits and workers who have opted-out from the limit (*2 years; in the case of opt-outs: 2 years after the opt-out was rescinded or ceased to apply*).

(iii) FSA Regulatory Requirements

There are many record keeping requirements in the FSA's Handbook of Rules and Guidance. Broadly speaking, the records should be capable of being reproduced in the English language on paper. Note that the Handbook changes regularly and the current version is available at - <http://fsahandbook.info/FSA/html/handbook/>.

Schedule 1 to each of the sourcebooks and manuals that have record keeping requirements provide a summary of those requirements. The others make it clear (usually in a schedule) that they have no record keeping requirements (see eg PRIN Sch 1.1G).

The table below identifies the modules that have record keeping requirements likely to be relevant to building societies, but the applicable requirements will vary depending on an individual society's business operations. The table below provides a summary only – for details, check the Handbook itself.

FSA HANDBOOK OF RULES AND GUIDANCE: RECORD KEEPING REQUIREMENTS		
Provision	Commentary	Retention time
SYSC - 9	<p>These provisions set out the general rules on record keeping.</p> <p>A firm must keep orderly records of its business and internal organisation, which must be sufficient to enable the competent authority to monitor the firm's compliance with regulatory requirements (SYSC 9.1.1R)</p> <p>Subject to any other record-keeping rule in the Handbook, the records should be capable of being reproduced in the English language on paper (SYSC 9.1.4G)</p>	<ul style="list-style-type: none"> • MIFID business - at least 5 years (SYSC 9.1.2R) • Non-MIFID business - as long as is relevant for the purposes for which they are made
10.1.6R	Conflict of interest	5 years
14.1.53R	Prudential risk management and systems and controls	3 years, or longer as appropriate
GENPRU 1.2.60-1R	A firm's assessment of its financial resources	At least 3 years
1.3.22R	Valuation models for marking to model	Not specified
BIPRU 2.2.5G	Firm's internal capital adequacy assessment process	Not specified
5.2.3R; 5.4.11R(2); 9.5.1R(5)	Legal opinions confirming enforceability	Review conducted as necessary
5.2.9R	Risk management processes	Not specified
5.4.12R	Collateral procedures	Not specified
5.4.59- 60R	Volatility adjustments for financial collateral	Not specified
5.7.8R	System to manage concentration of risk arising from guarantees and credit derivatives	Not specified
7.10.53 – 54R	Material risks not captured in the firm's VaR model	Not specified
9.4.3R	Legal opinions for securitised exposures	Review conducted as necessary
9.13.12R(1)	Capital plan in case of early amortisation	Not specified
9.13.21R	Capital plan in case of either scheduled or early amortisation	Not specified
10.4.47R	Exposure to undisclosed counterparties	Not specified
13.6.48R	Operation of CCR management system	Continuous
13.7.6R(2)	Legal opinion regarding netting agreements	While transaction held
<p>COBS relates mainly to designated investment business and to business regulated by the Markets in Financial Instruments Directive. However –</p> <ul style="list-style-type: none"> • the rules and guidance on financial promotion (marketing activities, advertising etc) extend to deposit business, • certain disclosure and cancellation rules are applicable to cash deposit ISAs, • some provisions are applicable to the building society treasury management activities. <p>Therefore, each society should satisfy itself which of the record keeping requirements are material to its business. Schedule 1 of COBS contains a reminder of the numerous record keeping requirements in COBS. Those most likely to be relevant to societies' normal business include -</p> <ul style="list-style-type: none"> • 15.3.4R – which requires adequate records concerning the exercise of a right to cancel or withdrawal eg 3 years for an ISA • 4.11.1R(1) – which requires a firm to make an adequate record of any financial promotion it 		

	communicates or approves (other than a financial promotion made in the course of a personal visit, telephone conversation or other interactive dialogue) and retain it for the period – varying with the product – set out in 4.11.1R(3)	
	<ul style="list-style-type: none"> 4.11.2G – which suggests that a firm should consider maintaining a record of why it is satisfied that the financial promotion complies with the financial promotion rules (but it does not specify a retention period). 	
ICOB 1 Annex 1 G, Part 2 3.1R(3)	Record of election to comply with COBS rules for pure protection policies	Indefinitely
MCOB 3.10.1R; 3.10.2G(2)-(5); 3.10.3G(1)	Various items of information concerning each non-real time financial promotion	1 year from the date on which the ^{financial promotion} was last communicated
4.7.17R(1)(a) – (b)	Various items information regarding suitability of a regulated mortgage product to the borrower	3 years
4.8.7R	Scripted questions used in non-advised sales of a regulated mortgage product	1 year from the date on which the scripted questions were superseded by a more up-to-date record
4.6.11R	Notice of cancellation of certain mortgage products	3 years
5.4.19R and 21R	Various items of information relating to key facts illustrations (KFIs)	1 year
6.4.3R	Offer document and tariff of charges	1 year
7.4.2R	Start of contract disclosure	1 year
8.3.1R(1)	Scripted questions used in non-advised sales of an equity release product	1 year from the date on which the scripted questions were superseded by a more up-to-date record
8.3.1R(1)	Notice of cancellation.	3 years
8.5.22R(1)(a)-(b)	Various items information regarding suitability of an equity release product to the borrower	3 years
9.3.1R	Various details of KFIs in equity release transactions	1 year
9.5.2R	Offer document and tariff charges in equity release transactions	1 year
9.6.1R	Certain illustrations in equity release transactions	1 year
9.7.10R	Various start of contract disclosure in equity release transactions	1 year
11.3.1R(2)	Evidence to demonstrate customer's ability to repay in advance	1 year from the date on which the regulated mortgage contract is entered into, or the further advance provided
11.3.4R(2)	Record of a firm's responsible lending policy	1 year from the date on which the policy is replaced
13.3.9	Various items of information regarding dealings with customers in arrears or with a mortgage shortfall debt	1 year from the date on which the relevant payment shortfall or mortgage shortfall debt is cleared
BCOBS will come into force on 1 November 2009	BCOBS might contain record-keeping requirements	To be confirmed
MAR 2.7R	Price stabilising action	3 years
TC 3.1.1R	Records to demonstrate compliance with the training and competence rules	Various periods after an employee stops carrying on the activity eg at least 5 years for MiFID business and 3 years for non-MiFID business
SUP 12.9.1-2R	Appointment, amendment of contract, or termination of contract of an appointed representative	3 years from termination or amendment of the contract (5 years for tied agents)
4.3.17R	Data for actuaries	Not specified

Various	Certain activities carried on from a branch, or providing cross- border services, into another EEA State	Various
DISP 1.9.1R	Each complaint received under DISP 1.3- 8 and measures taken for its resolution	5 years for complaints relating to MiFID business and 3 years for others
COMP 10.2.10-11R	<p>Sufficient details to identify potential claimants for whom the separate £50,000 maximum payment limit applies, following –</p> <ul style="list-style-type: none"> • a merger between two building societies or a building society and another mutual society, or • a transfer of protected deposits pursuant to the property transfer powers under the Banking Act 2009. <p>Also see Compensation Sourcebook (Mutual Society Mergers and Protected Deposit Transfers under the Special Resolution Regime) (Amendment) Instrument 2009</p>	Implicit from the rules in COMP

(iv) Statutory Limitation Periods

- **General**

The law lays down time limits for legal actions to be brought, which means that a person with a claim (for instance, for damages for breach of contract or negligence) will lose it if he or she does not claim within the specified period. Limitation is a procedural rule that has to be raised by the defendant in proceedings. Limitation periods promote legal and business certainty and encourage potential litigants not to delay their claims unduly.

A limitation period usually starts to run from the date of the event (eg a breach of contract) that gave rise to the legal cause of action. In certain circumstances the start of the limitation period is delayed; for example, where the claimant was under a disability (such as where the claimant was below the age of majority) or where there was deliberate concealment of relevant facts by the defendant.

“Deliberate concealment” does not include situations where the defendant had acted *negligently*, was unaware of his breach of duty, and failed to disclose information for that reason – ***Cave v Robinson Jarvis & Rolf*** [2002] UKHL 18

If and when a society knows that litigation is possible, it should retain any documents that have a link with the subject matter of the potential proceedings. Normal destruction procedures should be suspended in relation to the relevant documents until it is clear that they will not be needed.

The documents should be retained in the appropriate form. Generally speaking, the courts are willing to accept, as admissible in proceedings, copies of documents in electronic form, such as CD ROM (sections 8 and 9 Civil Evidence Act 1995 and section 27 Criminal Justice Act 1988). However, in certain proceedings, original documents are required.

In an Australian judgment, ***McCabe v British American Tobacco*** [2002] VSC 73 a claim for negligence against a tobacco company accused of destroying documents potentially relevant to the case, the judge held that the company’s document retention policy was “primarily directed towards the risks of litigation”. However, the Victoria Supreme Court of Appeal overturned the judgment.

Limitation is relevant to document retention times because, unless there is some other reason for keeping documents longer (such as a statutory requirement or a business need), documents need not be kept longer than the relevant limitation period.

Whether they should be kept for *as long as* the relevant limitation period will depend on the nature of the documents (for instance, contracts, deeds, signed statements, compliance documents etc are more likely to need to be kept); the likelihood of litigation and of the costs, losses, liability etc that could arise from it; insurers’ requirements (if relevant); and a commercial judgment as to business need (space, cost of storage etc).

In 2002, the accountancy firm Arthur Andersen was found guilty in the United States of obstructing justice. Part of the case related to allegations that the firm had shredded documents relating to its client, the energy company Enron, prior to an investigation by federal regulators.

Limitation is governed by different legislation in England and Wales on the one hand and Northern Ireland on the other. However, the two regimes are very similar. In Scotland, significantly different rules apply.

- **England and Wales**

The legislation in England and Wales is the Limitation Act 1980 (as amended). The paragraphs below cover the limitation periods that are most likely to be relevant to building societies, although the 1980 Act prescribes limitation periods for other causes of action as well.

(a) **Actions related to mortgages**

Section 20 of the 1980 Act governs this topic. The table below summarises the relevant provisions –

Cause of action	Limitation period: from cause of action arising	Section of 1980 Act
Recovery of capital sum	12 years	20(1)
Recovery of interest	6 years*	20(5)
Possession	12 years**	15(1); 17; 38(7)
Foreclosure	12 years***	15(1); 20(2)(4)
*but 12 years after repossession and sale (<i>West Bromwich Building Society v Layworth</i> (1999) unreported).	** in building society mortgages, this is usually from the date of default specified in the mortgage deed or terms.	*** from the date of default, unless the lender was in possession after the right of foreclosure accrued, in which case the date is the date that possession ended (s.20(2)).

For more details, see the *BSA Guide to Residential Mortgage Law & Regulation* www.bsa.org.uk/docs/bsa_mortgage_law_and_regulation_guide.pdf and the BSA note on mortgage law and practice www.bsa.org.uk/docs/mortgages/bsa_note_on_mortgage_law_and_practice.pdf.

(b) **Actions to recover land**

The limitation period for an action to recover possession of land is **12 years** from the date on which the cause of action accrued ie when the land was taken into adverse possession (section 15). Generally speaking, once the limitation period has expired, the right to take action is lost. This usually means that the occupier obtains title ('squatter's rights'). Actions to recover the proceeds of the sale of land are also subject to a **12 year** limitation period (section 20).

(c) **Breach of contract**

The limitation period for an action founded on a simple contract (a contract not by deed) is **6 years** from the date on which the cause of action accrued – ie from the date of the breach of contract (section 5). The limitation period for actions on a "speciality" (such as a contract by deed) is **12 years** from the accrual of the cause of action (section 8).

There is a special limitation period for loan contracts that do not provide for repayment of the debt on or before a fixed or determinable date - **6 years** from the date of the written demand (section 6). This provision could be relevant to recovery of shortfalls after sale of mortgaged property.

(d) **Tort**

A tort is, in effect, any civil wrong other than a breach of contract. Well known torts include the torts of negligence, nuisance, and of defamation. The limitation period for an action founded on tort is **6 years** from the date on which the cause of action accrued (section 2). This normally means the date when the tort was committed. Under section 14A, there is a special time limit for negligence actions where facts relevant to the cause of action were not known at the date of accrual (ie so called “latent damage”). In such case, the limitation period is either **6 years** from the date on which the cause of action accrued or **3 years** from the date when the plaintiff had the knowledge required to bring the action (whichever period ends later).

The “knowledge required” means knowledge of material facts about the damage itself, that it was attributable to the alleged negligence, and the identity of the defendant. In some cases, the damage may be ‘latent’ or hidden. Under section 14B, there is an overriding limitation period (sometimes called a “long-stop”) in these ‘latent’ cases of **15 years** from the date on which the alleged negligent act or omission happened.

There are separate limitation periods for certain other specific torts, such as for defamation or malicious prosecution (**1 year** from accrual of the cause of action).

There is also a special time limit for actions in respect of personal injuries, where the action is for damages for negligence, nuisance or breach of duty including breach of contract. By section 11, the limitation period is **3 years** from –

- the date on which the cause of action accrued (ie when the tort was committed) or
- the date of knowledge (if later) of the person injured.

Section 14 defines “date of knowledge” as being the date on which the injured person knew of certain facts including that the injury was significant and the identity of the defendant.

(e) **Others**

The 1980 Act prescribes a number of other limitation periods, some of which could conceivably be relevant to building societies. For example, actions for sums recoverable by statute (**6 years** from accrual of cause of action – section 9); actions for contributions (**2 years** from the date of judgment – section 10); actions to enforce judgments (**6 years** from the date the judgment becomes enforceable – section 24); claims for trust property (**various periods** – sections 21-22).

There is usually no limitation period for criminal prosecutions (eg criminal sanctions in respect of regulatory breaches).

(f) **Proposed reform**

The Law Commission (Report No 270: *Limitation of Actions*) proposed radical changes to the law relating to limitation in England and Wales. The main proposals are that the rules should be broadly the same irrespective of the type of claim and that there should be an initial limitation period of 3 years starting from the date that the claimant knew, or ought to have known, that he or she had a legal claim against the defendant.

The Government accepted the recommendations in principle but, in view of the fact that they are about 8 years old, we may never see the legislation.

- **Northern Ireland**

The main provisions in Northern Ireland is the Limitation (Northern Ireland) Order 1989 (SI No 1339 (NI 11)) but, as noted above, the effect is broadly the same as in England and Wales.

- **Scotland**

The relevant legislation in Scotland is the Prescription and Limitation (Scotland) Act 1973 and Prescription and Limitation (Scotland) Act 1984. In Scottish law, there are two relevant concepts – limitation and prescription. As in English law, limitation is a procedural rule. Prescription is a rule of substantive law whereby certain rights and obligations are created ('positive' prescription) or extinguished ('negative' prescription) after a specified period of time.

There are two time prescription periods under the 1973 Act – 5 years and 20 years. The **5 year** period applies to a number of actions including breach of contract; in delict (tort); on bills of exchange, cheques etc. The **20 year** period applies to most other actions, including those relating to land and mortgages. There are some overlaps between coverage of the two periods. Also, there are special limitation provisions relating to personal injuries and defamation.

- **Ombudsman Complaints**

The COMP rules in the FSA Handbook (see pages 9 – 11 above) set time limits for consumers to refer complaints to the Ombudsman. After these time limits have expired, the business can choose to object to the Ombudsman looking at the complaint on the grounds that it is time-barred.

Generally, the time limits are as follows -

- six months from the firm sending the consumer a final response (which has to mention the six-month time limit); *and*
- six years from the event the consumer is complaining about (or – if later – three years from when they knew, or could reasonably have known, they had cause to complain).

Special rules on time limits apply to mortgage endowment complaints. Under the rules, the FOS has discretion to look at complaints that fall outside these time limits in "exceptional circumstances". An example of this might be if the consumer was incapacitated during the period when they could have complained.

(iv) The Society's Constitution

The Companies Act 2006 requires a company to keep minutes of general meetings, Board minutes and various other constitutional documents. For example, section 248(2) requires minutes of "all proceedings at meetings of its directors" to be kept for 10 years.

As noted above (see pages 3 – 4 above), the Building Societies 1986 Act sets out certain requirements in relation to records of dealing with directors, retention of accounting records and the register of members. It also requires a society to have a memorandum and rules. However, unlike the companies' legislation, the Building Societies Act 1986 does not contain express requirements relating to retention of a society's constitutional documents.

Normal practice among building societies is to retain the following documents *indefinitely* –

- Memorandum

- Rules (existing and previous)
- AGM minutes
- AGM notices
- Board minutes
- Board Committee minutes.

So far as Board or Board Committee meetings papers are concerned, individual societies take a view. Some keep the papers indefinitely; others keep them for a long period (say, 6-10 years).

AGM proxy and ballot forms will sometimes be kept for a year, until the subsequent AGM. Again, this is a decision for each society.

(v) Business Needs and Costs/Commercial Judgment

As explained above, a society must first consider whether there are any legislative or regulatory requirements to retain certain documents. Whether there are or are not, statutory limitation periods may be relevant. For example, even if there is a statutory requirement, but it falls short of the relevant limitation period, then the society should consider adopting the longer period in its retention procedures.

If a society is subject to litigation and cannot produce relevant documentation, it will be no comfort that the society had complied with the statutory requirements in respect of the retention of those documents.

A society should also consider whether it has taken on board any retention requirements voluntarily; for example, by contractual arrangement – this might be particularly true of insurance arrangements. Furthermore, a society might have taken on obligations by subscribing to a code of practice.

The possibility of HMRC raising a tax assessment should also be considered. Data protection requirements must also be taken into account – they may require that documents be kept for a *shorter* period than might otherwise have been considered appropriate (see pages 16 – 20 below).

A society may also want to consider the possibility of customer complaints that relate to procedures that were adopted many years ago; this became an issue, for example, with the pre-1988 endowment complaints and problems arising from a lack of historical records of procedures.

However, once legal requirements (if any), limitation and similar factors have been taken into proper account, there are a number of business factors that come into play, such as the society's own informational requirements, storage space and cost of storage. Of course, a great deal of storage is in electronic form anyway; for example, Revenue & Customs Forms R85 etc. If it has not already done so, a society might consider implementing a document retention and disposal policy (see pages 21 – 23 below).

(vi) Data Protection

- **Background**

The Data Protection Act (the 1998 Act) regulates the processing of information relating to individuals, including the obtaining, holding, use or disclosure of such information
www.opsi.gov.uk/acts/acts1998/ukpga_19980029_en_1.

The Information Commissioner's Office (ICO) is the UK's independent public body set up to protect personal information and promote public access to official information. The ICO has issued guidance for the private sector on the 1998 Act
www.ico.gov.uk/for_organisations/data_protection_guide.aspx.

Section 1 of the 1998 Act defines "data" as including not only information processed automatically (or recorded with the intention of being processed automatically) but also recorded as part of a "relevant filing system" or forming part of an "accessible record".

A "**relevant filing system**" covers manual files provided they are structured in such a way that specific information relating to a particular individual is readily available.

"**Personal data**" covers data relating to a living individual and includes an opinion about the individual.

"**Data controller**" means a person or persons who determines the purposes for which and the manner in which any personal data is processed.

"**Data subject**" means the individual who is the subject of personal data

"**Processing**" is defined under section 1 to mean obtaining, recording or holding information or data, or carrying out any operation or set of operations on it (namely, organisation, adaptation, alteration, retrieval, consultation, use, disclosure, dissemination, otherwise making available, alignment, combination, blocking, erasure, or destruction of the information or data).

Section 2 defines "sensitive personal data" which consists of information relating to the data subject's racial or ethnic origin, political opinions, religious beliefs, physical or mental health, sexual life and certain information relating to crimes or alleged crimes.

- **Data protection principles**

The eight data protection principles are summarised in the table below.

Personal data shall -

- (a) be processed fairly and lawfully,
- (b) be obtained only for one or more specified and lawful purposes and not processed incompatibly with those purposes,
- (c) be adequate, relevant and not excessive in relation to the purposes for which they are processed,
- (d) be accurate and, where necessary, kept up-to-date,
- (e) not be kept longer than is necessary for the purposes for which it is processed,
- (f) be processed in accordance with the rights of the data subject,
- (g) be protected by appropriate technical and organisational measures being taken against unauthorised or unlawful processing, accidental loss and damage,
- (h) not be transferred to a country or territory outside the European Economic Area unless it has adequate levels of protection for data subjects.

Part I of Schedule I to the 1998 Act. (Part II of Schedule I deals with the interpretation of each of the eight data protection principles.)

• **Processing of data**

The first data protection principle is that personal data shall be processed fairly and lawfully and, in particular, shall not be processed until one of the conditions in Schedule 2 is met. The conditions under Schedule 2 include the data subject's consent and that, in summary, the processing is necessary -

- for performance of a contract to which the data subject is a party
- for compliance with a legal obligation of the data controller
- to protect the vital interests of the data subject
- for the carrying out of certain official functions
- for the legitimate interests of the data controller (provided the processing will not prejudice the legitimate interests of the data subject).

In the case of sensitive personal data (see above) at least one of the additional conditions set out in Schedule 3 must also be met (these include, for example, the "explicit" consent of the data subject; ie "opting in" as opposed to a negative option).

• **Rights of data subjects**

Part II of the 1998 Act governs rights of data subjects and others. The fundamental right is –

“to be informed by any data controller whether personal data of which that individual is the data subject are being processed by or on behalf of that data controller” (section 7(1)(a)).

The data subject has additional rights to be given a description of the personal data, the purposes for which it is being processed and the recipients or classes of recipients to whom they are or may be disclosed.

In certain circumstances, where the processing is by automatic means, relates to the evaluation of the data subject (performance at work, creditworthiness etc) and is likely to constitute the sole basis of any decision significantly affecting him, he is entitled to be informed by the data controller of the "logic involved in that decision-taking". (Certain qualifications on the right are set out in sections 7 and 8). The data subject is entitled to receive all the relevant information on payment of a single fee.

Certain rights were introduced by the 1998 Act -

- to prevent processing likely to cause damage or distress
- to prevent processing for direct marketing purposes
- rights in relation to automated decision-taking.

These rights are conferred, respectively, by section 10, 11 and 12 of the 1998 Act.

The right to prevent processing likely to cause damage or distress includes damage or distress to a third party and a defence for the data controller exists where certain of the conditions in Schedule 2 apply.

The third right precludes data controllers from making decisions, based solely on the processing by automatic means of personal data, which significantly affect an individual. An obvious example of where this could affect financial institutions is automated credit scoring. However, there is a defence if steps have been taken to safeguard the legitimate interests of the data subject (for example, by allowing him to make representations).

The data subject's remedies for breach of his rights include compensation (under section 13) and rectification, blocking, erasure or destruction of the offending data (under section 14).

- **Notification by Data Controllers**

Part III of the 1998 Act deals with notification by the data controller. The basic position is that, subject to certain exemptions (see below), it is a criminal offence for personal data to be processed unless there is an entry in the register maintained by ICO in respect of the data controller. To be included on the register, a data controller must notify the ICO, giving registrable particulars and other information in accordance with notification regulations. Data controllers are under a duty to notify the ICO of changes to the entry in the register.

- **Exemptions**

Part IV sets out a range of exemptions from the data protection principles, the rights of data users and others, and the notification requirements. These exemptions include national security; prevention and detection of crime; health, education and social work; certain regulatory activity; journalism, literature and art; research, history and statistics; disclosures required by law or in connection with legal proceedings etc; personal, family or household purposes; and a number of miscellaneous exemptions set out in Schedule 7 to the Act.

- **Enforcement**

Part V deals with enforcement. The Commissioner has certain powers including the service of enforcement notices, requiring a data controller to take or refrain from taking certain steps, and information notices, requiring the data controller to furnish certain information. Part V also covers appeals to the Data Protection Tribunal.

- **Relevance to document retention**

Building societies are required to implement all aspects of the data protection legislation relevant to their operations. This has ramifications going much wider than the scope of this Guide. However, certain elements of the legislation can be identified as being particularly important in the context of document retention times –

(i) **The fifth principle**

The fifth data protection principle states that records containing personal data processed for any purpose or purposes must not be kept longer than is necessary for the purpose or purposes for which they were created.

There is a lack of legal guidance on what the principle means in practice. Guidance on the Act, provided by the Information Commissioner www.ico.gov.uk/, states that to comply with the fifth principle, data controllers will need to review their personal data regularly and to delete the information that is no longer required for their purposes.

The Act does not specify actual time limits because it is for the data controller to justify the length of time the data should be held. For example, limitation periods in respect of possible claims will be relevant to certain documents.

A good example of the application of the fifth principle is employment of staff and an employee is the data subject. For instance, if the employee leaves the data controller's employment, the end of that relationship will not necessarily mean that the data controller should delete all personal data relating to that employee. Certain records might need to be retained; for example –

- for references, if requested in the future
- details of pension arrangements
- for defence of potential legal claims.

(ii) **Data should not be usually kept indefinitely (section 33(3))**

There are certain exceptions to this provision; for example, where it is processed for historical, statistical or research purposes.

(iii) **Employment records**

The Information Commissioner has published the *Employment Practices Data Protection Code* and also a “quick guide” to the Code.

- Code - www.ico.gov.uk/upload/documents/library/data_protection/detailed_specialist_guides/employment_practices_code.pdf.
- Quick Guide – www.ico.gov.uk/upload/documents/library/data_protection/practical_application/quick_guide_to_employment_practices_code.pdf.

The Code is written primarily for businesses where the employment of staff constitutes a significant activity, though much of it will be relevant to any employer. It contains a number of recommendations relevant to retention times (see section 2.15), including the following –

- Adopt a ‘risk analysis’ approach to retention policy. Consider how often particular categories of information are accessed in practice. Consider the realistic implications for the business,

staff and former staff, should certain information that is rarely accessed occasionally be unavailable.

- Base any decision to retain a record on the principle of proportionality; for example, records on very large numbers of employees should not be kept for a lengthy period simply because one might, at some point, question an aspect of his or her employment.
- Records should not be kept beyond the standard retention time unless there is a business justification for doing so.
- Eliminate personal information that is no longer of any relevance, once the employment relationship has ended.
- Ensure that information on criminal convictions of employees, if any, are deleted once the conviction is spent under the Rehabilitation of Offenders Act 1974.

(iv) **Exemptions**

As already noted, Part IV of the Act sets out a range of exemptions from some or all of the data protection principles, the rights of data users and the notification requirements. Where an exemption applies, it may be prudent or necessary to keep records longer than would have been the case had the Act applied. However, each exemption must be examined carefully as the nature and scope of each differs.

Exemptions that are most likely to be relevant to building societies include –

- prevention of crime
- the processing of data in respect of regulatory activity
- research, history and statistics
- information made available to the public by or under enactment
- disclosures required by law
- disclosures made in connection with legal proceedings
- confidential references given by the data controller
- management forecasts and planning
- negotiations with a data subject
- corporate finance
- legal professional privilege.

3. A Document Retention and Disposal Policy

(i) Introduction

It is prudent for each society to have its own document retention and disposal policy. The complexity of the policy will depend very much on the size of the organisation but each society, as a minimum, needs to ensure that it complies with legal requirements.

Societies will presumably, as part of their normal business operations, have already dealt with this task. This Guide does not provide detailed information on retention policies or on wider record management principles, except length of retention but, as well as deciding the length of retention, a society will in practice consider the matters set out below.

(ii) Broad Framework of the Policy

The objectives of the policy should be identified, such as to –

- ensure legal compliance
- be capable of complying with potential disclosure requirements in respect of litigation, investigations by regulators, competition authorities etc
- meet the society's information needs (obviously, including commercial needs) and reduce the need to reinvent the wheel every few years
- be certain that records are kept in an appropriate form – this helps ensure minimisation of costs, benefits the circulation of information within the business, helps facilitate admissibility in court if needed etc
- ensure that the policy is proportionate, ie as straightforward and simple as reasonably possible with storage costs kept to a minimum and amendment of the policy details is as simple as possible (but without jeopardising the other objectives).

(iii) The Creation of a Retention Schedule

The objective is to ensure that a clear, well-defined set of procedures may be put in place. The BSI *Guide to Developing a Retention and Disposal Schedule for Business Information* specifies the following benefits of introducing a retention schedule –

- supports the records retention and disposal policy
- frees up manual storage space by removing unnecessary information
- frees storage space on hard drives and servers by removing unnecessary data, saving costs
- improves access to current records
- helps 'legitimise' appropriate destruction of information
- can save on staff costs, as they do not have to spend as much time searching
- ensures that the correct information receives the appropriate level of protection

www.bsi-global.com/en/Shop/Publication-Detail/?pid=00000000030154438.

The ICSA Guide to Document Retention recommends the conduct of an information survey (or audit) to collect, or update, information about records held within the organisation and about the effectiveness of existing arrangements www.icsabookshop.co.uk/disp.php?ID=121.

(iv) Procedures in Relation to Different Categories of Document

It is important to –

- identify which documents fall into which categories, so that they may then be earmarked in relation to retention times
- decide methods of storage and destruction including arrangements to stop the process if, for example, legal proceedings are pending ease of retrieval
- establish audit requirements
- avoid of unnecessary duplication etc.

(v) Line-manager Responsibility

Line manager responsibility should be defined. For instance, the manager responsible for human resources might be in charge of personnel records, or the manager responsible for finance might be in charge of accounting records – much will depend on the society's size, operational arrangements and staffing.

(vi) Storage Methods

How the documents are stored will depend on a combination of the reasons - legal requirements, business needs etc - for storing them in the first place (see above) and the physical and electronic storage facilities available to the society.

(vii) Retained Document Access and Security

Depending on the size of the society and its operational needs, the possibility of introducing arrangements for centralised access to all retained files might be considered. This might not suit the particular business (especially in the case of a small society) but, however the documents are stored and accessed, there need to be proper arrangements to ensure both the physical security of the documents and security of access.

Back-up arrangements also need to be considered, for example in case of computer failure, fire etc.

(viii) Destruction/disposal Methods and Responsibility

The destruction method, if any, will need to be decided. Obviously, there are possible legal and reputational risks in insufficiently secure destruction of certain documents. This is equally true of electronically stored documents, for example when old computer hard drives are disposed of and in view of the fact that deleted information can be reconstructed.

Whether paper documents need to be shredded and the destruction of electronic media such as disks etc that contain personal information are other important considerations.

Appropriate supervision arrangements for destruction of documents etc also need to be decided.

(ix) Destruction Records

A society might also consider how to record that the destruction has taken place. The record would not reproduce personal information but would usually be "generic", for example referring to the types of documents, periods they covered etc.

(x) Staff Awareness

Relevant staff will need to be aware that there is retention and destruction policy and to be able to refer to it when necessary. Otherwise, there is a risk that important documents might be inadvertently destroyed.

4. Further Sources of Information

Further sources of information on document retention times, and the wider subject of document management, retention and disposal, include –

British Standards Institute (BSI)

BSI is the national standards body of the UK. It produces standards in a range of area, including a number relating to document management and retention.

The BSI *Code of Practice for Legal Admissibility of Information Stored Electronically* (BIP 0008 – 1:2008) is helpful in ensuring that electronically stored information will be admissible as evidence in court and given due weight.

The BSI *Guide to Developing a Retention and Disposal Schedule for Business Information* (BIP 0067:2006) is a general guide to retention scheduling.

The BSI website has a search facility for finding and purchasing copies of standards.

BSI
389 Chiswick High Road
London W4 4AL
Phone: 020 8996 9001
www.bsigroup.co.uk
email: cservices@bsigroup.com

Chartered Institute of Personnel and Development (CIPD)

CIPD is the professional body for those involved in the management and development of people. Its mission statement is to lead the development and promotion of good practice in the field of the management and development of people, for application both by professional members and their organisational colleagues; to serve the professional interests of members; and to uphold the highest ideals in the management and development of people.

The CIPD also issues helpful guidance on the retention of personnel and other related records, including *Retention of Personnel and Other Related Records* (revised January 2009).

CIPD
151 The Broadway
London SW19 1JQ
Phone: 020 8612 6200
www.cipd.co.uk

Information Commissioner's Office (ICO)

The ICO, among other things, promotes good information handling and enforces data protection and freedom of information legislation, and also produces certain codes of practice and other materials relevant to document retention.

Most notably, *The Employment Practices Data Protection Code* deals with, among other things, employment records.

The Information Commissioner
Wycliffe House
Water Lane
Wilmslow
Cheshire SK9 5AF
Phone: 01625 545 700
www.ico.gov.uk

HM Revenue & Customs (HMRC)

HMRC produces a wide range of guides, some which are relevant to documentation that needs to be retained for tax purposes – www.hmrc.gov.uk/index.htm.

Institute of Chartered Secretaries and Administrators (ICSA)

ICSA is the professional body for Chartered Secretaries, who work as company secretaries and in other senior positions in many different types of organisation. Among other things, ICSA produces useful guidance on corporate governance and on document retention.

The ICSA Guide to Document Retention (2nd edition) by Andrew C Hamer 2008, provides a very good overview of the law and best practice relating to the retention and storage of key business documentation.

ICSA
16 Park Crescent
London W1B 1AH
Phone: 020 7612 7020
Email: info@icsa.co.uk
www.icsa.org.uk

Public Record Office (National Archives)

The National Archives (formerly the Public Records Office) manages the national archives and is responsible for looking after the records of central government.

It also provides useful guidance for public bodies on records management, including electronic records management, some of which could (but not all eg Freedom of Information Act requests) equally be applicable to the private sector; see www.nationalarchives.gov.uk/recordsmanagement/advice/schedules.htm.

The National Archives
Kew
Surrey TW9 4DU.
Phone: 020 8876 3444
www.pro.gov.uk/

Records Management Society of Great Britain

The Records Management Society of Great Britain organises meetings and training programmes concerning records and information. Membership is open to anyone concerned with records or information.

Among other things, it has published a Code of Practice for Records Managers and Archivists (2007).

Records Management Society of Great Britain
Benchmark Communications
14 Blandford Square
Newcastle upon Tyne NE1 4HZ
Phone: 0191 244 2839
E-mail: info@rms-gb.org.uk
www.rms-gb.org.uk

5. Sample Retention Schedule

It is not practicable to prepare a retention schedule applicable to all building societies. This is because of the range of sizes, operations and products among societies; their different head office, branch and group structures and organisations; and because different commercial decisions will be taken in respect of business needs from one society to another.

However, the tables that follow show what a building society retention schedule might look like in respect of a cross-section of document classifications. A practical schedule would, of course, go into more detail on individual document types.

The tables below include the headings 'document', 'retention period' and 'source'. In practice, a retention schedule could also include columns headed –

- **'storage method' or 'format'** (stating the format for retention, for instance whether the document is to be retained in paper or electronic form and, if the latter, the specific format),
- **'line manager responsibility'** and,
- if the schedule extends to disposal of the documents, a reference to **'disposal method'** or something similar.

Some schedules will give reference numbers to individual documents. This might help with classification, especially in larger businesses.

In the tables below, where there is no specific legal requirement, a range of times is sometimes given under 'retention period' – this reflects the fact that different societies will make different commercial decisions on the matter. The reference number in the third column refers back to the relevant page of this Guide.

Where a period is indicated by limitation (eg 6 years), some organisations add an additional year as an extra safety margin (eg 7 years).

Where the suggested period is indefinite, this is usually based on the common practice of archiving the type of document in question.

Constitutional and Senior Management

DOCUMENT	RETENTION PERIOD	SOURCE
Memorandum	Indefinitely	Common practice
Rules	Indefinitely	Common practice
AGM minutes	Indefinitely	Common practice
AGM notices	Indefinitely	Common practice
Board minutes	Indefinitely	Common practice
Board Committee minutes	Indefinitely	Common practice
Board and Board Committee papers	6 - 10 years	Common practice
AGM proxy and ballot forms	1 year	Common practice
Register of members	Continuing requirement	Schedule 2, paragraph 13 to Building Societies Act 1986 ³
Business and internal organisation	5 years (MiFID) or "as long as relevant" (non-MiFID)	FSA SYSC 9.1 ¹⁹
Conflict of interest	5 years	FSA SYSC 10.1.6R
Register of transaction with directors etc	Current year and 10 previous financial years	Section 68 Building Societies Act 1986 ³
Register of particulars in respect of business associates	Current year and 10 previous financial years	Section 69 Building Societies Act 1986 ³
Other Registers (officers, charges etc)	Indefinitely	Common practice
Significant policy papers	Indefinitely	Common practice

Contracts and Marketing

DOCUMENT	RETENTION PERIOD	SOURCE
Contracts by deed	12 years after contract performed	Limitation
Other contracts	6 years after contract performed	Limitation
Contracts relating to building construction, repair, maintenance etc	15 years after contract performed (latent damage long-stop)	Limitation
Literature and product leaflets	6 years	Limitation *

* But note the risk of Ombudsman complaints where the normal limitation periods may not apply in the usual way and marketing literature may provide important evidence.

Data Protection

DOCUMENT	RETENTION PERIOD	SOURCE
Consents for processing of personal and sensitive data	For as long as data processed and held and subject is alive	Data Protection Act ²²

Health and Safety

DOCUMENT	RETENTION PERIOD	SOURCE
Statement of general policy	If amended, previous version kept at least 6 years, possibly indefinitely	Health and Safety at Work Act 1974; Limitation
Records of consultations with safety committee	6 years	Limitation
Accident Book	3 years (from date of each entry)	Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 ⁷
Pre-employment health screening questionnaires	3 years after employment ends	Management of Health and Safety at Work Regulations 1999 ⁶
Occupational health records	40 years	Management of Health and Safety at Work Regulations 1999 ⁶
Records relating to asbestos	40 years	Control of Asbestos at Work Regulations 2002 *

* although unlikely to be relevant to building societies, there are other statutory requirements necessitating very lengthy retention of documents, where similar hazards become evident (eg regarding ionising radiation, lead etc).

Information Management *

DOCUMENT	RETENTION PERIOD	SOURCE
Key documents eg policy documents, retention and disposal schedules, procedure manuals etc	Indefinitely	The BSI Code (see below)
Operational logs	As long as any information retained on the system still exists	The BSI Code (see below)
Records relating to storage	2 – 6 years, depending on item	The BSI Code (see below)

* This is a very specialist subject and the table above provides a brief overview only – for more details, see The BSI Code of Practice for Legal Admissibility of Information Stored Electronically (BIP 0008 – 1:2008)

Insurance

DOCUMENT	RETENTION PERIOD	SOURCE
Record of election to comply with COBS rules for pure protection policies	Indefinitely	FSA ICOBS 1 Annex 1G ¹⁸
Policies and correspondence (eg regarding claims)– <ul style="list-style-type: none"> • public liability • product liability • employers' liability • indemnity (crime, professional etc) • mortgage-related (block buildings, block contents, mortgage indemnity guarantee etc) 	Until claims barred and all outstanding claims settled (may depend on policy terms, but 3 years after lapse or settlement is common). Possibly, <i>much</i> longer (eg 40 years) in cases of a policy required to be kept by statute eg employer's liability insurance certificate. Where policy effected on 'claims made' basis, there will be a set period for claims. Note – where the insurance e was compulsory (ie legal requirement) the main paperwork (at least the certificates should be retained as long as practicable, in case of regulatory investigations.	Various, including limitation, commercial reasons and possible regulatory investigations.

Money Laundering

(also see Mortgages, and Savings and Investments)

DOCUMENT	RETENTION PERIOD	SOURCE
Customer identification	5 years from end of relationship	JMLSG Guidance chapter 9 *
Transactions		
Internal and external reporting		
Information not acted upon		
Training and compliance monitoring		

* [www.jmlsg.org.uk/content/1/c4/98/00/Final Part I 030306.pdf](http://www.jmlsg.org.uk/content/1/c4/98/00/Final_Part_I_030306.pdf)

Mortgages

DOCUMENT	RETENTION PERIOD	SOURCE
Mortgage Regulation	Various provisions	FSA MCOB ¹⁹
Customer's Mortgage File (comprising core items* - <ul style="list-style-type: none"> • application form • valuation report • title report • references • mortgage offer) 	6 years after redemption *	Limitation
Mortgage not proceeding	3 months from date of decline/withdrawal	Common practice
Possession files	6 years after sale	Limitation

* The contents of a mortgage file will vary from one society to another. In some cases, non-core items will be retained for only a short period (eg one month) after the mortgage is completed. What is core or non-core is also a matter for each society to decide. The experiences in relation to complaints about endowment mortgages will, in practice, lead to a closer examination of which items should be retained and also whether they should be retained longer than the normal limitation period would indicate.

Pensions *

DOCUMENT	RETENTION PERIOD	SOURCE
Various retirement benefits scheme documents	6 years	Retirement Benefits Schemes (Information Powers) Regulations 1995 ⁷
Occupational pension scheme records	6 years	Occupational Pension Schemes (Scheme Administration) Regulations 1996 ⁷
Minutes of meetings of trustees	Indefinitely	Common practice
Actuarial reports	Indefinitely	Common practice
Pension scheme trust deeds and rules, annual accounts etc	Indefinitely	Common practice
Pensioners' records	12 years after benefit ceases	Limitation

* see the Pensions Regulator: *Record-keeping: A consultation document* (July 2008)
www.thepensionsregulator.gov.uk/pdf/RecordKeepingConDoc.pdf

Personnel/Human Resources
(also see *Health and Safety, Taxation, and Pensions*)

DOCUMENT	RETENTION PERIOD	SOURCE
Training and Competence	3 or 5 years	FSA TC ²⁰
Working time records	2 years after opt-out rescinded or ceased to apply	Working Time Regulations 1998 ⁸
Statutory maternity pay records etc	3 years after end of tax year in which maternity leave ends	Statutory Maternity Pay (General) Regulations 1986 ⁷
Statutory sick pay records etc	3 years after end of relevant tax year	Statutory Sick Pay (General) Regulations 1982 ⁷
Payroll, wages, bonuses and expense account records	6 years	Taxes Management Act 1970 ⁷
Job application forms and interview notes (unsuccessful applicants)	6 months - 1 year	Common practice *
Individual employee's records (references, qualifications, contract, changes to contract, training, assessments, disciplinary, redundancy, resignation etc)	6 years after employment ends * *	Limitation/Data Protection
Annual leave records	2 years	Common practice
Parental leave records	5 years from birth/adoption or 18 years if child receives disability allowance	(See Maternity and Parental Leave (Amendment) Regulations 2002)
Life assurance expression of wish records	6 years after employment ends or death	Limitation
Travel claims and authorisations	6 years	Limitation
Senior executives' records	6 years after employment ends	Limitation

* 3 months used to be fairly common, but increasing litigation and anti-discrimination legislation (6 months) and the limitation period for defamation (1 year) indicate longer periods.

** But the simple facts of employment (dates of appointments, positions held will be kept much longer, possibly indefinitely, for references, confirmation of employment etc. Sometimes certain records might also be kept longer for historical purposes.

Property

DOCUMENT	RETENTION PERIOD	SOURCE
Title deeds	Until property sold – copies should be kept for 6 years after that	Limitation
Leases	15 years after expiry	Limitation
Consents eg planning, listed buildings etc	Until property sold	
Maintenance records	15 years	Limitation

Prudential

DOCUMENT	RETENTION PERIOD	SOURCE
Prudential risk management systems and controls	3 years, or longer as appropriate	FSA SYSC 14.1.53R
Assessment of financial resources	At least 3 years	FSA GENPRU 1.2.60-1R
Various	Usually not specified	FSA GENPRU and BIPRU various

Public Relations *

DOCUMENT	RETENTION PERIOD	SOURCE
Press cuttings and other media reports affecting the society	1 - 6 months	Entirely custom and practice – will vary with each organisation (longer periods where the piece directly relates to the society). NOTE: copyright and terms of agreement with relevant authority eg newspaper licensing
Media releases, correspondence with media etc	6 years	Largely limitation
PR policy documents eg PR strategy, its implementation etc	Indefinitely for key papers	Common practice for any major policy documents
Guides to media contacts	When superseded	Common practice
Events	1 year after the event for administrative correspondence and papers, leading up to 6 years for feedback, results etc	Largely common practice (possibly limitation in certain cases)
Donations and sponsorship	6 years	Limitation (also see Tax)

* There are no specific legal requirements in this area, so it is very much a matter of custom, practice and business choice. The Records Management Society of Great Britain has produced guidance on press and PR document retention, but it should be borne in mind that this is intended for the public sector www.nationalarchives.gov.uk/documents/sched_press.pdf

Press adverts can be obtained from the Newspaper Library (part of British Library www.bl.uk/) or from local history libraries. Press articles themselves can be accessed via services such as Lexis Nexis.

Savings and Investments

DOCUMENT	RETENTION PERIOD	SOURCE
Notice of cancellation of cash deposit ISA	3 years	FSA COB 15.3.4R ¹⁹ FSA BCOBS 6.2.3R (from 1 November 2009)
Child Trust Fund records	3 years	Child Trust Funds Regulations 2004 ⁴
Customer files	6 years after closure	Limitation
Paid cheques	6 years	Limitation
Stopped cheques	6 years	Limitation
Deposit/withdrawal slips	6 years	Limitation
Standing order/direct debit instructions	6 years	Limitation
<p><i>Note – Dormant accounts (page 230 above)</i></p> <p><i>BCOBS might contain record-keeping requirements (from 1 November 2009)</i></p>		

Taxation and Accounts *

DOCUMENT	RETENTION PERIOD	SOURCE
Corporation Tax records	6 years	Finance Act 1998 ⁶
VAT records	6 years	Value Added Tax Act 1994 ⁷
PAYE records (bit see above for payroll records – 6 years)	3 years * * *	Income Tax (Pay As You Earn) Regulations (Amendment) 2009 ⁶
Certificates of non-liability to tax	2 years	Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 as amended ⁶
Record of transferred ISAs	3 years	Inland Revenue PEP & ISA Guidance Notes ⁶
Society Report and Accounts	Indefinitely	Common practice
Society Interim Report and Accounts	Indefinitely	
General accounting records as required by section 71 Building Societies Act 1986 (bank statements and reconciliations, journal rolls, branch accounting forms etc)	6 years	Section 71(9) Building Societies Act 1986

* See *Changes to how HM Revenue & Customs carries out compliance checks from 1 April 2009* www.hmrc.gov.uk/about/new-compliance-checks.htm. Note: longer periods might be appropriate in certain cases eg where there is an enquiry by HMRC.

** See www.hmrc.gov.uk/ct/keeping-records/record-keeping.htm#2.

*** But also form part of the records required to be kept for 6 years (see Personnel/Human Resources: Payroll and wages records).

Miscellaneous

<i>DOCUMENT</i>	<i>RETENTION PERIOD</i>	<i>SOURCE</i>
Treasury Records	6 years	Limitation
Certificates of registration of trade/service marks	6 years after registration ends	Limitation
Market Conduct	Various provisions	FSA MAR Schedule 1 ²⁰
Appointed Representatives: details	3 years	FSA SUP 12.9.1 – 2R ²¹
Branch cross-border/EEA activities	3 years	FSA SUP various
Records of customer complaints	5 years for complaints relating to MiFID business; otherwise 3 years	FSA DISP 1.9.1R
See pages 9 – 11 above for further information about the record-keeping requirements in the FSA Handbook		

* Also see FSA Handbook of Rules and Guidance – Market Conduct (MAR).

INFORMATION GOVERNANCE

This sub-section provides guidance on managing the security of members' personal information and other information classed as "personal data" by the Data Protection Act 1998.

1. Introduction

This section focuses on the governance of the security of personal information and other information that a building society might wish to keep confidential for commercial reasons. It is designed to help building societies in developing their own regime information governance. The majority of day-to-day security activity is on an operational level, but effective management oversight and contingency planning for data loss incidents should be an integral part of the information governance regime.

Examples of "Personal data" include -

- Members' / customers' personal data contained in account records.
- The personal data of third parties customers held by you eg third party mortgage processing.
- Personnel records for employees, contractors and temporary staff.
- Directors' personal details.

As previously, this is intended to be of help to societies when they review their policies and procedures and is *not* of a regulatory nature; it contains guidance rather than recommendations.

2. Why is Information Governance Important?

It is a basic assumption to building society members that their society will keep their personal data secure. Hence, the high legal and regulatory burden on societies and other data controllers to have suitable risk assessment and controls in place (see Section 4 below).

Where personal data is lost or stolen, incidents will have a direct impact on the reputation of the affected firm as a safe place to do business with and on confidence in the whole industry. Restoring your reputation after the event is expensive, intrusive and absorbs resource and management time that could be better employed elsewhere.

Protecting personal information is also important in reducing fraud – lost / stolen ID data is used to commit fraud in a variety of ways and other crimes such as people trafficking. Organised criminal gangs lead the appropriation of personal ID for fraud and ID data itself has become a tradable commodity within the criminal underworld.

An example of how stolen ID data is used to commit fraud

In 2008, the FSA fined Norwich union £1.26m for failing to spot an ID fraud in which customers had lost £3.3m. Using illegally obtained ID data, a criminal gang had posed as the genuine customers contacting Norwich Union by telephone to cash in their policies and diverted the proceeds.

3. What Should Information Governance Cover?

A building society's information governance regime needs to cover a number of types of activity – it is not solely an operational or IT matter but a combination of 3 levels of control activity –

- **Data Security** – the operational controls needed to maintain day to day security.
- **Data Management** – policies and training supporting proper use / care of personal data and ensuring that employees are aware of their responsibilities in this area.
- **Policy Oversight** – How the directors and executive management discharge their responsibility to assess the risks of data loss and take reasonable steps to prevent that risk occurring.

The table below shows the specific activities that each of the above covers.

Data Security	Data Management	Policy Oversight
<ul style="list-style-type: none"> • Data security controls within systems & processes • Access rights • Passwords & user accounts • Authentication • Data back up • Encryption • Key logging devices • Laptops • Portable storage media • Storage of paper & other hard files • Premises security • Proper disposal of data • Transfer of data to / from third parties. 	<ul style="list-style-type: none"> • Data handling policy • Data Protection Act compliance responsibilities • Data retention & disposal policy (see pages 227-260 above) • Recruitment & vetting • Employee training & awareness • Internet / e,mail access policy • Managing third party suppliers • Data loss reporting. 	<ul style="list-style-type: none"> • Risk assessment • Corporate attitude • Executive roles & responsibilities for oversight • Benchmarking • Monitoring & communicating organisational performance • Audit & compliance monitoring • Contingency plans for loss / theft • Incident management.

Good practice in terms of policy oversight is to have a specific senior manager in charge of information governance, reporting to the Board / and / or the Audit committee. Also, that the relevant senior manager has access to support from every business area – often achieved by a senior level information governance committee.

In 2007, Nationwide was fined £980,000 following the theft of a laptop with members' personal data from an employee's home.

The fine was not primarily for the loss of the data but for failures in data management and policy oversight, particularly the failure to check that employees understood their information governance responsibilities and not having a contingency plan in place for the loss.

4. Information Governance Arrangements with Third Parties

It is important that building societies wanting to use third parties to process data on their behalf assess the information governance risks involved and that are confident that the third party organisation has a suitable information governance regime in place to manage those risks before. The Society will remain the data controller for any personal data passed to a third party and so is ultimately accountable for loss / theft involving them.

Where third parties process data on a society's behalf – e.g. bulk mailing and printing, data mining, archiving, waste disposal, recruitment and employee vetting – the society has responsibilities under the Data Protection Act to –

- Select the partner with due consideration to their information governance regime.
- Include appropriate information governance conditions within the contract of engagement.
- Include a specific focus on information risks & controls as part of due diligence.
- Actively use their contractual rights to monitor risk and develop appropriate solutions.

The FSA expects that this approach is applied to all other servicing arrangements which involve third party personnel proximity to personal data – eg couriers, security, cleaners, IT maintenance.

Societies also have responsibilities not to allow the transfer of personal data shall not be transferred to any country or territory outside the European Economic Area unless that country or territory ensures an adequate level of protection so relationship management of third party processors must include controls on off-shoring or sub-contracting.

In 2008, HSBC was fined an undisclosed amount for the loss of a disk containing the personal details of 270,000 customers.

In fact, the disk was lost by a third party courier firm in transit between two of the firm's depots with no HSBC employee involvement. However, as owner, HSBC was found responsible.

5. The Legal & Regulatory Background

(i) Data Protection Act 1998

The Data Protection Act 1998 (DPA), regulates the processing of information relating to individuals including obtaining, holding usage and disclosure. The main features of the DPA relevant to information governance are summarised below – more general information on the DPA is included in the *Document Retention Times* sub-section of this Guide, (section 2.V)

- **Personal data**

Part 1, section 1 defines “personal data as -

“Data which relate to a living individual who can be identified -

(a) from those data, or

(b) from those data and other information which is in the possession of, or is likely to come into the possession of, the data controller, and includes any expression of opinion about the individual and any indication of the intentions of the data controller or any other person in respect of the individual”.

- **Data protection principles**

The DPA sets out 8 data protection principles; the relevant principles for information governance being Principle 7 -

“Appropriate technical and organisational measures shall be taken against unauthorised or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data.”

Principle 8 is also relevant in the context of societies making arrangements with third parties to undertake data processing on their behalf -

“Personal data shall not be transferred to a country or territory outside the European Economic Area unless that country or territory ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data.”

Further detail, particularly in respect of data processing by third parties on a firm’s behalf, is provided in Schedule 1.

“Having regard to the state of technological development and the cost of implementing any measures, the measures must ensure a level of security appropriate to –

- (a) the harm that might result from such unauthorised or unlawful processing or accidental loss, destruction or damage as are mentioned in the seventh principle, and
- (b) the nature of the data to be protected.

10. The data controller must take reasonable steps to ensure the reliability of any employees of his who have access to the personal data.

11. Where processing of personal data is carried out by a data processor on behalf of a data controller, the data controller must in order to comply with the seventh principle -

- (a) choose a data processor providing sufficient guarantees in respect of the technical and organisational security measures governing the processing to be carried out, and
- (b) take reasonable steps to ensure compliance with those measures.

12. Where processing of personal data is carried out by a data processor on behalf of a data controller, the data controller is not to be regarded as complying with the seventh principle unless –

- (a) the processing is carried out under a contract -
 - (i) which is made or evidenced in writing, and
 - (ii) under which the data processor is to act only on instructions from the data controller, and
- (b) the contract requires the data processor to comply with obligations equivalent to those imposed on a data controller by the seventh principle.”

- **Unlawful obtaining of personal data**

Part VI, section 55 of the DPA makes unlawful obtaining of personal data a criminal offence -

“A person must not knowingly or recklessly, without the consent of the data controller—
(a) obtain or disclose personal data or the information contained in personal data, or

(b) procure the disclosure to another person of the information contained in personal data.”

- **Directors’ liability for breaches of the Data Protection Act**

Part VI, section 55 DPA clarifies the data protection responsibilities of directors & officers of corporate bodies -

“Where an offence under this Act has been committed by a body corporate and is proved to have been committed with the consent or connivance of or to be attributable to any neglect on the part of any director, manager, secretary or similar officer of the body corporate or any person who was purporting to act in any such capacity, he as well as the body corporate shall be guilty of that offence and be liable to be proceeded against and punished accordingly.”

(ii) **FSA Principles for Business**

The FSA’s requirements for information governance are defined in the FSA’s Principles for Businesses - firms have a responsibility to assess the risks of data loss and take reasonable steps to prevent that risk occurring. In particular, note -

- **Principle 2** - A firm must conduct its business with due skill, care and diligence.
- **Principle 3** – A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems’
- **FSA Rule SYSC 3.2.6R** - ‘A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime’.
- **SYSC 3.2.6A R** - Firms’ relevant systems and controls must be ‘comprehensive and proportionate to the nature, scale and complexity of their operations’.

The secure handling of customer data is also part of the ‘Treating Customers Fairly’ standard that all firms must adhere to.

5. Further Reading

Data Security in Financial Services – Firms’ controls to prevent data loss by their employees & third party suppliers

FSA, April 2008

http://www.fsa.gov.uk/pubs/other/data_security.pdf

A comprehensive guide to the FSA’s view on what constitutes effective information governance including a range of good and bad practice examples

Directors’ Guide to Managing Information Risk

Information Assurance Advisory Council, April 2008

<http://www.iaac.org.uk/Default.aspx?tabid=31>

A guide aimed at company directors outlining their information governance responsibilities and advising on how to position their organisation to understand and address information governance risks.

Statute List

Statute List

This list is divided, for ease of reference, into three sections –

- The Building Societies Act 1986
- Building societies' statutory instruments
- Other legislation

Notes –

- many of the provisions of the 1986 Act have been repealed by other legislation, especially by the 1997 Building Societies Act eg the old lending provisions in sections 10-20; therefore, there are a number of gaps, such as between sections 1 and 5, and between sections 9B and 32. But sometimes, later legislation has inserted new provisions – these are often indicated by a capital letter after the relevant number eg section 101A, Schedule 2A etc
- section 119 of the 1986 Act is the interpretation section and defines many of the terms used elsewhere in the Act
- the Schedules to the 1986 Act contain a great deal of detailed material, especially Schedule 2, which covers a wide range of constitutional matters
- during 2010, we plan to include the full, updated text of the 1986 Act on the BSA Members' Website
- text of recent legislation can be found at www.opsi.gov.uk/legislation/about_legislation.

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