

*SUPERVISORY NOTICE – Immediate effect – Application for suspension of immediate effect – Credit Union – Failure to maintain positive capital in breach of FSA Rule CRED 8.3.1 R – Notice required Credit Union to make no new loans, redemptions of shares or repayments of deposits – Whether requirements in Supervisory Notice should be suspended pending hearing of reference – No – Application dismissed*

**FINANCIAL SERVICES AND MARKETS TRIBUNAL**

**ROTTON PARK AND WINSON GREEN CREDIT UNION LTD Applicant**

**- and -**

**FINANCIAL SERVICES AUTHORITY**

**Respondents**

**Tribunal: STEPHEN OLIVER QC  
MAURICE BATES**

**Sitting in public in London on 11 April 2006**

**Michael Blake, President, for the Applicant**

**Adrian Berrill-Cox, counsel, for the Respondents**

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## DECISION

1. This is an application by the Rotton Park & Windsor Green Credit Union Ltd  
5 (“the Credit Union”) to have the immediate effect of a Supervisory Notice issued by  
the Authority suspended. The application was made by letter dated 15 March 2006.

2. Rule 10(1)(e) of the Financial Services Markets Tribunal Rules 2001 provides  
10 that directions given by the Tribunal may –

“... (e) suspend the effect of an Authority notice (or prevent it taking effect)  
until the reference has been finally disposed of, or until any appeal against the  
Tribunal’s determination of the reference has been finally disposed of, or  
15 both.”

Rule 10(6) provides that the Tribunal may give such a direction only:

“if it is satisfied that to do so would not prejudice the interests of any persons  
(whether consumers, investors or otherwise) intended to be protected by the  
20 Authority notice”.

3. At the start of his hearing Mr Michael Blake, the president of the Credit  
Union, provided us with the Credit Union’s Quarterly Return to 31 March 2006. This  
had been sent to the Authority but had not yet apparently been received by the  
individual officers responsible for the issuing of the Supervisory Notice. We decided  
25 to look at this Quarterly Return and to hear Mr Blake’s explanation of the present  
state of affairs. Before explaining those, we will summarize the background  
circumstances leading to the hearing of this application.

### **Background circumstances**

4. On 23 November 2005 the Authority issued its First Supervisory Notice to the  
30 Credit Union. Under paragraph 1.2 of their Notice the Authority varied the Credit  
Union’s permission under Part IV of the Financial Services & Markets Act 2000 (“the  
Act”) by, effectively, making requirements that the Credit Union should not make any  
new loans, should not redeem any member’s shares, should not repay any deposits or  
35 should otherwise only reduce its assets in accordance with legitimate business  
expenses. Further, under paragraph 1.1, the Authority removed the regulated activity  
of accepting deposits from the Credit Union’s permission under Part IV.

5. On 19 December 2005 the Credit Union purported to make written  
40 representations to the Authority’s Regulatory Decisions Committee (“the RDC”).  
The Credit Union stated that the effect of the First Supervisory Notice would be very  
detrimental to the Credit Union and would almost certainly mean its closure. The  
waiver of the requirements would, the Credit Union suggested, enable it to carry out a  
plan maximizing current income and reducing expenditure raising profit to £12,000 in  
45 a year, collecting outstanding loans with interest and merging with a neighbouring

credit union. On 4 January 2006 the Authority responded to the Credit Union's representations.

5 6. On 19 January 2006, by telephone conference call, the Credit Union made oral representations to the RDC. In summary, the Credit Union proposed to maximize income and reduce expenditure. The Credit Union suggested that substantial money could be saved by staff refraining from taking wages and by the Credit Union negotiating a rent-free agreement over their premises for three years. The Credit Union further suggested that it would employ two debt collectors and that it expected  
10 to collect arrears at the rate of £4,000 a year realizing an income of £12,000 over three years of which they would receive £9,000. They suggested that the effect of the requirements in the First Supervisory Notice and the removal of their permission to accept deposits would frustrate their abilities to remedy the situation.

15 7. On 7 February 2006 the Authority issued a Second Supervisory Notice to the Credit Union. The action taken at paragraph 1.1 of the Notice is effectively identical to that taken in the First Supervisory Notice.

20 8. On 3 March 2006 the Credit Union referred the Second Supervisory Notice to the Tribunal on the grounds that:

(i) not enough credence was given to the recovery plan outlined during the telephone conference of 19 January;

25 (ii) whereas the RDC had stated that other credit unions might be put at a disadvantage if the Second Supervisory Notice was not issued, this was unfair as each credit union should be treated on its own merits and

30 (iii) not enough weight had been given to how detrimental the Notice would be to the Credit Union and their ability to recover.

9. On 15 March 2006 the Credit Union applied to have the effect of the Supervisory Notice suspended pending determination of the reference. The application was listed for a hearing on 11 April.

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### **The new information**

40 10. The Quarterly Return to 31 March 2006 ("the newest Quarterly Return"), provided by Mr Blake at the present hearing, was said by him to cover the period from 1 October 2005. The Quarterly Return before the Authority and the RDC had been for the period to 31 September 2005. We were not provided with a Quarterly Return for the period to the end of 2005.

45 11. The newest Quarterly Return appears to show a significant improvement in the solvency position of the Credit Union. The Quarterly Return to 31 September 2005 had shown a negative "total capital" of £31,784. The newest Quarterly Return shows an improvement by some £10,000 to £21,941. Mr Blake explained the improvement.

The Credit Union had negotiated a three-year rent reduction, and the one part-time member of its staff had foregone any salary. A reduction of expenditure at that rate, coupled with a continuation of the Credit Union's efforts to collect in interest and bad debts should, claimed Mr Blake, result in the elimination of the Credit Union's negative total capital position within a year at the outside.

### **The legal position**

12. The Authority's power to vary the permission of an authorized person derives from section 45(1)(a) of the Act where the authorized person is failing, or likely to fail, to satisfy the threshold conditions and (c) where it is desirable to exercise the power in order to protect the interests of consumers or potential customers. The power to impose requirements upon a Part IV permission lies under section 45(1) of the Act. Under section 53(3) of the Act, if the Authority reasonably considers that it is necessary, such variations may take immediate effect.

13. The Authority, in exercising its power to vary a permission, will have regard to the FSA Handbook. In this case the Credit Union Sourcebook ("CRED"), the Threshold Conditions ("COND") and the Enforcement Manual ("ENF") set out the relevant guidance. In particular CRED 5.1.5 provides that the FSA may exercise its powers if one of the Threshold Conditions is not met (in this case COND 2.4 – inadequate resources, expressed by COND 2.4.2G(2) to include financial resources, capital, provisions against liabilities, holdings of or access to cash and other liquid assets). In terms of financial resources, a credit union "must at all times maintain a positive amount of capital" (CRED 8.2.1R) and CRED 8.3.3G states that this implements the principle that every pound saved by a depositor with a credit union should always be worth at least a pound.

14. CRED 5.2.1(5) requires the Authority to be satisfied that the Credit Union is fit and proper to be authorized and to be allowed to carry on regulated activities and CRED 5.2.4 allows the Authority to exercise powers under section 45 of the Act where it is likely that the Credit Union is failing or is likely to fail to satisfy the threshold conditions (effectively reiterating section 45(1)(a)).

15. Paragraph 3.5 of ENF covers the Authority's policy on variation of Part IV permissions providing that the Authority should have regard to its regulatory objectives and the regulatory tools available to it (ENF 3.5.2G); that relevant circumstances will include where the Authority has serious concerns that the person has breach requirements imposed on it by, or under, the Act and that those breaches are material in number or individual seriousness (ENF 3.5.8G) and where an urgent response to serious concerns may be necessary, the extent of loss or risk of loss or adverse effect on consumers and steps taken by the authorized person to address the issue (ENF 3.5.13G).

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## **The Authority's case in relation to this application**

16. The Authority emphasized the requirement that credit unions should have positive capital. As at September 2005, according to its audited Quarterly Return, the Credit Union had negative capital of £31,784. On that basis there was insufficient capital in the Credit Union to return to each of the depositors the entirety of their deposits. To allow further deposits to be accepted would simply mean that more people found themselves in this position; this would constitute a risk to potential consumers as well as, as a consequence of the expansion of liabilities, a risk to existing consumers. It was not clear to the Authority how any new loans might be funded. Moreover, in circumstances where the Credit Union had, as here, shown itself on the available information to be insolvent, the repayment of one depositor without the repayment of all of them would effectively amount to the preference of one creditor over another in circumstances where not all creditors could be repaid in full. This would not be fair to consumers. Similarly, in such circumstances, the increasing of liabilities would seem likely to be prejudicial to the interest of all creditors.

17. The Authority recognized that the Credit Union had made proposals of recovery plans, but the Authority considered that those proposals lacked sufficient impact and could be implemented notwithstanding the variation of permission and the requirements imposed. The Credit Union's audited accounts (i.e. the quarterly returns to the end of September 2005) showed negative capital of £31,784. This, it was observed, was only a marginal (6 per cent) improvement on the negative capital position of £33,922 as at September 2004 and worse than a negative capital of £29,344 shown in September 2003. Thus, notwithstanding having been given a reasonable period in which to correct its capital position and having attempted to do so, the Credit Union had failed to achieve any, or any significant, improvement.

18. The Authority also observed that on 11 February 2005 it had asked the Credit Union to provide an action plan by 14 March 2005. The Credit Union had provided an action plan stating that it intended to recoup all bad debts by 31 January 2006, to obtain a subordinated loan by April 2005 and to reduce its deficit to "an appropriate amount" by 31 March 2006. In the events, it was observed by the Authority, no subordinated loan had been arranged and, at least until the hearing of the present application, there had been no evidence indicating any significant reduction in recovery of bad debts.

19. The Authority's reaction to the new information provided by Mr Blake at the present hearing was to suggest that more time was needed, first to analyze the figures in the newest Quarterly Return and secondly to see if the apparent improvement was being sustained. Bearing in mind that the deficit had been there since at least 2003, an improvement shown by one Quarterly Return was not, suggested the Authority, enough to warrant a decision that remedial action was no longer required or, at least, should be suspended.

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### **The justification put forward by the Authority for its action**

20. The Authority addressed the suggestion of the Credit Union that the effect of its (the Authority's) action was so detrimental that it could force the Credit Union to close down. The Authority observed that, to the extent that it had been open to the  
5 Credit Union to take steps to return itself to solvency prior to the Supervisory Notice, it remained open to the Credit Union to do so, but it had not done so. The Credit Union had failed to maintain a positive amount of capital since September 2003 until at least September 2005. It was clear from both COND and CRED that this was not an acceptable position, principally because of the risk it posed to consumers. That  
10 risk continued and would not be made any worse if the Credit Union were to close down. In those circumstances, the Financial Services Compensation Scheme could become involved and members would recover at least most, and probably all, of their savings.

15 21. The Authority claimed that the risk of loss to consumers attributable to the Credit Union's financial position caused such concern to the Authority that the use of its powers to remove the Credit Union's permission to accept deposits with immediate effect was justified, particularly in the light of the matters referred to above.

20 22. Finally, observed the Authority, the Credit Union had had sufficient opportunity to rectify its financial position prior to the action of the Authority and had failed to do so.

### **The Applicant's Case**

25 23. The new information (summarized in paragraphs 10 and 11) made it unnecessary for the Notice to have immediate effect. Suspension of the immediate effect of the Notice would enable the Credit Union to continue all its activities and so achieve a state of solvency.

### **30 Conclusions**

24. We have to be satisfied that a direction of ours suspending the effect of the Supervisory Notice or any of the requirements contained in it would not prejudice the interests of any investors or shareholders in and borrowers from the Credit Union. The evidence does not satisfy us on those matters.  
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25. In all the circumstances, and even allowing for the improvements shown in the newest Quarterly Return, we have decided that we should not suspend the effect of the Supervisory Notice or any of the requirements contained in it. Moreover, it seems to us, on the face of it, that the terms of the Supervisory Notice were sufficiently  
40 appropriate in all the circumstances.

26. The most significant feature of the case is the substantial negative capital position of the Credit Union. This had not been adequately addressed from 2003 until at least October 2005, and even with the improvements shown in the newest Quarterly

Return it would still not be possible to repay all the depositors should repayment be required. That negative capital position appears to show, at the time when the Supervisory Notice was issued, that the Credit Union presented a risk to consumers and potential customers and, notwithstanding the figures in the newest Quarterly Return, that risk continues. We recognize that the figures in the newest Quarterly Return show a trend towards a positive total capital position; but figures in one Quarterly Return are not enough for present purposes. The trend needs to be sustained.

27. It seems to us that the removal of the Credit Union's permission to accept deposits and the requirements placed upon the Credit Union in the Supervisory Notice do not prevent the Credit Union from implementing any of the remedial measures proposed by the Credit Union or other suitable measures. And if the Authority's action did prevent the implementation of some or all of the proposed remedial measures, the action set out in the Supervisory Notice is still, on the evidence available to us at this stage, necessary and proportionate given the legal position and seriousness of the Authority's concerns.

28. In summary we think that, on the face of it and subject to the outcome of a full hearing of the substantial reference, it is reasonable and proportionate for the Authority to impose the requirements set out in the Supervisory Notice and the variation of permission upon the Credit Union in pursuance of the Authority's statutory objectives and, particularly, in order to protect the consumers. No doubt the Authority will pay close attention to the financial position of the Credit Union and, if the trend continues, will reconsider the necessity of imposing the restrictions contained in the Supervisory Notice.

29. For those reasons we dismiss the Application.

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**STEPHEN OLIVER QC**

**CHAIRMAN**

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