Friendly Societies

Expert knowledge means success

Contents

Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Friendly Societies have been around for more than 200 years. They became increasingly popular in the eighteenth century when members subscribed towards financial benefits in times of sickness, old age and unemployment.

A Friendly Society is a mutual, self-help organisation whose funds, after the deduction of running costs, are owned by its policyholders. The main purpose of a Friendly Society is to provide life assurance and to assist members during sickness and unemployment. Some of these societies grew into large mutual insurance companies and still exist today. Friendly Societies are regulated by the Financial Services Authority (FSA). Friendly Societies that advertise and market life assurance products, are regulated by the Personal Investment Authority (PIA).

Total funds of UK Friendly Societies are some £15 billion and membership is estimated to be over 5 million; around 50 societies are members of the Association of Friendly Societies. Between them these societies offer a wide range of financial services, including banking facilities, personal insurances, savings facilities such as ISAs and unit trusts, and credit broking.

Many of the products from Friendly Societies require relatively low premium and contribution levels – for example only a few £s per week – and are taken up by people with modest incomes (often without a bank account), the elderly or on behalf of children. A Friendly Society is often distinguished from other financial institutions in their commitment to mutuality – for example, they often provide discretionary benefits to which the members are not contractually entitled.

Nowadays, Friendly Societies may be connected with certain trades, employers or unions or simply people living in a neighbourhood. Many Friendly Societies carry out charitable and social functions designed to help members and the communities in which they live and work.

Today, Friendly Societies enjoy a special tax concession enabling them to offer tax-exempt savings plans of up to £25 per month (or £270 per year) running over 10 years or more. Some Friendly Societies have developed a single product niche for a small but well-defined sector of the community, whilst other Societies offer the range of savings, insurance and banking services in the same way as other financial institutions.

The legislation governing Friendly Societies is covered in the Friendly Societies Act 1992 – it can be viewed on line at: www.hmso.gov.uk/acts/acts1992/Ukpga_19920040_en_1.htm.

History

The earliest Friendly Societies started with members meeting in pubs and other hostelries, the social side being an important part of their meeting. The members paid a subscription to the fund, which was used to relieve the financial misery caused by death and illness. At this time, the bleak prospect faced by many poor people was the workhouse making the advantages of joining an organised Friendly Society seem very attractive since subscribing to one provided assurance that your family would be provided for in the event of illness or death.

By 1875 the government appreciated more and more the advantages of promoting the use of Friendly Societies and the Act of 1875 called for proper auditing and registration. The societies became more efficient at managing their funds and with no shareholders to bleed the profits the members got the full benefit. In 1911, Chancellor Lloyd George introduced the National Insurance Act to the UK. It provided health care, sickness and maternity benefit. The necessary expertise to run the scheme was already available within Friendly Societies and "approved societies" which were then used to administer the scheme until 1945 when the Ministry of National Insurance was created and took over the running of the scheme.

Industrial and Provident Societies

Industrial and provident societies are governed by the registrar of Friendly Societies. There are two routes to registration either as a bona fide co-operative or as a society for the benefit of

New Rules for Friendly Societies

The FSA is proposing to make changes that will affect Friendly Societies. They have published two consultation papers (CPs 06/19 and 06/20) which set out proposals for a revised conduct of business sourcebook (NEWCOB) and changes to certain other areas of their Handbook.

These changes are a combined result of the FSA's move towards a more principles-based regime and implementation of the MiFID.

To make it easier to determine the impact of their proposals on societies, the FSA has designed a table showing "at a glance" the areas where changes to their requirements are likely to have the greatest significance and impact.

The consultation documents are available at:
www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06_19.shtml
and
www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06_20.shtml

the community with the application option for exempt charity status. To qualify for registration under the Industrial and Provident Societies Act, a group should be carrying on 'an industry, business or trade, whether retail or wholesale'.

The Friendly Societies Commission was established by the Friendly Societies Act 1992. The Act placed statutory responsibility for the supervision of Friendly Societies on the Commission. The Commission administered the system of regulation of the activities of Friendly Societies and promoted their financial stability and the protection of their funds. The responsibilities of the Commission for Friendly Societies supervision passed to the Financial Services Authority following implementation of the Financial Services and Markets Act.

The Registry of Friendly Societies was a Government department serving three statutory bodies, the Building Societies Commission, the Central Office of the Registry of Friendly Societies and the Friendly Societies Commission, together with the Assistant Registrar of Friendly Societies for Scotland. The FSA took over the functions of the Central Office of the former Registry of Friendly Societies and those of the Assistant Registrar for Scotland on 1 December 2001.

These functions include:

- registering new industrial and provident societies; registering and recording documents on behalf of industrial and provident societies;
- registering and recording documents on behalf of friendly societies and certain other types of mutual societies registered under the Friendly Societies Act 1974;
- registering and recording documents on behalf of building societies;
- registering and recording documents on behalf of credit unions.

The Financial Services Authority is an independent body that regulates the financial services industry in the UK. Their areas of responsibility include the banks, investment firms, insurance companies, building societies and Friendly Societies. The FSA sets standards and makes rules. All investment firms are subject to the FSA's ten high-level principles that cover matters such as market conduct and information for customers. The FSA wants to raise and maintain standards in the industry. They define the minimum standards of regulated firms and provide training for the industry including workshops for small firms of independent financial advisers.

Industrial and Provident Societies - payment of interest on share capital

On 5 January 2012, the Charity Commission published a document setting out its position in relation to Industrial and Provident Societies and the payment of interest on share capital. Industrial and Provident Societies (IPSs) are registered with the Financial Services Authority (FSA). Currently, those that are charities are 'exempt' charities. They cannot register with the Charity Commission, but are otherwise subject to charity law. HMRC decides whether they are eligible for tax relief as charities.

The Charities Act 2006 will require all exempt charities either to have a principal regulator to oversee their compliance with charity law, or (where there is no suitable body to act as principal regulator) to lose their exempt status and be regulated by the Commission. It is unclear how charitable IPSs will be regulated in future; the Government has not yet made a decision about this. Any change is unlikely to be agreed before mid 2012 or implemented before 2013.

Some IPSs are set up as co-operatives, which cannot be charities, but others are set up as community benefit societies, which can be charities in certain circumstances. The activities of charitable IPSs include such things as redevelopment, regeneration and housing projects.

Some IPSs for the benefit of the community receive tax benefits as charities but have the power to pay interest on share capital. While the rules of industrial and provident societies often make a distinction between interest and dividends, they also indicate in many cases that the payment of interest is out of profits and so is clearly a distribution of profits.

The Commission considers that a power to distribute profits is fundamentally incompatible with charitable status. This is because a power of a corporate body to apply its property and assets for the purpose of making profits and devoting the resulting profit to the distribution of dividends among the members is considered by the courts to be incompatible with charitable status.

The Commission has looked at the legal framework in this area and discussed it with the FSA and HMRC and is now satisfied that there are circumstances in which limited payments of interest may be made, which would not amount to a distribution of profits.

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

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

Source:
www.charitycommission.gov.uk/Start_up_a_charity/Do_I_need_to_register/industrial_provident_societies.aspx

Regulatory issues for Industrial and Provident Societies

The Friendly and Industrial and Provident Societies Act 1968 (Audit Exemption) (Amendment) Order 2006 came into force on 6 April 2006 and is effective in relation to any year of account ending two months or more after the Order comes into force – i.e. June 2006 year ends onwards for most.

It reduces audit requirements for industrial and provident societies, and raises the turnover level below which non-charitable societies (and to a limited extent charitable societies) do not need to have accounts fully audited.

Audit requirements are now reduced where a society has assets not exceeding £2,800,000 and where the society's turnover does not exceed £5,600,000.

The Act is available at:
www.opsi.gov.uk/si/si2006/20060265.htm

The Community Benefit Societies (Restriction on Use of Assets) Regulations 2006 also came into force on 6 April 2006. The Regulations make provision to allow community benefit societies to introduce a rule to ensure, that on dissolution or amalgamation, their assets will permanently be used to benefit the community. Often referred to as an "asset lock", this serves to eliminate the possibility that a society's accumulated assets could be distributed to members following conversion to a company incorporated under the Companies Acts.

The Act is available at:
www.opsi.gov.uk/SI/si2006/20060264.htm

Taxation

There is no statutory definition of a 'Friendly Society'. The general concept of a Friendly Society is that the membership contributes to a fund to be used for the welfare of the members or for their assistance when in need or distress. However, the term can cover societies with a wide range of differing activities and objectives. The Taxes Acts provide for three categories of society:

Unregistered Friendly Societies

This category covers any society which (1) calls itself a Friendly Society, and (2) provides for the welfare of its members, but (3) does not fall into the other two categories.

An unregistered Friendly Society is generally charged to tax in the same way as any other unincorporated association, so the lack of a definition does not cause a problem.

Registered Friendly Societies

A registered Friendly Society is a society registered with the Financial Services Authority (FSA) under Section 8 of the Friendly Societies Act 1974. Registration provides a society with a formal structure for its operations. It is only open to societies with rules following a prescribed general framework.

The functions which can be undertaken by a registered Friendly Society are limited to the provision of specified provident benefits for the members and their dependants. However, the provisions of the Act have been interpreted widely and a registered society may offer its members most forms of life insurance, annuity, unemployment and health insurance contracts. Some societies take full advantage of these opportunities, whereas others do no more than provide a social forum and make discretionary grants of a benevolent nature.

Societies other than Friendly Societies can be registered under the Friendly Societies Act 1974. They are registered in specific categories (such as, cattle insurance societies or old people's homes societies) and fall outside the taxation provisions covering registered Friendly Societies. Registration of a society within one of these categories is irrelevant for taxation purposes. They are chargeable to tax in the same way and to the same extent as an unregistered society carrying on the same activities.

Some registered Friendly Societies have a federal structure consisting of a central organisation which has local branches tied to it. These societies generally have the word 'order' in their titles. The title of the branch will combine the name of the order with the name of the branch, for example, 'Ancient Order of Foresters, Court George Stephenson No 4018' is a branch of the registered Friendly Society the 'Ancient Order of Foresters'. For tax purposes, a branch of a registered Friendly Society is an unincorporated association in its own right and is entitled to the same tax exemptions as a registered Friendly Society.

Incorporated Friendly Societies

The Friendly Societies Act 1992 created a new corporate structure within which a Friendly Society can be set up and be registered. Incorporated societies are registered by the Friendly Societies Commission. They are given a specific registration number and are required to include the word 'Limited' in their names.

From 1 February 1993, a new society can only be registered as an incorporated society. An existing registered Friendly Society can (but does not have to) convert itself to an incorporated society. Incorporated societies and unincorporated societies will continue to exist in parallel for many years.

An incorporated society can undertake much the same activities as a registered Friendly Society. Additionally, incorporated Friendly Societies can set up subsidiary companies which may engage in a wider range of activities than their parent society. There are special provisions covering the taxation of profits passed up by a subsidiary to an incorporated Friendly Society.

The legislation provides for an incorporated society to set up local branches. These will have less autonomy than the branches of registered societies. They will be charged to tax as part of the incorporated society, not as separate entities. Individual branches will, in general, only be engaged in tax-exempt activities.

Taxation and Tax Exemptions

All Friendly Societies are companies for Corporation Tax purposes:

- Incorporated Friendly Society are companies in their own right;

APB issues revised guidance on the audit of Friendly Societies

On 26 July 2011, the APB of the FRC published a revision of Practice Note (PN) 24 '*The Audit of Friendly Societies in the United Kingdom*'. A consultation draft of the revised PN was issued in January 2011 for public comment.

The revised guidance reflects:

- the provisions of the clarified ISAs (UK and Ireland) (which apply to the audit of financial statements of friendly societies for periods ending on or after 15 December 2010; and
- changes in the legislative and regulatory framework.

Enhanced guidance is included in the PN with respect to:

- Auditing accounting estimates.
- Materiality.
- Evaluation of misstatements identified during the audit.

Source: www.frc.org.uk/apb/press/pub2621.html

- Registered and unregistered Friendly Societies are unincorporated associations.

Although Friendly Societies are chargeable to Corporation Tax, they enjoy a range of specific exemptions:

- Unregistered Friendly Societies: Exemption - An unregistered Friendly Society with income not exceeding £160 is exempt from Corporation Tax. This exemption covers both income and chargeable gains;
- Registered or Incorporated Friendly Societies: business categories - A distinction is made between the 'life or endowment business' and the other business carried on by a Friendly Society. Within the category of 'life or endowment business' pension business needs to be separately identified;
- Friendly societies: exemption for life or endowment business - The profits attributable to life or endowment contracts with members are exempt from tax within certain limits. These limits have been changed frequently over the years.
  The current limits for tax exempt business with an individual member are:
  - Life assurance contracts. The total premiums payable by a member in any 12-month period must not exceed £270. This limit rises to £300 if premiums are payable more than once a year – typically £25 per month.
  - Annuity business. The total annuities secured under contracts with a member must not exceed £156 (though any bonus added to a with-profits annuity is disregarded).

A Friendly Society will not be chargeable to Corporation Tax (and can therefore claim a repayment of all income tax suffered by deduction and tax credits on dividends) if:

- It only carries on life or endowment business (excluding pension business); and
- Its rules limit a member's policies to the statutory limits on tax exempt business.

Pension business is outside the scope of the exemption for life or endowment business, irrespective of the level of premium and can therefore give rise to profits chargeable to Corporation Tax.

A Friendly Society is exempt from tax on income or gains relating to 'other business'. 'Other business' is that part of the business that is not life or endowment business. This exemption is given to a society (or branch of a society) registered on or before 31 May 1973. If societies registered before that date merge to create a new society, they retain their exemption provided that none of the societies had had their exemption withdrawn as mentioned below (this applies equally to the merger of branches). Societies registered or incorporated after 31 May 1973 may also be entitled to an exemption from tax in respect of 'other business'. This is dependent on their rules limiting the range of membership or the maximum members' contributions. However, few societies are likely to have such restrictive rules.

"Partnership Societies" – an alternative to SIPPS

In the late 1980s it was realised that the creation of a Friendly Society offered small groups of individuals an attractive route to a Revenue-approved retirement annuity contract. As members of the Friendly Society, and of its management committee, the individuals could retain control of the investment of their contributions. During a brief period, prior to the advent of personal pension schemes, around 200 such societies were registered and obtained Inland Revenue (now HM Revenue & Customs) approval for the retirement annuity contracts which they offered to their members. The personal pensions' legislation has given the HMRC greater control over the investment policy of Friendly Societies – thus greatly reducing the attractiveness of such societies and since then only a small number of societies have been set up. However, such societies may offer an alternative pension structure to self-invested personal pensions (SIPPS) – check with us for further details.

The rules of such a society will limit membership to a select group. This is normally the partners of a particular partnership, or the directors of a partnership service company, but will occasionally be broader. It may consist, for example, of the directors or employees of a family company. For convenience, societies in which:

- membership is restricted to a narrow group of individuals; and
- the objectives are limited to the provision of retirement annuity contracts or personal pensions, are known as 'partnership societies'.

The activities of a partnership society constitute pension business and as such are outside the exemptions from tax that are specific to Friendly Societies.

Useful Links

A selection of Friendly Societies is shown below together with the web address:

- Homeowners Friendly Society (www.homeowners.co.uk)
- Family Assurance (www.family.co.uk)
- Scottish Friendly (www.scottishfriendly.co.uk)
- Cirencester Friendly Society (www.cirencester-friendly.co.uk)
- Exeter Friendly Society (www.exeterfriendly.co.uk)
- Wiltshire Friendly Society Limited (www.wiltshirefriendly.co.uk)
- Tunbridge Wells Equitable Friendly Society (www.twefs.co.uk and www.babybond.co.uk)
- Holloway Friendly Society (www.holloway.co.uk)
- National Deposit Friendly Society (www.nationaldeposit.co.uk)
- Liverpool Victoria (www.lv.com/)
- Sons of Temperance Friendly Society (www.sonsoftemperance.co.uk)

Regulators

The regulators' contact details are:

Financial Services Authority
25 The North Colonnade,
Canary Wharf,
London E14 5HS

Website: www.fsa.gov.uk
Tel: (+44) 20 7066 1000

The Association of Friendly Societies

The Association of Friendly Societies represents the friendly society movement, and has over 50 members. Between them, these organisations manage the savings and investments of over 4.5 million people, and have total funds under management of around £15 billion.

Their web site provides useful information for customers including a list of their member societies at: www.friendlysocieties.co.uk/

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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