
STATUTORY INSTRUMENTS

1994 No. 749

BUILDING SOCIETIES

**The Building Societies (Undated
Subordinated Debt) Order 1994**

<i>Made</i>	- - - -	<i>11th March 1994</i>
<i>Laid before Parliament</i>		<i>18th March 1994</i>
<i>Coming into force</i>	- -	<i>15th April 1994</i>

The Building Societies Commission, with the consent of the Treasury, in exercise of the powers conferred upon it by section 45(5) of the Building Societies Act 1986⁽¹⁾, hereby makes the following Order:—

Citation and commencement

1. This Order may be cited as the Building Societies (Undated Subordinated Debt) Order 1994 and shall come into force on 15th April 1994.

Interpretation

2. In this Order—

“the Act” means the Building Societies Act 1986;

“the applicable provisions” means section 97 of the Act and the other applicable provisions as therein described;

“borrower” in relation to qualifying subordinated debt means the person to whom that debt was advanced or to the extent that some other person has succeeded to the rights and obligations under the issue terms of the recipient of the advance, that other person;

“commercial company” means a company within the meaning of the Companies Act 1985⁽²⁾;

“crediting” in relation to interest on qualifying subordinated debt shall not include incurring in lieu of interest, further qualifying subordinated debt credited as fully paid by the application of reserves to an amount not greater than the interest foregone;

“creditors” in relation to a society extends to members holding shares in the society, other than deferred shares, as regards the principal of those shares and all interest due thereon in accordance with their terms;

(1) 1986 c. 53.

(2) 1985 c. 6.

“the first criterion” means the first criterion in section 45(3) (the criteria for prudent management) of the Act;

“issue terms” in relation to an issue of qualifying subordinated debt means the provisions of a document which sets out or of a connected series of documents which set out the rights and obligations of the borrower, the lender and other persons if any in relation to such debt;

“lender” in relation to qualifying subordinated debt means the person by whom that debt was advanced or to the extent that some other person has succeeded to the rights and obligations under the issue terms of the person by whom the debt was advanced, that other person;

“the prescribed terms” means the terms specified in Schedule 1 hereto and “the disqualifying terms” means the terms specified in Schedule 2 hereto;

“qualifying subordinated debt” has the meaning ascribed to it in article 3(2);

“rate” in relation to interest means the rate per annum and “fixed rate”, “floating rate”, “market rate” and “stepped rate” have the respective meanings assigned by article 3(3);

“relevant consent” has the meaning ascribed to it in article 5(2);

“society” in relation to an issue of undated loan capital means a building society which is or proposes to become the borrower in relation to the qualifying subordinated debt from which such capital is derived;

“specified” means specified by issue terms;

“supervisory authority” means—

- (a) in relation to a borrower which is a society, the Commission;
- (b) in relation to a borrower which is an authorised institution for the purposes of the Banking Act 1987(3), the Bank of England; and

“undated loan capital” means financial resources derived from qualifying subordinated debt.

Capital resources which may be aggregated with reserves

3.—(1) Subject to articles 4 and 5 below where a society has obtained fully paid up undated loan capital derived from qualifying subordinated debt in respect of which the society is the borrower that undated loan capital may, for the purposes of the first criterion be aggregated with reserves save that in so far as the amount of such undated loan capital exceeds the extent, or contravenes any conditions specified by any order made under section 45(5) of the Act in relation to such capital or to the total of such capital with other items which, apart from such extent or such contraventions would be aggregable with reserves, that excess shall be excluded from such aggregation.

(2) For the purposes of this article “qualifying subordinated debt” means a sum borrowed on issue terms which—

- (a) have the effect that no repayment will be made to the lender except—
 - (i) with the relevant consent of the supervisory authority, or
 - (ii) subject to sub-paragraph (b) of this paragraph in the winding up of the borrower;
- (b) have the effect that in the winding up of the borrower claims in respect of such debt shall be limited to such amount as would have been payable in respect thereof if immediately prior to the commencement of the winding up and thereafter the lender—
 - (i) in the case where the borrower is a society, were the holder of a share having a value calculated in accordance with section 119(3) of the Act equal to the principal amount of such debt, being a deferred share which the borrower, being a society having power to issue such shares, would be able to aggregate with reserves pursuant to an

- order made under section 45(5) of the Act, but ranking for the purposes of a dividend in the winding up prior to any such shares which had been issued by the society, or
- (ii) in the case where the borrower is a commercial company, were the holder of a share in the capital of the company of nominal value equal to the amount of such debt, being a share having a right, preferred over equity share capital and any preference shares which had been issued by the company, in the winding up of the company to a return of capital and accrued interest;
- (c) provide for payment, subject to a term which has the effect of the prescribed term, in respect of such periods as may be specified, of interest at a specified rate which shall be—
 - (i) a fixed rate;
 - (ii) a stepped rate; or
 - (iii) a floating ratebut which shall not be ascertained by reference to the profits of the society or any other factor other than a market rate;
 - (d) issued upon issue terms which have the effect of the prescribed terms without other terms or with only such other terms as are not inconsistent with the prescribed terms, and
 - (e) are not issued upon issue terms which have the effect of any of the disqualifying terms.
- (3) In this article—
- “a fixed rate” means a rate of interest which remains the same for so long as the debt remains outstanding;
- “a stepped rate” means a rate of interest which increases or reduces from time to time by steps specified in time and amount;
- “a floating rate” means a rate of interest which is ascertained from time to time by reference to a specified market rate or by reference to a specified market rate varied by a specified margin;
- “a market rate” means—
- (a) a rate being one of, or an average of, any published rates of interest applicable from time to time for the purpose of calculating interest on debt or other financial obligation arising from transactions between institutions which are authorised for the purposes of the Banking Act 1987;
 - (b) a rate being one of, or an average of, any rates of interest applicable from time to time for the purpose of calculating interest payable on any class of securities issued in the United Kingdom by Her Majesty’s Government;
 - (c) a rate being one of, or an average of, any published figures specifying the rate of yield obtainable on any class of securities issued in the United Kingdom by Her Majesty’s Government;
 - (d) the rate of interest payable on such interest bearing shares other than deferred shares in the society as have from time to time the lowest rate of interest; or
 - (e) the rate of interest payable on such interest bearing shares other than deferred shares in the society as have from time to time the highest rate of interest.
- (4) For the purposes of this article—
- (a) a market rate shall be taken to be specified notwithstanding that the issue terms contain a provision to the effect that, if a specified rate of interest or of yield applying to the issue as a market rate ceases to be published, another published market rate may be substituted therefore, being a rate which is calculated on principles as near as possible to the principles of calculation of the previously applicable rate, and subject thereto, such that immediately

after substitution, the market rate shall be as nearly as practicable the same, as that applying immediately before the substitution, and

- (b) for the purposes of this article a rate of interest or of yield shall be taken to be published if it is ascertainable at regular intervals by reference to any national newspaper or other periodical publication or by reference to any electronic retrieval system accessible by the borrower and the lender or is notified to the borrower by an institution which is authorised for the purposes of the Banking Act 1987 being a rate of interest or of yield applicable as between institutions so authorised.

Shares not to be written down

4. Undated loan capital shall not be aggregated with the reserves of a society for the foregoing purposes at any time at which the terms on which shares in the society other than deferred shares are held, whether contained in the society's rules or otherwise, enable those shares to be written down.

Effect of supervisory authority's consent to repayment

5.—(1) Where the supervisory authority gives relevant consent to repayment by a society of qualifying subordinated debt the undated loan capital derived from the debt to which such consent relates shall cease to be aggregable with the reserves of the society for the foregoing purposes when such consent is notified to the society whether or not such debt is repaid pursuant to that consent.

(2) For the purposes of this article, "relevant consent" means consent applied for by the borrower otherwise than in consequence of a provision among the issue terms requiring the borrower so to apply or granting a benefit to the borrower for so applying or imposing a sanction against failure by the borrower so to apply.

Amendment of the Building Societies (Designated Capital Resources) (Permanent Interest Bearing Shares) Order 1991

6. The Building Societies (Designated Capital Resources) (Permanent Interest Bearing Shares) Order 1991(4) shall have effect except in relation to any permanent interest bearing shares issued by a society prior to the date on which this order comes into force as if, in the definition of "subordinated debt" in article 2(1) thereof the words "within a period not less than five years from the date of the transfer" were omitted.

In witness whereof the common seal of the Building Societies Commission is hereunto fixed and is authenticated by me, a person authorised under paragraph 14 of Schedule 1 to the Building Societies Act 1986, on 7 March 1994.

L.S.

7 March 1994

J. Dennis
Secretary to the Commission

We consent to this Order.

11 March 1994

T. Kirkhope
I. Patnick
Two of the Lords Commissioners of Her
Majesty's Treasury

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SCHEDULE 1

Article 2

THE PRESCRIBED TERMS FOR QUALIFYING SUBORDINATED DEBT

1. Subject to paragraph 2 of this schedule the prescribed terms are terms which have effect so as—

(a) to prohibit the payment or crediting of interest on the debt if on the date on which such interest would, in the absence of such term, fall to be paid the borrower is for the purposes of such term insolvent and the borrower for such purpose shall be taken to be insolvent if the borrower is unable to pay its debts as they fall due or if the assets of the borrower at that date are, or after such payment of interest if made would be, not greater than the borrower's liabilities including all liabilities to creditors other than creditors in respect of the debt upon which such interest would be payable on in respect of qualifying subordinated debt ranking thereafter or *pari passu* therewith.

(b) to prohibit the payment or crediting of interest on the debt in respect of any financial year of the borrower or part of a year (hereinafter called "the interest period") if the borrower has cancelled the interest or dividend upon—

(i) shares of the borrower, being a society, of any class other than deferred shares, or

(ii) deposits with the borrower except other subordinated debt,

which falls, in accordance with the terms applying to that class of share or those deposits, to be paid or credited at any time before the end of the interest period and for the purposes of this term interest shall, if the borrower has deferred or suspended payment thereof, for so long as it remains outstanding be taken to have been cancelled, and interest upon shares or deposits shall be taken to fall to be paid or credited if it would have so fallen but for any provisions relating thereto entitling the borrower to cancel defer or suspend payment.

For the purposes of this term "other subordinated debt" means debt ranking before the qualifying subordinated debt but in respect of which no repayment will be made to the creditor in a winding up except where at least all sums due to other creditors in the winding up are paid to those creditors in full.

(c) to prohibit the payment or crediting of interest on the debt for any specified period if the board of directors of the borrower, being a society are of opinion that—

(i) there has been a failure by the society to satisfy the first criterion and such failure is then continuing, or

(ii) the payment or crediting of that interest or, as the case may be, payment or crediting in full of that interest, would cause or contribute to such a failure by the society,

and in such case passes a resolution cancelling such interest or as the case may require reducing it to such extent as may be necessary to secure that there will be no such failure and upon the passing whereof the lender in respect of that debt shall cease to have any right to the interest for that period so cancelled or, as the case may be, any interest other than the reduced amount payable in accordance with that resolution;

but it shall not be contrary to this prescribed term for arrears of interest which but for such term would have accrued, to be payable if the board of directors of the borrower shall, being satisfied that there is no continuing failure to satisfy the first criterion, pass a resolution to make payment of such arrears, or such part thereof as may be paid without breach of such criterion.

2. Issue terms shall not be taken for the purposes of article 3(2)(d) of this order to be inconsistent with the prescribed terms by reason only of a provision permitting interest, the payment or crediting of which is prohibited by the prescribed term, to be accumulated, with or without interest accumulating thereon, until such date as the borrower may pay it without a breach of the prescribed term.

SCHEDULE 2

Article 2

THE DISQUALIFYING TERMS FOR QUALIFYING SUBORDINATED DEBT

1. The disqualifying terms are—

- (a) any term which requires or permits the debt to be repaid otherwise than in sterling;
- (b) subject to paragraph 3 below any term which has effect so as to prohibit, restrict or impose any sanction against the taking by the borrower, being a society, of any steps towards—
 - (i) amalgamation with another building society under section 93 of and Schedule 16 to the Act;
 - (ii) transfer of its engagements to any extent to another society in accordance with section 94 of and Schedule 16 to the Act; or
 - (iii) transfer of the whole of its business to a company in accordance with the applicable provisions.
- (c) any term which has the effect that the rate of interest, or as the case may be, margin, specified in respect of the debt is increased by more than—
 - (i) 0.75% in a single step;
 - (ii) 0.75% in aggregate by a number of steps in any period of 5 years; or
 - (iii) 1.5% in aggregate by a number of steps without limit of time,ascertained in accordance with paragraph 2 below.

2.—(1) The increase of the rate of interest for the purposes of an issue of qualifying subordinated debt the issue terms whereof specify a stepped rate, is to be ascertained—

- (a) for the purposes of paragraph 1(c)(i) above, by deducting from the rate of interest specified for the period immediately after the increase the rate of interest specified for the period immediately before the increase;
- (b) for the purposes of paragraph 1(c)(ii) above, by deducting from the highest rate of interest specified for any part of any period of five years, the lowest rate of interest specified for any other part of that period;
- (c) for the purposes of paragraph 1(c)(iii) above, by deducting from the highest rate of interest specified for any period, the lowest rate of interest specified for any other period.

(2) The increase of the margin for the purposes of an issue of qualifying subordinated debt the issue terms whereof specify a floating rate, being a market rate varied by a margin, is to be ascertained in the manner set out in subparagraph (1) above, save the references to the rate of interest specified shall be read as references to the margin specified.

3.—(1) None of the following terms shall be a term to be taken to be a disqualifying term pursuant to paragraph 1(b) above—

- (a) a provision which requires notification of any other person of a proposal to take any of those steps;
- (b) a provision which requires the consent of the lender (or, where the lender comprises more than one person, of all or some of them), or of a person acting on behalf of the lender, to a transfer of engagements of the borrower where that transfer is not a transfer of all its engagements;
- (c) a provision, in the case where the interests of the lender are represented by a trustee, which requires a borrower which proposes to transfer its business to a company to satisfy that trustee that the transferee of the business will be or (as the case may be) remain an authorised institution or (if that trustee is not so satisfied) to obtain the consent of the

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- lender (or, where the lender comprises more than one person, of all or some of them) to the transfer;
- (d) a provision which, in connection with a transfer of the business of the borrower to a company, requires or permits issue terms to be varied or supplemented where and only where—
- (i) that variation or supplement is not one which would or might cause any of the supplementary financial resources to which those issue terms relate and which comprise supplementary capital to be excluded from the financial resources considered appropriate by the Bank of England for the purposes of paragraph 4(2) of Schedule 3 (minimum criteria for authorisation) of the Banking Act 1987, and
 - (ii) the circumstances in which that variation or supplement may take place are restricted by one of the qualifying restrictions set out in subparagraph (2) below.
- (2) For the purposes of subparagraph (1)(d) above the qualifying restrictions are—
- (a) a restriction to the effect that the variation or supplement of the issue terms referred to in that subparagraph is limited to dealing with matters arising out of the procedure by which the transfer takes place and the constitution of the transferee;
 - (b) a restriction that the issue terms may be varied or supplemented to an extent beyond the limits specified in paragraph (a) only if the Bank of England consents to that variation or supplement.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order is made under section 45(5) of the Building Societies Act 1986 which permits the Building Societies Commission with the consent of the Treasury to specify descriptions of capital resources which may be aggregated with reserves for the purpose of the first criterion of prudent management (maintenance of adequate reserves and other designated capital resources) in section 45(3) of the Act.

It designates, by article 3(1), as capital resources, undated loan capital namely financial resources deriving from qualifying subordinated debt, that is to say debt which is only repayable with the consent of the supervisory authority (which in the case of a building society is the Commission) or in the winding up of the borrower ranking after all liabilities save those in respect of deferred shares, or in the case of a commercial company as successor to the borrower, equity capital.

Such qualifying subordinated debt must also be debt—

in respect of which interest may be at a fixed or variable rate, but not ascertained by reference to the borrower's profit (article 3(2)(c));

in respect of which payment of interest is prohibited if the borrower is insolvent, or the borrower has cancelled the interest or dividend upon any shares of the society other than deferred shares or upon deposits other than other subordinated debt, or the society is, or would, upon payment of the interest, be in breach of the first criterion in section 45(3) of the Act (article 3(2)(d) and Schedule 1);

and must not be issued upon terms which—

require or permit repayment other than in sterling (article 3(2)(e) and Schedule 2, paragraph 1(a));

restrict a society from merging with or transferring any of its engagements to another society or transferring the whole of its business pursuant to section 97 (transfer of business to a commercial company) of the Act (article 3(2)(e) and Schedule 2, paragraph 1(b));

permit the rate interest (or in case of interest related to some other rate, the margin with respect to that rate) to rise by more than specified percentages (article 3(2)(e) and Schedule 2 paragraph 1(c));

Undated loan capital is not to be aggregated with the reserves of the society for capital adequacy purposes if the rules of the society permit any shares of the society, other than deferred shares, to be written down (article 4).

If the supervisory authority gives consent to repayment of qualifying subordinated debt the undated loan capital derived therefrom ceases to be aggregable with reserves for capital adequacy purposes (article 5).

The Order also amends the Building Societies (Designated Capital Resources) (Permanent Interest Bearing Shares) Order 1991 by amending the definition of subordinated debt in article 2(1) thereof. The effect of this amendment is that future issues of permanent interest bearing shares will be required to be upon terms that, upon transfer of the society's business to a commercial company, the shares will be converted into debt repayable only upon winding up subordinated to all sums due to other creditors or with consent of the Bank of England. As originally enacted, the 1991 Order confined the necessity for Bank of England consent to five years from the transfer (ie the debt in replacement of the shares could be term subordinated debt).

The Order gives effect, in respect of undated subordinated debt issued by building societies, to the provision of the European Communities Council Directive on the own funds of Credit Institutions (89/299/EEC) (OJNo. L142, 5.5.89 p.16) that among other sources of capital, securities of indeterminate duration of a credit institution may be counted as own funds for solvency and prudential purposes.

The extent to which such resources may be aggregated is limited by the Building Societies (Designated Capital Resources) Order 1992 (SI 1992/1611) as amended by the Building Societies (Designated Capital Resources) (Amendment) Order 1994, (together "the Designated Capital Resources Orders") of even date with this Order. This gives effect to a limitation in the Directive.

This Order enables societies to count as capital, subject to the limitations of the Designated Capital Resources Orders, the proceeds of issue of a new category of subordinated debt, but does not impose any new burden on business and no compliance cost assessment has been prepared.