



**COMMUNITY  
INTEREST  
COMPANIES**

## **Consultation on the dividend and interest caps**

To inform the Regulator's decision on whether to vary the share dividend cap, aggregated dividend cap, or performance related interest cap

Issued by the Regulator of Community Interest Companies

30 March 2009

**BERR** | Department for Business  
Enterprise & Regulatory Reform

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# **1. Executive Summary**

## **Basis of consultation**

1.1. This consultation seeks views on the Community Interest Company Regulations 2005 (“the Regulations”) Part 6, regulations 17 to 22, which deal with the caps on dividend payments and performance related interest paid. The relevant extracts from the Company (Audit, Investigations and Community Enterprise) Act 2004 and the Community Interest Company Regulations 2005 are attached at Annex A.

1.2. The community interest company (CIC) is a new type of company introduced on 1 July 2005. It is designed for social enterprises that want to use their profits and assets for public good.

1.3. The dividend caps and performance interest cap strike a balance between encouraging people to invest in community interest companies and the principle that the assets and the profits of a CIC should be devoted to the benefit of the community. Any dividends, or performance related interest, should not be disproportionate to the amount invested and the profits made by the company.

1.4. In the consultation process to establish CICs, it was recognised that once a significant number of community interest companies were operating, there may be evidence to support changes in the general levels of these caps, or value in setting different limits for different types of CICs where it may be desirable and necessary to encourage investment in particular sectors.

1.5. The Regulations provide that the Regulator may review the caps and set new limits after consulting with the sector and with the approval of the Secretary of State for the Department for Business, Enterprise and Regulatory Reform (BERR).

1.6. Any change to the level of any cap or the way it is expressed is subject:

- to the share dividend cap being expressed as a percentage of the paid up value of the shares to which it applies;
- the aggregated dividend cap being expressed as a percentage of distributable profits; and
- the interest cap being expressed as a percentage of the average amount of debt, or the sum outstanding on a debenture, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations).

1.7. If the Regulator sets a new cap it will not take effect until three months after it is published in the London Gazette.

## **Who is being consulted**

1.8. The purpose of the consultation is as part of a process to call for evidence from organisations and individuals who would have an interest in, or would be

affected by, a change in the general levels of the caps on dividend payments and performance related interest paid, and their experience to date. We expect that the consultation will principally be of interest to social enterprises and those who finance social enterprises by way of equity (shares) or the financing of debt (loans).

### **When does the consultation open and close**

1.9. The consultation opens on 30 March 2009 and will close on 19 June 2009.

### **How to Respond**

1.10. When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

### **Additional copies**

1.11 An electronic version of this document can be found at: [www.cicregulator.gov.uk/consultation](http://www.cicregulator.gov.uk/consultation). You may also make copies of this document without seeking permission.

1.12 Hard copies of the consultation document and the response form are available on request from Phillip Horrell (see 1.15 below)

1.13 Further printed copies can be obtained from:

BERR Publications Orderline

ADMAIL 528

London SW1W 8YT

Tel: 0845-015 0010

Fax: 0845-015 0020

Minicom: 0845-015 0030

[www.berr.gov.uk/publications](http://www.berr.gov.uk/publications)

1.14 Other versions of the document in Braille, other languages or audio-cassette are available on request.

1.15. Please respond, using the response form at Annex D (or use a similar format). Your response should be sent by email (or alternatively by letter or fax) to:

Phillip Horrell  
Office of the Regulator of Community Interest Companies  
Room3.68  
Companies House  
Crown Way  
Cardiff  
CF14 3UZ  
Email – [cicregulator@companieshouse.gov.uk](mailto:cicregulator@companieshouse.gov.uk)  
Voicemail – 02920 346228  
Fax – 02920 346229

1.16. General questions about community interest companies can also be addressed to Phillip Horrell.

1.17. If you have comments, or complaints, about the way this consultation has been conducted, these should be sent to:

Julie Court  
Office of the Regulator of Community Interest Companies  
Room 3.68  
Companies House  
Crown Way  
Cardiff  
CF14 3UZ  
Email – [jcourt@companieshouse.gov.uk](mailto:jcourt@companieshouse.gov.uk)  
Voicemail – 02920 346228  
Fax – 02920 346229

1.18. A copy of the Code of Practice on Consultation is at annex C.

### **Confidentiality & Data Protection**

1.19. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including

personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.20. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Office of the Regulator of Community Interest Companies.

1.21. We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1988.

### **Impact Assessment**

1.22. A Consultation Stage Impact Assessment has been prepared. You are invited to comment on the analysis, and/or provide further evidence to demonstrate potential costs or benefits of the proposals set out in the consultative document. An electronic version of this document can be found at: [www.cicregulator.gov.uk/impactassessment](http://www.cicregulator.gov.uk/impactassessment). You may also make copies of this document without seeking permission.

### **Consultation questions**

1.23. The Regulator welcomes your feedback on the questions below:

#### **Questions 1– 4 for Social Enterprises, excluding community interest companies.**

##### **Question 1 – dividend cap**

Would the maximum dividend per share cap (5% above the Bank of England base rate) have any bearing on your decision to form as a community interest company?

##### **Question 2 – dividend cap**

Would the maximum aggregated dividend cap (35% of a relevant company's distributable profits) have any bearing on your decision to form as a community interest company?

##### **Question 3 – dividend caps**

Would the interrelation between the dividend per share cap and aggregated dividend cap have any bearing on your decision to form as a community interest company?

##### **Question 4 – performance related interest cap**

Would the cap on performance related interest (4% above the bank of England base rate) have any bearing on your decision to form as a community interest company?

**Questions 5 & 6 for Social Enterprises and community interest companies.**

**Question 5 – dividend cap**

Do you consider that the double cap on dividends unduly restrict your ability to raise adequate financing of business start-up and growth?

**Question 6 – performance related interest cap**

Do you consider that the cap on performance related interest unduly restricts your ability to raise adequate financing of business start-up and growth?

**Questions 7 - 11 for Equity Investors and Debt Financiers**

**Question 7 – dividend cap**

Do you consider that the maximum dividend per share cap (5% above the Bank of England base rate) unduly limits incentive to those who might make an equity investment?

**Question 8 – dividend cap**

Do you consider that the maximum aggregated dividend cap (35% of a relevant company's distributable profits) unduly limits incentive to those who might make an equity investment?

**Question 9 – dividend cap**

Do you consider the interrelation between the dividend per share and aggregated dividend caps unduly limit incentive to those who might make an equity investment?

**Question 10 – performance related interest cap**

Do you consider that the cap on performance related interest (4% above the bank of England base rate) unduly limits incentive to those who might consider debt financing?

**Question 11 – performance related interest cap**

Do you consider that the 1% more by way of return on equity (under the dividend cap) than on performance related loans unduly limits incentive to those who might make equity or loan investments in a CIC to choose equity rather than a loan?

**Questions 12 – 17 for all**

**Question 12 – dividend cap**

Do you consider the limit to the level of return on investment to **equity investors** (the dividend caps) provides adequate protection of community assets?

### **Question 13 – performance related interest cap**

Do you consider the limit to the level of return on investment to **debt financiers** (the performance related interest cap) provides adequate protection of community assets?

### **Question 14 - general**

Do you consider the Bank of England base rate should be the preferred option for calculating the caps?

### **Question 15 – dividend cap**

What principles should be used to set the dividend cap?

### **Question 16 – performance related interest cap**

What principles should be used to set the performance related interest cap?

### **Question 17 - general**

Please tell us anything else from your own experience that you consider can add to a body of evidence about the dividend and performance related interest caps.

### **Next Steps**

1.24. The Regulator will review the responses, together with other evidence relating to the level of the caps considered during this review. The findings and Regulator’s response will be published on the Office of the Regulator of Community Interest Companies website ([www.cicregulator.gov.uk](http://www.cicregulator.gov.uk)) within six months of the end of the consultation. If the Regulator decides the evidence supports a change to the current limits, she will announce her decision in the Gazette, subject to the Secretary of State’s approval.

## **2. Background to the consultation**

### **The reason for the introduction of community interest companies**

2.1. The community interest company is a new type of company designed for social enterprises that want to use their profits and assets for public good. The concept was outlined in the Cabinet Office Strategic Unit report “Private Action, Public Benefit”<sup>1</sup> published in September 2002.

2.2. The report recognised that many social enterprises were attracted to the company form which is familiar, flexible and easy to set up. But it was also recognised that there were disadvantages:

- it was difficult to lock in assets to ensure they are always used for the benefit of the community;

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<sup>1</sup> The report can be found under ‘project reports’ on the Strategy Unit’s website at [www.number10.gov.uk](http://www.number10.gov.uk)

- there was no obvious way of distinguishing social enterprise companies from those set up purely to make profits for their owners;
- “social enterprise” generally was not widely understood and there could be difficulties in raising finance.

2.3. In March 2003 BERR (previously DTI), in co-operation with the Treasury and the Home Office, published a consultation document with detailed proposals for implementing community interest companies and subsequently published a response outlining Her Majesty’s Government’s (HMG) intentions.<sup>2</sup>

2.4. The consultation document received a very large measure of support and consequently HMG brought forward the Bill which became the Companies (Audit, Investigations and Community Enterprise) Act 2004 (“the Act”), Part 2 of which contains the basic provisions on community interest companies<sup>3</sup> and received Royal Assent on 28 October 2004.

2.5. The Act contains provisions to ensure CICs work for the benefit of the community, which means they must comply with some additional statutory requirements, including an asset lock, which is defined under the Community Interest Company Regulations 2005 (the Regulations).

### **Previous consultation on the dividend and interest caps**

2.6. The 2003 consultation<sup>4</sup> set out the rationale for the asset lock which was intended, along with the community interest test, to ensure that community interest companies operate in pursuit of their community purpose and can be seen to do so.

2.7. Whilst the consultation supported using the company limited by shares legal form, it did acknowledge that a statutory asset lock would mean CICs would not be able to approach equity finance in the same way as other companies. HMG considered the option of real equity through the issuing of shares with uncapped dividend to benefit from capital growth, but concluded that this was contrary to the concept of CIC purpose and the asset lock.

2.8. In October 2004, a consultation<sup>5</sup> was issued on the draft Community Interest Company Regulations, which set out proposals for a single dividend cap and a cap on returns provided by performance related loans, debt and debentures with “equity-like” characteristics (as the return/interest varies according to the company’s financial performance).

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<sup>2</sup> “Enterprise for Communities: Proposals for a Community Interest Company: Report on the public consultation and government’s intentions” (October 2003) is available at <http://berr.ecgroup.net/Publications/BusinessLaw/CommunityInterestCompanies.aspx>

<sup>3</sup> The Companies(Audit, Investigations and Community Enterprise) Act 2004 is available at <http://www.opsi.gov.uk/si/si2005/20051788.htm>

<sup>4</sup> “Enterprise for Communities: Proposals for a Community Interest Company: Report on the public consultation and government’s intentions” (October 2003) is available at <http://berr.ecgroup.net/Publications/BusinessLaw/CommunityInterestCompanies.aspx>

<sup>5</sup> “Consultation on draft Regulations for Community Interest Companies” (October 2004) available at [www.berr.gov.uk/files/file14630.pdf](http://www.berr.gov.uk/files/file14630.pdf)

2.9. In response to the consultation in October 2004 HMG decided to revise the draft Regulations so that as well as there being a limit on the amount of dividend that can be paid out on each share, there would also be an “aggregate dividend cap” which limits the proportion of a community interest company’s distributable profits that can be paid in dividends in a given year.

2.10. This was to ensure that private investors in community interest companies would not receive a disproportionate rate of return, and that whenever it has distributable profits, the majority of those profits would either be re-invested in the business or used in some other way for the benefit of the community, rather than being distributed in the form of dividends to private investors.

2.11. The Act and the Regulations reflect the need to strike the right balance between attracting investment and preserving the assets for community benefit while providing the flexibility for the limits to be reviewed and changed in the light of experience and changes in the market. The relevant sections of the Act and the Regulations are set out at Annex A. Worked examples of the ‘double dividend cap’ set at these levels are provided in Annex B.

2.12. Regulations 7 to 10 in Part 3 and Schedules 1 to 3 deal with the special provisions which community interest companies must have in their memoranda and articles. Part 6, comprising of regulations 17 to 25, contains essential elements of the asset lock and deals with the cap on dividend payments, the distribution of any residual assets when a community interest company is wound up, and with share redemptions, buy-backs and capital reduction.

### **Previous research on access to finance for community interest companies**

2.13. There have been a number of research studies and surveys on access to finance for social enterprise including most recently the Social Investment Pilots and the Report by SQL Limited, which were commissioned by the Office of the Third Sector, but most of these predate community interest companies (Bank of England Report 2003)<sup>6</sup> or do not deal with social enterprise companies limited by shares (University of Warwick Business School study in 2007)<sup>7</sup>. So there is limited information on community interest companies as a subset of social enterprises.

2.14. It is worth noting the Bank of England report findings that social enterprises make only very limited use of equity (shares) finance and this was cited as a barrier to growth for the sector as a whole.

2.15. Studies carried out by the University of Warwick Business School (2007) suggest approximately 3% of SME in the private sector will access venture capital funds.

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<sup>6</sup> Bank of England report on the Financing of Social Enterprises 2003 is available at: [http://www.bankofengland.co.uk/publications/financeforsmallfirms/financing\\_social\\_enterprise\\_report.pdf](http://www.bankofengland.co.uk/publications/financeforsmallfirms/financing_social_enterprise_report.pdf)

<sup>7</sup> A report on the 2006 UK survey of SME finances Social Interest Booster Survey [http://www.cabinetoffice.gov.uk/third\\_sector/~media/assets/www.cabinetoffice.gov.uk/third\\_sector/me\\_finance%20pdf.ashx](http://www.cabinetoffice.gov.uk/third_sector/~media/assets/www.cabinetoffice.gov.uk/third_sector/me_finance%20pdf.ashx)

2.16. In addition, the Bank of England report found that the most fundamental barrier to social enterprises accessing equity finance was seen as the unfavourable risk/reward relationship which points to the need for development of “patient capital” i.e. accepting lower rates of return on the basis of social gains.

2.17. The Government is investing up to £10 million to demonstrate the viability of investment in social enterprise, by way of example, by encouraging an increase in the flow of independent risk capital into the equity gap and improving access for new and growing social enterprises that are seeking equity financing to develop their business. CICs are expected to be among potential investees

2.18. The Office of the Regulator of Community Interest Companies has received anecdotal evidence of the impact of the dividend caps on CICs ability to attract investment. Two schools of thought have emerged which reinforce the views expressed during the original consultation process. Firstly, the dividend caps may be too restrictive to attract start-up and growth capital and the other that the dividend caps are pitched at the right level to safeguard community purpose. The Regulator would like to gather wider evidence on this question to inform her views on whether the level of the caps should be changed and, if so, how.

#### **Statistical information about the growth of community interest companies**

2.19. As at 28 February 2008, 2,607 applications to be a CIC were approved and 2,507 remain live on the public register.

2.20. The average number of applications approved per month to date for 2008-09 was 86 up by 21% on last year indicating that the CIC legal form remains an attractive model.

2.21. 1,836 CICs (73%) are companies limited by guarantee and 671 CICs (27%) are limited by shares.

2.22. Year on year the growth of CICs limited by shares has remained steady averaging 27% of the total on the register.

2.23. A breakdown of the growth of community interest companies since 1 July 2005

	<b>Received</b>	<b>Approved</b>	<b>Live on Public Register</b>
2005-06	260	208	208
2006-07	729	637	637
2007-08	873	814	776
2008-February 09	1038	948	886
<b>Total</b>	<b>2900</b>	<b>2607</b>	<b>2507</b>

### **3. Rationale for limits on dividends and interest**

#### **The rationale for the dividend cap**

- 3.1. Together with the community interest test, the principle of reinvesting profits so they are used to benefit the community is central to the CIC concept.
- 3.2. As they grow, most companies raise equity by issuing shares. Equity shareholders provide risk capital and expect a corresponding return on their investment, enjoying a share of profits in the form of dividends on shares.
- 3.3. CICs are not able to adopt the same approach to equity as other companies, since unrestricted distribution of CICs' profits to investor shareholders would clearly be incompatible with a lock on profits and assets. However, to enable CICs the scope to grow they need access to a range of sources of finance, and the model needs to be appropriate for growing and large companies, as well as small.
- 3.4. HMG considered whether it would be appropriate for CICs to access a measure of real equity (risk capital) by issuing shares with an uncapped dividend and the ability to benefit from capital growth. This would open up a wider range of sources of finance to CICs with the assets, income streams and strong governance structures to attract equity investors, and so could contribute to the development of social enterprise. Without the ability to do this, CICs could not access risk capital and would be limited to organic growth. Equity investors expect to make profits from their shares if the CICs does well.
- 3.5. The way of reconciling this with the principle of the primacy of community benefit was to restrict such shares to participation of profits or residual assets, leaving the large majority of assets (65%) locked into the CIC and the public benefit.
- 3.6. The dividend cap strikes a balance between encouraging people to invest in CICs and the principle that the assets and profits of a CIC should be devoted to the benefit of the community. This helps to ensure that the dividends are not disproportionate to the amount invested and the profits made by the company.

#### **The three elements of the dividend cap**

3.7. The restriction on distributions (the dividend cap), as required by Part 6, regulations 17 to 20 of the Community Interest Company Regulations 2005, has three elements:

- The maximum dividend per share limits the amount of dividend that can be paid on any given share. Currently, the limit is 5% above the Bank of England base lending rate.

This figure reflected the findings of the Bank of England report on the Financing of Social Enterprises 2003, which suggested that banks typically charge 2-4% over base rate for loans and overdrafts to social enterprises. The figure of 5% over base rate allows a small premium for the additional risk of equity compared to loans.

- The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is 5 years.

3.8. The Bank of England's base lending rate (also referred to as the Repo Rate) is available from its [website \(www.bankofengland.co.uk\)](http://www.bankofengland.co.uk), which also gives details of what the rate has been in the past.

3.9. It should be noted that these caps set maximums. They should not be taken as in any sense suggesting that those who invest in community interest companies are entitled to a particular rate of return on their investment. The caps should also not be seen as limiting companies' discretion as to whether or not to pay dividends at all, or whether to pay a dividend in any given year. Finally, there is no reason why a company should not restrict distributions to lower amounts than would be permitted under the caps in its memorandum and articles of association, or share prospectus, or offer documents. If the company has, for example, issued fixed rate preference shares, the dividend on those shares will be subject to the caps but if the caps allow a higher rate this does not entitle the shareholders to receive that higher rate.

### **The rationale for the performance related interest cap**

3.10. Community interest companies need to be able to raise debt i.e. loans and bonds in the commercial markets on the same terms as other companies. Lenders will assess the risk to their investment, and will set interest rates, in the usual way. The transparency of the CIC form should help lenders to understand the risks and result in fair prices for debt finance.

3.11. Subject to its memorandum and articles of association, CICs have the same borrowing powers as any other company and generally will be able to borrow and pay normal commercial rates of interest to lenders.

3.12. The interest cap refers to the somewhat rare circumstances where the interest payable on debts or debentures is linked to the performance of the CIC. Such debt is regarded as similar to equity shares (it is sometimes referred to as "debt with equity characteristics" or "quasi-equity") and the ability to pay uncapped interest on such debt would circumvent the dividend cap.

3.13. The Act and Regulations therefore provide that payment of such performance related interest should be subject to a cap. The cap is expressed in terms of a percentage rate on the average amount outstanding on any given loan, or debenture (debt).

3.14. It will be the rate in force at the date the agreement for payment of the interest was made, or, for existing debt, the date the company became a CIC. The rate for a particular debt is fixed for the life of that debt and will not change if the rate generally is changed. It can, however, fluctuate if the Bank of England rate changes (Bank of England base lending rate plus a fixed percentage).

## **The performance related interest cap**

3.15. The initial interest cap is fixed by Part 6, regulation 21 of the Community Interest Company Regulations 2005 at “4 percentage points higher than the Bank of England base lending rate”. This figure reflects the finding in the Bank of England report.

3.16. If, for example, the agreement is made when the Bank of England Base Rate at the time is 3%, the cap will be 7%. If the Bank of England Base Rate subsequently rises to 5%, the rate for that debt will rise to 9%.

3.17. The rate applicable to any interest payment is that in force on the first day of the financial year in which the interest is due and the amount is calculated on the average amount of the debt, as defined in the Regulations, in the 12 months ending on the day before the payment is due.

3.18. If, for example, the company borrowed £100,000, the interest was agreed at 10% of the company turnover, the debt remained at £100,000 all year and the turnover was £130,000 the lender would be entitled under the agreement to £13,000 interest. If, however, the interest cap was 8% the interest payment would be restricted to £8,000.

3.19. It should be noted that if the contractual rate is lower than the interest cap rate this does not entitle the lender to receive the higher cap rate.

## **4. Subsequent variation of the dividend caps and interest cap**

4.1. Under Part 6, regulation 22(3) of the Regulations, the Regulator may, with the approval of the Secretary of State, set a new share dividend cap, aggregated dividend cap, or interest cap.

4.2. Under Part 6, regulation 22(4)(b) and regulation 22(5) to (7) of the Community Interest Regulations 2005 (‘the Regulations’), any change to the level of any cap or the way it is expressed is subject:

- to the the share dividend cap being expressed as a percentage of the paid up value of the shares to which it applies;
- the aggregated dividend cap being expressed as a percentage of distributable profits; and
- the interest cap being expressed as a percentage of the average amount of debt, or the sum outstanding on a debenture, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations).

4.3. Under Part 6, regulation 22(3) of the Regulations, the Regulator may, with the approval of the Secretary of State, set a new share dividend cap, aggregated dividend cap, or interest cap

## **5. Consultation questions - see page 7 or Annex D**

## **Annex A: CAICE Act 2004 and CIC Regulations 2005**

### **Section 30 of the Companies (Audit, Investigations and Community Enterprise) Act 2004**

Cap on distributions and interest

30(1) Community interest companies must not distribute assets to their members unless regulations make provision authorising them to do so.

(2) If regulations authorise community interest companies to distribute assets to their members, the regulations may impose limits on the extent to which they may do so.

(3) Regulations may impose limits on the payment of interest on debentures issued by, or debts of, community interest companies.

(4) Regulations under this section may make provision for limits to be set by the Regulator.

(5) The Regulator—

(a) may set a limit by reference to a rate determined by any other person (as it has effect from time to time), and

(b) may set different limits for different descriptions of community interest companies.

(6) The Regulator must (in accordance with section 27)—

(a) undertake appropriate consultation before setting a limit, and

(b) in setting a limit, have regard to its likely impact on community interest companies.

(7) Regulations under this section may include power for the Secretary of State to require the Regulator to review a limit or limits.

(8) Where the Regulator sets a limit he must publish notice of it in the Gazette.

### **Regulations 17 to 22 of the Community Interest Regulations 2005**

17(1). A relevant company may declare a dividend to its members only —

(a) to the extent that its memorandum and articles permit it to do so;

(b) if an ordinary or special resolution of the company's members has approved the declaration of the dividend; and

(c) if the declaration of the dividend does not cause —

(i) the total amount of dividend declared on any of the company's shares for the financial year for which it is declared to exceed the maximum dividend per share for that financial year; or

(ii) the total amount of all the dividends declared on shares in the

relevant company for the financial year for which it is declared to exceed the maximum aggregate dividend for that financial year.

(2) Paragraph (1)(c) does not apply to a dividend if, or to the extent that, it is an exempt dividend.

(3) A dividend declared on a share in a relevant company is an exempt dividend if one of the conditions specified in paragraph (4) and one of the conditions specified in paragraph (5) is satisfied in respect of it.

(4) The conditions specified in this paragraph are—

(a) that the dividend is declared on a share which is held by an asset-locked body (but this condition is not satisfied in respect of a share which the directors recommending the dividend are aware is being held on trust for a person who is not an asset-locked body);

(b) that the dividend is declared on a share which is held on behalf of an asset-locked body (or is believed by the directors recommending the dividend to be so held).

(5) The conditions specified in this paragraph are—

(a) that the Regulator has consented to the declaration of the dividend;

(b) that the asset-locked body by or on behalf of which the share on which the dividend is declared is held (or on behalf of which the directors declaring the dividend believe that it is held) is named in the memorandum or articles of the company as a possible recipient of the assets of the company.

(6) If a relevant company has made the substitutions prescribed in regulation 9(2), references to "asset-locked body" in this article shall have effect as if there were substituted for them references to "charitable body", with the meaning prescribed in regulation 9(1).

### **Regulation 18 - Maximum dividend per share**

18.(1). The maximum dividend per share for a financial year is the dividend which a relevant company declares on a share when the total amount of dividend declared on that share for that year (when expressed as a percentage of the paid up value of the share) equals that share's applicable share dividend cap.

(2) The applicable share dividend cap of a share in a relevant company is the share dividend cap which had effect in relation to that share at the time that the share was issued or the company became a community interest company, whichever is the later.

(3) Where the expression of the applicable dividend cap includes reference to a rate or figure determined by any person other than the company, the Regulator or the Secretary of State, the maximum dividend per share for any financial year shall be

calculated by reference to that rate or figure as it had effect at the beginning of the first day of that financial year.

#### **Regulation 19 - Maximum aggregate dividend**

19. The maximum aggregate dividend for a financial year of a relevant company is declared when the total amount of all dividends declared on its shares for that year, less the amount of any exempt dividends, equals (when expressed as a percentage of the relevant company's distributable profits) the aggregate dividend cap which had effect in relation to that company on the first day of the financial year in respect of which the dividends are declared.

#### **Regulation 20 - Carrying forward of unused dividend capacity from previous financial years**

20(1). Notwithstanding regulation 17(1)(c)(i), but subject to regulation 17(1)(c)(ii), the total amount of dividends declared on a share in a relevant company for a financial year may, subject to the company's articles, include the whole or any part of the share's unused dividend capacity.

(2) For the purposes of this regulation, a share's unused dividend capacity is A minus B where—

A is the aggregate of any sums by which, for any of the four financial years immediately preceding the financial year for which a dividend is to be declared under this regulation, the total amount of dividend declared and paid on the share for that financial year was less than the maximum dividend per share for that financial year; and

B is any part of A which has already been distributed by way of a dividend declared and paid for a previous financial year.

#### **Regulation 21 - The interest cap**

21(1). This regulation applies to debentures issued by, and debts of, a community interest company in respect of which—

(a) a performance-related rate of interest is payable; and

(b) the agreement to pay interest at a performance-related rate was entered into by the company on or after the date on which it became a community interest company.

(2) In connection with debentures and debts of the kind specified in paragraph (1), a community interest company shall not be liable to pay, and shall not pay, interest at a higher rate than the applicable interest cap.

(3) The applicable interest cap is the interest cap which had effect at the time that the agreement to pay interest at a performance-related rate was made.

(4) Where the expression of the interest cap includes reference to a rate or figure determined by any person other than the company, the Regulator or the Secretary of State, the interest payable on any debt or debenture to which the interest cap applies

shall be calculated by reference to that rate or figure as it had effect at the beginning of the first day of the financial year in which the interest became due.

(5) Nothing in paragraph (2) shall be taken as releasing a community interest company from liability to pay, or as preventing a community interest company from paying—

(a) interest which accrued before the company became a community interest company; or

(b) arrears of interest which if it had been paid at the time it became due would not have breached paragraph (2).

**Regulation 22 - Initial level and subsequent variation of dividend caps and interest cap**

22(1). Subject to paragraph (3)—

(a) the share dividend cap shall be that percentage of the paid up value of a share in a relevant company which is 5 percentage points higher than the Bank of England's base lending rate;

(b) the aggregate dividend cap shall be 35 per cent of a relevant company's distributable profits; and

(c) the interest cap shall be that percentage of the average amount of a community interest company's debt, or the sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4) which is 4 percentage points higher than the Bank of England's base lending rate.

(2) For the purposes of paragraph (1), the Bank of England's base lending rate is the base lending rate most recently set by the Monetary Policy Committee of the Bank of England in connection with its responsibilities under Part II of the Bank of England Act 1998.

(3) The Regulator may from time to time, with the approval of the Secretary of State, set a new share dividend cap, aggregate dividend cap, or interest cap.

(4) A new cap set under paragraph (3)—

(a) shall not take effect from a date less than three months after it is published; and

(b) subject to paragraphs (5) to (7), may result in a change to both the level of any cap and the way in which it is expressed.

(5) The share dividend cap must be expressed as a percentage of the paid up value of the shares to which it applies.

(6) The aggregate dividend cap must be expressed as a percentage of distributable

profits.

(7) The interest cap must be expressed as a percentage of the average amount of a debt, or the sum outstanding under a debenture, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4).

(8) The Secretary of State may from time to time require the Regulator to review any cap set under this regulation.

## **Annex B: Worked Examples of Dividend Calculations**

### **Example 1**

A CIC has a number of shareholders, all of them individuals who have invested in the company in order to acquire shares. The size of the different shareholders' holdings varies, but between them, they hold 1,000 shares. Each share has a paid up value of £5, and all the shareholders are entitled to receive a dividend, in proportion to the number of shares they hold, when a dividend is declared.

The company's shares were all issued when the share dividend cap was Bank of England base lending rate plus 5 per cent, and on the first day of the CIC's first financial year (Year 1), Bank of England base lending rate was 4.5 per cent. In Year 1, the CIC makes distributable profits of £12,000. On the first day of Year 1, the statutory aggregate dividend cap was 35 per cent.

### **Calculation**

The maximum dividend per share is the applicable share dividend cap multiplied by the paid up value of each share. The applicable share dividend cap is the share dividend cap in force at the beginning of the first day of Year 1, which was 9.5 per cent (i.e. 4.5 per cent + 5 per cent). The paid up value of each share is £5. The maximum dividend per share is therefore £5 x 9.5 per cent, or 47.5 pence. Given a total of 1,000 shares in issue, a dividend paid at this rate would result in an aggregate dividend (i.e. the total dividend to all shareholders) of £475 (i.e. 1,000 x 47.5 pence). This is well within the maximum aggregate dividend of £4,200 (i.e. £12,000 x 35 per cent).

The £475 can therefore be distributed among the shareholders by way of dividend according to the number of shares which each of them holds if the directors decide to recommend such a dividend and the shareholders approve their recommendation.

### **Example 2**

All the facts are as for Example 1, except that the distributable profits for Year 1 are only £1,000.

### **Calculation**

The maximum dividend per share is still 47.5 pence, but the maximum aggregate dividend is now only £350 (i.e. £1,000 x 35 per cent). If the maximum dividend per share is declared on all 1,000 shares, the aggregate dividend would be £475, which is £125 more than the maximum aggregate dividend. This is not permitted under the draft Regulations. Since the maximum aggregate dividend is £350, the largest dividend which can be declared on each share is 35 pence (i.e. £350 divided by 1,000 (the total number of shares)).

### **Example 3**

At the end of Year 1, the CIC in Example 1 decides that it wishes, in future, to give half of its distributable profits to charity each year. It amends its articles to give effect to this policy and issues the charity which is to benefit from this distribution with a special share. The distribution will take the form of a dividend on the special share and the amended articles refer to the charity by name.

In the next financial year (Year 2), the CIC has distributable profits of £2,000. At the start of Year 2, Bank of England base lending rate is 5 per cent. The other facts are as for Example 1.

### **Calculation**

Under the articles, an “exempt dividend” of £1,000 is paid to the named charity. There is no need to consider either the maximum dividend per share or the maximum aggregate dividend before paying this dividend (see draft Regulation 17(2) to (5)).

However, dividends payable to the individual investors are still subject to the dividend capping rules in the draft Regulations. The applicable share dividend cap is the share dividend cap in force at the beginning of the first day of Year 2, which was 10 per cent (i.e. 5 per cent + 5 per cent). The paid up value of each share is £5. The maximum dividend per share on the individual investors’ shares is therefore £5 x 10 per cent, or 50 pence. Given a total of 1,000 shares in issue, a dividend paid at this rate would result in an aggregate dividend (i.e. the total dividend to all shareholders) of £500 (i.e. 1,000 x 50 pence).

The maximum aggregate dividend for Year 2 is £700 (i.e. £2,000 x 35 per cent), which is more than £500, so the maximum dividend per share can be paid to the individual investors if the directors decide to recommend such a dividend and the shareholders approve it. (Note that the £1,000 dividend paid to the charity is not included in the calculation of the maximum aggregate dividend and that, taking account of both the capped and the uncapped dividends, the company has paid out considerably more than 35 per cent (in fact, 75 per cent) of its distributable profits in dividends: before recommending such payments, the directors must satisfy themselves that such a recommendation is consistent with their duties to the company.)

### **Example 4**

A CIC has 5,000 shares in issue, each with a paid up value of £4. It makes the following distributable profits:

Year 1 £2,000  
Year 2 £5,000  
Year 3 £1,000  
Year 4 £15,000  
Year 5 £10,000

In each of Years 1 to 5, the applicable share dividend cap is 10 per cent (so the maximum dividend per share is 40 pence) and the aggregate dividend cap is 35 per cent.

The application of the aggregate dividend cap means that the maximum aggregate dividends for each year are:

Year 1 £700  
Year 2 £1,750  
Year 3 £350  
Year 4 £5,250  
Year 5 £3,500

Suppose that the company pays no dividend in Year 1. This means that there is 40 pence per share of unused dividend capacity in respect of Year 1. In Year 2, the company pays a dividend of 25 pence per share (in aggregate, £1,250). This means that there is a further

15 pence per share of unused dividend capacity in respect of Year 2. In Year 3, the company pays no dividend. This means that there is a further 40 pence per share of unused dividend capacity in respect of Year 3.

In Year 4, if the company paid the maximum dividend per share, the total amount of dividend paid would be £2,000. However, the directors and members decide that a larger dividend is justified, and would like to make use of some of the company's unused dividend capacity to pay as much as possible (i.e. up to the maximum aggregate dividend for of £5,250 for the year).

$$£5,250 - £2,000 = £3,250$$

The dividend per share which the company wants to pay in excess of the maximum dividend per share for Year 4 is 65 pence (£3,250 divided by 5,000 shares). This will use up all the unused dividend capacity from Years 1 and 2 and 10 pence per share of the unused dividend capacity from Year 3.

In Year 5, a dividend of 70 pence per share is declared (maximum dividend per share of 40 pence for Year 5 plus 30 pence per share of unused dividend capacity from Year 3, which equals, but does not exceed, the maximum aggregated dividend of £3,500).

Note, however, that even if profits for Year 6 continue at levels similar to those of Years 4 and 5, there will be no possibility of paying a dividend of more than 40 pence per share, because all the unused dividend capacity has been used up.

### **What is meant by maximum dividend per share**

2.11. The maximum dividend per share is fixed by reference to the "share dividend cap" in force at the time that the share was issued, or, if the share was already in existence on the date the company became a CIC, the cap applicable on that date.

2.12. The share dividend cap is expressed as a percentage of the paid up value of the share (the rate). The paid up value of the share is so much of the share's nominal value as has been paid up and any premium paid on that share to the company. Thus if the company issued £1 shares fully paid at a premium of £2.50 a share the paid up value of those shares would be £3.50. This should not be confused with market value; if, for instance, the same share were purchased from an existing shareholder for £5 the paid up value would still remain at £3.50

2.13. The rate for a particular share is fixed for the life of that share and will not change if the rate generally is changed. It can, however, fluctuate if the Bank of England base lending rate changes.

2.14. For example if shares are issued when the Bank of England Base Rate at the time is 3% the maximum dividend per share will be 7%. If the Bank of England Base Rate subsequently rises to 5% the rate for those shares will rise to 9%.

2.15. Where the rate is subject to this kind of fluctuation, the rate applicable to any dividend payment is that in force on the first day of the financial year in which the dividend is declared. This may not be the same as the rate when the dividend is actually declared. For example, if the financial year begins on 1 April when the rate

is 7%, but the dividend is paid in October when the rate is 7.25% because the Bank of England has put its Base Rate up by 0.25% in the meantime.

2.16 If more than one dividend is declared in a financial year the total of all such dividends must not exceed the maximum dividend per share. For example, if the share dividend cap is 7% on the first day of the financial year the maximum amount of dividend that may be declared over the course of that financial year on a fully paid up £1 share is 7p. This may be paid either as a single dividend of 7p, or for example, an interim dividend of 3p and a subsequent final dividend of 4p.

### **What is meant by the maximum aggregated dividend**

2.17. This element of the Cap is calculated by reference to the aggregate dividend cap in force at the first day of the financial year for which the dividend is declared and is a proportion of the company's distributable profits for that year. Unlike the maximum dividend per share therefore, where the amount payable is fixed for the life of the particular share, the amount of the maximum aggregate dividend will vary from year to year in line with the distributable profits available.

2.18. For example if the cap is fixed at 25% and the distributable profits for the year are £2,000, the maximum aggregate dividend for all the company's shares would  $£2,000 \times 25\% = £500$ .

2.19. However, for any particular share the dividend must not exceed the maximum dividend per share. So, for example, if a company issued 5000 fully paid shares, each with a value of £1, but the maximum dividend per share is 9%, the company will not be able to pay a dividend per share of more than  $£1 \times 9\% = 9p$  per share. If 5000 shares are issued  $5000 \times 9\% = £450$  in total, £50 short of the maximum aggregate dividend.

## **Annex C: Code of Practice on Consultation**

1. Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. Consultation should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Consultation exercise should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

## Annex D: Consultation Response Form

**Closing date 19 June 2009**

The Regulator may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual consultation responses. This will extend to your comments unless you inform us you wish them to remain confidential.

**Please tick if you want us to keep your response confidential**

Name.....

Organisation (if applicable).....

Address

.....  
 .....  
 .....  
 .....

**Please tick one or more boxes from the list of options that best describes you or the organisation on whose behalf you are responding:**

<b>Social Enterprise</b>	<input type="checkbox"/>	<b>Central Government</b>	<input type="checkbox"/>
<b>Community Interest company</b>	<input type="checkbox"/>	<b>Local Government</b>	<input type="checkbox"/>
<b>Company limited by shares</b>	<input type="checkbox"/>		
<b>Company limited by guarantee</b>	<input type="checkbox"/>	<b>Interest Group</b>	<input type="checkbox"/>
<b>Representative/Membership organisation</b>	<input type="checkbox"/>	<b>Other (please describe)</b>	<input type="checkbox"/>
		.....	
<b>Investor/Financier</b>	<input type="checkbox"/>	.....	

**Please return completed forms by email (or alternatively by letter or fax) to:**

Phillip Horrell

Office of the Regulator of Community Interest Companies

Room 3.68

Companies House

Crown Way

Cardiff

CF14 3UZ

Email – [cicregulator@companieshouse.gov.uk](mailto:cicregulator@companieshouse.gov.uk)

Voicemail - 02920346228

Fax – 02920 346229

**Questions 1-4 for Social Enterprises, excluding community interest companies.**

**Q1.** Would the maximum dividend per share cap (5% above the Bank of England base rate) have any bearing on your decision to form as a community interest company? If “Yes” please comment below (and provide any supporting evidence) on how the cap would influence your decision.

Yes       No       Not Sure

Comments:

**Q2.** Would the maximum aggregated dividend cap (35% of a relevant company’s distributable profits) have any bearing on your decision to form as a community interest company? If “Yes” please comment below (and provide any supporting evidence) on how the cap would influence your decision.

Yes       No       Not Sure

Comments:

**Q3.** Would the interrelation between the dividend per share cap and aggregated dividend cap have any bearing on your decision to form as a community interest company? If “Yes” please comment below (and provide any supporting evidence) on how the cap would influence your decision.

Yes       No       Not Sure

Comments:

**Q4.** Would the cap on performance related interest (4% above the bank of England base rate) have any bearing on your decision to form as a community interest company? If “Yes” please comment below (and provide any supporting evidence) on how the cap would influence your decision.

Yes       No       Not Sure

Comments:

**Questions 5 & 6 for Social Enterprises, including community interest companies.**

**Q5.** Do you consider that the double cap on dividends unduly restricts your ability to raise adequate financing of business start-up and growth? If “Yes” what evidence is there that the dividend caps are unduly restrictive?

Yes       No       Not Applicable

Comments:

**Q6.** Do you consider that the cap on performance related interest unduly restricts your ability to raise adequate financing of business start-up and growth? If “Yes” what evidence is there that the performance related interest cap is unduly restrictive?

Yes       No       Not Sure

Comments:

***Questions 7 - 11 for Equity Investors and Debt Financiers***

**Q7.** Do you consider that the maximum dividend per share cap (5% above the Bank of England base rate) unduly limits incentive to those who might make an equity investment? If “Yes” what evidence is there that the maximum dividend per share cap unduly limits incentive?

Yes       No       Not sure

Comments:

**Q8.** Do you consider that the maximum aggregated dividend cap (35% of a relevant company’s distributable profits) unduly limits incentive to those who might make an equity investment? If “Yes” what evidence is there that the maximum aggregated dividend cap unduly limits incentive?

Yes       No       Not sure

Comments:

**Q9.** Do you consider the interrelation between the dividend per share and aggregated dividend caps unduly limit incentive to those who might make an equity investment? If “Yes” what evidence is there that the interrelation between the dividend per share and aggregated dividend caps unduly limit incentive?

Yes       No       Not Sure

Comments:

**Q10.** Do you consider that the cap on performance related interest (4% above the bank of England base rate) unduly limits incentive to those who might consider debt financing? If “Yes” what evidence is there that the performance related interest cap unduly limits incentive?

Yes       No       Not sure

Comments:

**Q11.** Do you consider that the 1% more by way of return on equity (under the dividend cap) than on performance related loans unduly limits incentive to those who might make equity or loan investments in a CIC to choose equity rather than a loan? If “Yes” what evidence is there that the 1% more by way of return on equity than on performance related loans unduly limits incentive?

Yes       No       Not sure

Comments:

*Questions 12 – 17 for all*

**Q12.** Do you consider the limit to the level of return on investment to **equity investors** (the dividend caps) provides adequate protection of community assets? If “No” what evidence is there that the limit to the level of return on investment to **equity investors** does not provide adequate protection?

Yes       No       Not Sure

Comments:

**Q13.** Do you consider the limit to the level of return on investment to **debt financiers** (the performance related interest cap) provides adequate protection of community assets? If “No” what evidence is there that the limit to the level of return on investment to **debt financiers** does not provide adequate protection?

Yes       No       Not Sure

Comments:

**Q14.** Do you consider the Bank of England base rate should be the preferred option for calculating the caps? If “No” what evidence is there that the Bank of England base rate should not be the preferred option?

Yes       No       Not Sure

Suggestion(s):

**Q15.** What principles should be used to set the dividend caps?

Suggestion(s):

**Q16.** What principles should be used to set the performance related interest cap?

Suggestion(s):

**Q17.** Please tell us anything else from your own experience that you consider can add to a body of evidence about the dividend and performance related interest caps.

Additional information