



Department for
Business, Energy
& Industrial Strategy

Office of the Regulator of Community
Interest Companies: Information and
guidance notes

Chapter 6: The Asset Lock

MAY 2016

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6.1. Restrictions on the transfer of assets (the Asset Lock)

The Asset Lock is a fundamental feature of Community Interest Companies (CICs). It is important that you understand the concept before setting up a CIC as it has permanent long-term consequences.

The Asset Lock is designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.

6.1.1. A transfer of assets must satisfy certain requirements

This means that, subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must satisfy one of the following requirements:

- It is made for full market value so that the CIC retains the value of the assets transferred;
- It is made to another asset-locked body (a CIC or charity, a registered society or non-UK based equivalent) which is specified in the CIC's Articles of Association;
- It is made to another asset locked body with the consent of the Regulator; or
- It is made for the benefit of the community.

Provision to this effect must be included in a CIC's Articles. CICs are also able to adopt asset lock rules that impose more stringent requirements, provided they also include these basic provisions.

6.1.2. What is a 'specified' asset-locked body

An asset-locked body means a community interest company, a charity, a permitted registered society or a body established outside the United Kingdom that is the equivalent to those persons.

It is important to consider whether you want to specify an asset-locked body as a recipient of your CIC's assets in the CIC's Articles.

Such a nomination may prove particularly important in the event of the CIC being wound up or dissolved when it is not insolvent, as, in the absence of a nomination, the CIC will be in consultation with the Regulator to decide the destination of any remaining assets.

In addition, the Regulator will have to approve any transfers (for less than full consideration) to asset-locked bodies which are not nominated in the CIC's Articles.

6.1.3. Restrictions on the return assets to members

With only very limited exceptions such as the payment of dividends and the return of paid up capital on liquidation, a CICs assets cannot be returned to its members unless they are themselves asset locked bodies. Chapter 6.3 explains the payment of dividends and the cap on dividends which is an important feature of the Asset Lock that applies to dividends paid to non-asset locked bodies.

6.1.4. Assets can be used as collateral

Normal trading conditions apply. A CIC is a limited company with all the usual duties and obligations. The Asset Lock should not be seen as a bar to the CIC using its assets for normal trading, or other business activities, and meeting its financial obligations.

For example, a CIC may take on a commercial venture with the purpose of generating profits to support its objects. If the venture fails and makes losses the CIC must still meet its contractual obligations in regard to the venture even if this means depleting its assets or selling some of them to meet its debts.

6.1.5. Interpretation of transfer of assets

The transfer of assets at less than market value must be given a wide interpretation and it should always be remembered that cash is often an organisation's main asset. Payments for services etc must represent full market value. This means, for example, that payments to staff and directors must not be disproportionately high in relation to their abilities and the services they perform. Similarly management, or other service charges (particularly if provided by associates who are not asset locked bodies), must represent value for money.

6.1.6. The community interest test and the asset lock

There is a clear relationship between the asset lock and the community interest test in that the test may not be seen to be met if a reasonable person might consider that the activities of the CIC are being carried on for the benefit of the company's directors, employees or service providers rather than for the benefit of the community.

6.1.7. Providing a service at less than the market rate

There is no reason why a CIC should not be able to provide a service, which is delivered at less than the going open market rate providing it covers its outgoings and does not infringe other legal considerations, such as, wrongful trading or unfair competition.

6.2. Dividends and the Dividend Cap Overview

The ability of a CIC to pay dividends to shareholders depends on its constitution.

6.2.1. CIC CLG without a share capital

A CIC which is a company limited by guarantee without share capital has no shareholders and so cannot pay dividends (see Chapter 3).

6.2.2. CIC with a share capital, adopting Schedule 2

A CIC which is a company limited by shares adopting Schedule 2 Articles may only pay dividends to specified asset-locked bodies, or other asset-locked bodies with the consent of the Regulator (see Chapters 3 and 5).

In these circumstances, the amount of dividend is not subject to the dividend cap, but is subject to the same constraints that apply to an ordinary company, for example, the rules as to distributable profits. This is a detailed subject beyond the scope of these notes and professional advice should be obtained.

6.2.3. CIC with a share capital, adopting Schedule 3

A company limited by shares adopting Schedule 3 Articles may pay dividends to shareholders who are not asset locked bodies, including private investors. However, the payment of a dividend to a private investor is subject to a dividend cap.

Any dividend paid is subject to the Companies Act 2006, the company's Articles of Association and the CIC legislation. (see Chapter 5)

6.2.4. Restrictions on the payment of dividends

If an asset-locked body holds shares, then there is no additional constraint on the payment of dividends, provided that:

- The Regulator has consented to the payment; or
- The asset-locked body concerned is named as a possible recipient of the company's assets in its Articles.

The dividend will be subject to the dividend cap if shares:

- Are not held by an asset-locked body, or

- Are held by an asset-locked body not specified in the Articles of Association and the Regulator has not consented to the payment of the dividend.

Unlike most companies CICs may only declare a dividend by ordinary or special resolution, of the members. This means that the directors cannot declare a dividend without consulting the members and gaining their support.

Annex A contains a flow chart of the steps typically taken for a CIC to pay a dividend.

6.3. The Dividend Cap

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.

With effect from 01 October 2014, the dividend cap has a single element called the maximum aggregate dividend cap. This ensures that 65% of the CICs profits are reinvested back into the company or used for the community it was set up to serve.

The cap previously had three elements:

- The dividend per share cap, which linked dividend payments to the paid up value of the share;
- the maximum aggregate dividend cap;
- the capacity to carry-over unused dividend payments for up to 5 years;

The changes made by the Secretary of State on 01 October 2014 removed the dividend per share cap, which was linked to the paid up value of the share, and the capacity to carry forward unused dividend payment to future years. The decision was taken to retain the maximum aggregate dividend cap at the current level.

This change was retrospective effectively removing the dividend per share cap from all dividend payments

6.3.2. Changes to the dividend per share cap

The dividend per share cap was removed on 01 October 2014.

The first dividend per share cap was set under the CIC Regulations 2005. The Regulations allowed the Regulator to make further changes to the rates after consultation with the sector and with the approval of the Secretary of State.

The table below shows the changes to the cap, commencing with the most current which took effect from 01 October 2014.

Shares in Issue	Dividend Per Share Cap
All shares issued by CICs to non-asset locked bodies	The dividend per share cap has been removed retrospectively from 01 October 2014.
06 April 2010 - 30 Sep 2014	20% of the paid-up value of a share in a relevant company
01 July 2005 - 05 April 2010	5% points higher than the Bank of England's base lending rate of the paid up value of share

Please note that these caps are maximums. They should not be taken as in any sense suggesting that those who invest in CICs 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 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.

6.3.3. The maximum aggregate dividend cap explained

The cap is calculated by reference to the aggregate 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. The amount of the maximum aggregate dividend will vary from year to year in line with the distributable profits available.

The maximum aggregate dividend cap is retained at 35%. The rate has been set at 35% since CICs were introduced in July 2005.

A worked example of the maximum aggregate dividend cap is at Annex A.

6.4. Performance related interest cap

Subject to its Articles, 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. This Chapter is not concerned with normal lending of this type but with 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”) and the ability to pay uncapped interest on such debt would circumvent the dividend cap.

The CIC Regulations 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. 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 is changed.

6.4.1. Changes to the performance related interest cap

The performance related interest cap was increased to 20% on 01 October 2014.

The CIC Regulations set the first caps. The Regulations allowed the Regulator to make further changes to the rates after consultation with the sector and with the approval of the Secretary of State. There have been three changes to the caps since the introduction of CICs in July 2005. The table below shows the changes to the cap, commencing with the most current which took effect from 01 October 2014.

A worked example of the performance related interest loan for debts secured post 06 April 2010 is at Annex A.

Agreements made between	Interest Cap:
01 October 2014 to date.	20 percent of the average amount of a community interest company’s debt, or 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 (Schedule 4 of the CIC regulations 2005)
06 April 2010 to 30 September 2014	10 percent of the average amount of a community interest company’s debt, or sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest

Agreements made between	Interest Cap:
	on that debt or debenture becomes due (Schedule 4 of the CIC regulations 2005)
01 July 2005 to 05 April 2010	Four percentage points higher than the Bank of England's base lending rate of the average amount of a community interest company's debt, or 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 (Schedule 4 of the CIC Regulations 2005)

6.5. Redemption and repurchase of shares and reduction of capital

A company with a share capital may, subject to its constitution and compliance with company law, redeem shares, purchase its own shares or reduce its share capital. If your CIC is considering doing any of these things, you should seek professional advice. This is a complex area of law for any company, and a general treatment of the requirements of the Companies Act 2006, in relation to these operations, is beyond the scope of this guidance. This chapter concentrates on the additional rules that apply to CICs in this area.

In many circumstances, redemption and repurchase of shares, or reduction of share capital, is in effect a distribution of assets to members particularly where the member receives a premium over the paid up value of the shares. CICs are subject to additional rules in relation to such operations because if they were able, for example, to reduce their share capital without restriction, this could undermine the asset lock. Sections 30(1) & (2) of the CAICE Act and regulations 24 and 25 of the CIC Regulations 2005, therefore contain a number of provisions to prevent this.

6.5.1. Redemption and repurchase of shares

Regulation 24 prevents a CIC from distributing its assets through the redemption or purchase of its own shares unless the payments are set at, or below, the paid up value of the shares. This supplements the asset lock provisions in the Articles of Association of a CIC.

A company must have the necessary powers to issue redeemable shares, or to purchase its own shares, in its Articles of Association. Additionally, the Articles of Association must comply with the Companies Act 2006 and the CIC Regulations with regard to such distributions.

The amount paid must not exceed the paid up value of the shares, that is, the amount of the nominal value paid up together with any premium paid to the company. Please note that section 686 and section 691 provides that redeemable shares must be fully paid on redemption.

The Companies Act 2006 contains detailed rules (which are different for public and private companies) as to the funds that may be used for the redemption.

When the shares have been redeemed they are cancelled and the issued share capital is reduced by their nominal value.

6.5.2. Reduction of capital

Regulation 25 prevents a CIC from distributing its assets by reducing its share capital, unless it does so:

- By reducing part of the value of shares that is not paid up, or
- By paying to members no more than the paid up value of their shares.

The company must have the necessary powers to reduce its capital in its Articles of Association. Additionally, the Articles of Association must comply with the Companies Act 2006 and the CIC Regulations with regard to such distributions.



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CIC14/1089