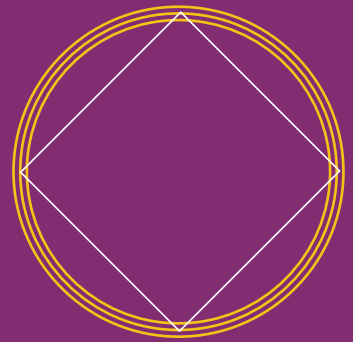
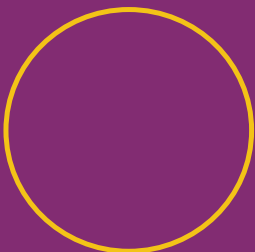


**Withdrawable
share capital**



A flexible option

**Insights from
societies**



CO-OPERATIVES UK



Introduction

This document summarises the key insights gained from interviews with the nine large retail societies that sponsored the Co-operatives UK Members' Money initiative.

This initiative was a review of how withdrawable share capital (WSC) is being used as a form of funding by the large retail societies and the opportunities to extend its use within the current legal and regulatory framework.

The interviews covered the following subjects:

- the role of members in funding societies;
- equity vs. debt;
- financing costs;
- the different administrative processes associated with debt and equity;
- managing liquidity;
- risk and regulation;
- what would societies like to see? and
- what are the things that are more likely to make an active programme successful?

The role of members in funding societies

Over recent decades, members have become less likely to see societies as the natural home for their money as their access to mainstream financial products and services has increased.

Equally, societies have built up considerable reserves and, in particular over the last decade, have been able to borrow money from banks at historically low interest rates.

This has resulted in some societies being less proactive with their WSC programmes, offering reduced interest rates and providing fewer and less visible facilities for members to carry out WSC transactions.

As such, it was no surprise to see member shares being less than 15% of total capital and reserves at two thirds of the societies interviewed. There are, however, a small number of societies which have very active member capital programmes and have been successful in raising significant sums via this method.

Some innovation has been seen with, for example, one society offering higher rates of return to members if they leave their money with the society for longer periods of time – 1 year, 2 years or 3 years. Early withdrawal is allowed but with the loss of all interest.

There was considerable variation in the extent to which societies see WSC as an important element of members' engagement and participation in their society and a way to deepen relationships.

The use of member funds as a percentage of total capital for each of the sponsoring societies is shown in the graph below (Figure 1). The data has been anonymised to maintain confidentiality.

Figure 1

Equity vs. Debt

Whilst everyone interviewed had a very clear understanding of the difference between equity (member capital) and debt, in practical terms most societies, and particularly the finance teams, were simply interested in funding options – in other words, they were agnostic to whether funding came from debt or members money provided that they were using the most cost-effective method. Some respondents made the point, however, that member involvement in financing a society is a key element of the overall member proposition and should always be considered and encouraged when raising funds.

Societies generally seek the lowest cost funding available whether this be debt or equity. In broad terms, the cheaper the funding from banks or members, the greater the societies' surpluses which, in turn, can then be applied to fulfilling the society's co-operative purposes, including distributions to members based on their trade.

Financing costs

Societies thought that rates offered to members (for new capital) should be no more than the organisation would have to pay for funding from other sources. This is consistent with the FCA's approach as set out in its recent Guidance (see report by Anthony Collins Solicitors). A good (upper) benchmark is, therefore, the cost of bank debt.

Some societies made the (valid) argument, that the benchmark to offer to members should be what members might get paid for their capital if they were to place it in other instruments with a similar risk profile.

Societies recognised, however, the need to avoid positioning WSC as simply a financial investment and something which members should be comparing against building society deposits or other financial products.

There was also a recognition that explicitly or implicitly linking interest rates on immediately withdrawable share capital to interest that could be earned on, for example, a building society account posed the risk of having to respond to future changes in base rates. If members see such a link and building society rates rise rapidly but societies do not respond, there is a reasonable expectation that there will be WSC outflows from societies (also see liquidity risk section below).

There was an acknowledgement that it would be appropriate for members to expect a higher interest rate if they:

- were required to give more notice to withdraw their funds – for example 60 or 90 days; or
- agreed to leave their funds with the society for an extended specified period – for example 5 years.

The different administrative processes associated with debt and equity

The observations above, of course, take no account of the different operational costs associated with bank debt and WSC. At its extreme, £1m of bank debt requires some activity at the outset but is essentially a single transaction (of £1m), a small amount of legal work and an element of covenant monitoring, typically by the finance team.

In contrast, raising £1m from members where the average amount is £1,000 requires the administration of 1,000 transactions and the ongoing maintenance of records.

There is an understandable concern amongst those that do not have an active withdrawable share capital programme that the costs of administration are significant and, if added to the financing cost, make withdrawable share capital uncompetitive compared to bank debt.

Whilst administration does pose challenges, the societies with an active programme have shown these are not insurmountable.

Societies generally agree that:

- administering small withdrawable share capital receipts and withdrawals is administratively burdensome and expensive;
- share accounts should not be used as an alternative to a bank account;
- WSC transactions should not be processed in society stores alongside

grocery shopping;

- it has proved to be expensive to offer a high-street presence specifically to process WSC transactions unless this can be done via, for example, post offices within stores;
- legacy membership systems and records increase the operational challenges;
- a capability to accept online applications would significantly ease the administrative burden; and
- if they are to create new or extend existing WSC programmes, this needs to be designed to attract larger sums – say a minimum amount of £500 or £1,000.

A number of societies thought that the administrative burden would be more manageable if the flexibility within existing legislation could be used to create quasi-fixed term capital. For example, an invitation to members to buy shares with an interest rates of x% but with the right to withdraw suspended for, say, five years. In this scenario, temporary teams could be created to administer the initial invitation and collect the funds.

Managing liquidity

Importantly, suspending withdrawals would give societies significantly more certainty in respect of capital management which in turn leads to more efficient planning.

In the absence of a suspended withdrawal period, societies will always need to be prepared to repay members' funds at short notice. This, of course, is not problematic if the number of members and amounts involved are small. It would be a significant issue if WSC is a key source of funding and large groups of members wanted to withdraw funds immediately.

Risk and regulation

All societies were cognisant of the serious nature of the regulatory environment and the need to be cautious in respect of:

- promoting new shares and the language used in communications to members. It is noted that it is possible to concurrently invite non-members to become members and purchase withdrawable share capital;
- being clear with members about the risks associated with withdrawable shares and, in particular, the fact that they are not covered by the Financial Services Compensation Scheme. This scheme guarantees savings of £85,000 placed with banks, building societies and other regulated firms; and
- anti-money laundering requirements.

What would societies like to see?

Alongside the current models, what many societies want is something which:

- invites members to place larger sums with societies – perhaps £500 or £1,000 minimum (excluding the original membership share);
- raises money in tranches – for example an invitation to participate in a £1m tranche which is only open for, say, three months; and
- most significantly, creates an unambiguous limitation on members ability to withdraw for a period. This could be 5 years or even greater.
- What are the things that are more likely to make an active programme successful?
- Everyone agrees that a cold invitation to everyone currently on a society's membership register is unlikely to yield a significant response. Instead, success is likely to require a combination of activities:
- an attractive invitation to place funds with the society including a fair interest rate as part of the general members' proposition;
- an explanation of why the funds are needed;
- communications which explain the ownership model;
- a strong membership engagement programme which encourages participation in events and communicates the nature of the organisation they are part of;
- feedback to members on how their money is being used;
- a 'clean' membership register so that the invitation is targeted to members whose details are up to date and who use the society's stores or other services; and
- simple processes and systems which are easy for members who want to provide capital to use. In most cases, this is likely to be an online capability.

Only by taking such a holistic approach, are members likely to be persuaded that placing funds with their society is a natural activity and just part of a wider membership proposition.