



COMMUNITY INTEREST COMPANIES

SUMMARY OF THE RESPONSES TO THE
CONSULTATION ON THE DIVIDEND AND
INTEREST CAPS

Issued by the Regulator of Community Interest
Companies

October 2009

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SECTION 1 - INTRODUCTION

Background

- 1. On 30 March 2009, the Regulator of Community Interest Companies consulted to seek 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.
- 2. The purpose of the consultation was 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. The closing date for responses was 19 June 2009.

Legislative context and the scope for change by the Regulator

3. Under regulation 22(3) of the Regulations the Regulator may, subject to the approval of the Secretary of State, set a new share dividend cap, aggregated dividend cap or interest cap, which may result in a change to the level of any of the caps and/or the way it is expressed. This means the Regulator may consider changes as outlined below:

In respect of the maximum dividend per share cap:

- the percentage points (currently 5%) higher than the Bank of England’s base lending rate; and
- the reference to the Bank of England base rate.

In respect of the maximum aggregated dividend cap:

- the percentage (currently 35%) of the relevant company’s distributable profits.

In respect of the interest cap:

- the percentage points (currently 4%) higher than the Bank of England’s base lending rate; and
- the reference to the Bank of England base rate.

Who was consulted?

4. As part of the consultation exercise, we wrote to over 3,000 organisations to inform them about the proposals. This cut across various regional, professional and business groups (including banking and finance; accounting; legal; and social enterprises). A breakdown of those organisations is as follows:

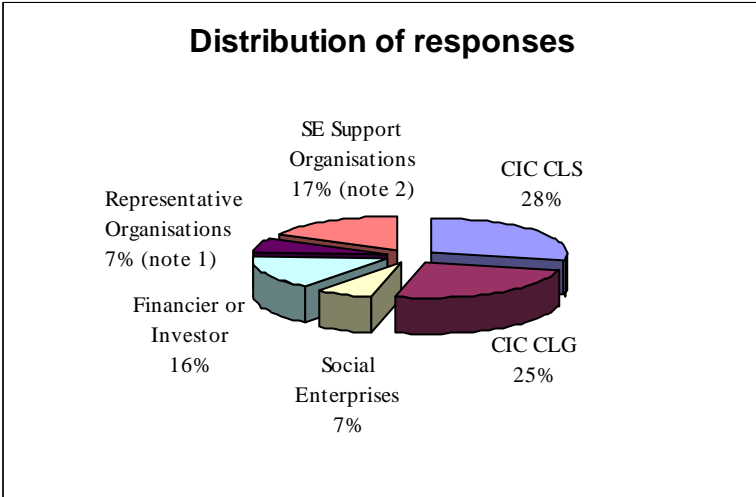
England Wales and Scotland	Number
Banks	09
Solicitors	09
Accountants	07
Her Majesty’s Government	20

Investors and Funders	15
Social Enterprises	11
Organisations providing support to Social Enterprises	35
Regional Development Agencies	09
Community interest companies (CIC)	2,690
Northern Ireland	Number
Chartered Accountants, Solicitors, Building Societies	252
Social Enterprises, Credit Unions, Support Services	198
Community interest companies (CIC)	17

5. In addition, the consultation document was available on the Regulator’s website and the Regulator met with key stakeholder groups to discuss the consultation process.

Number of responses received

6. Seventy-one responses were received (a list of respondents is at annex A).
- Twenty were community interest companies limited by shares, of which eighteen were under schedule 3 of the Act and two were under schedule 2 the Act¹
 - Eighteen of the respondents were community interest companies limited by guarantee
 - Twelve were social enterprise support organisations
 - Eleven were financiers or investors
 - Five were social enterprises that were not CICs
 - Five were representative organisations which held meetings for a number of attendees.



Note 1
Representative organisations responded following discussion with interested parties. The numbers of those consulted was not indicated.

Note 2
Social enterprise support organisations include, solicitors, accountants, university interest group, RDA.

7. Although the response appears to be comparatively low, over 2,000 of those contacted were community interest companies limited by guarantee who would not be affected by a change in the level of the dividend caps. They could, however, be affected by a change in the

¹ The Companies (Audit, Investigations and Community Enterprise) Act 2004

performance related interest loan cap, but this type of loan is considered to be relatively rare for community interest companies.

8. The response from Northern Ireland was particularly low, less than 1%, but this equates to the number of registered community interest companies in Northern Ireland being less than 1% of the total number of community interest companies currently registered in the UK.

9. In addition, a significant number of responses were from membership organisations representing the views of their wider membership or organisations that consulted others. These included the Social Enterprise Coalition in England and Scotland; CIC Association; Social Firms UK; Charity Law Association; Advantage West Midlands and CAN Mezzanine.

10. The Regulator is very grateful to all respondents for their feedback. In particular, it was very helpful to receive collective feedback, agreed through discussion of mutual concerns.

The consultation questions

11. The consultation posed 17 questions in total.

12. Four questions were for social enterprises excluding community interest companies to feedback whether the dividend or performance related interest caps would influence their decision to form as a community interest company.

13. Two were for social enterprises including community interest companies to feedback whether the ‘caps’ unduly restrict the ability to raise finance.

14. Five were for Equity Investors and Debt financiers to feed back whether the ‘caps’ limit incentive to invest.

15. Two asked all respondents to feed back whether the caps provide adequate protection of community assets.

16. The final four questions asked all respondents to feed back about the principles that should be used in setting the caps and anything further that should be considered.

17. A summary of the questions asked in the consultation document is at annex B

Grouping of questions and responses

18. The responses to the consultation were carefully analysed and can be grouped most easily under 3 broad headings:

- the impact of the dividend caps (questions 1-3, 5, 7-9, & 12)
- the impact of the performance related interest cap (questions 4, 6, 10, 13)
- the principles applying to the cap (questions 11, 14-17)

19. We have followed this order in summarising the responses rather than the order in which the questions were asked as it enables us to identify more clearly the specific issues relating to the dividend caps and the interest cap. We were also able to compare the responses from the various groups, i.e. social enterprises; social enterprises and community interest companies; and investors/financiers, in respect of each cap.

20. Fuller details of the responses are at annex C, including the number and a breakdown of respondents to each question.

Statistical analysis of the responses to questions

21. The respondents were separated into groups of yes & no responses. A reasonableness test was then applied to responses which did not indicate yes or no. The responses that could not be categorised as yes or no were separated into a neutral group. The groups were then calculated as a percentage of total number of responses.

22. Overall the approach was qualitative rather than quantitative to ensure that the responses were correctly analysed.

Responses outside the scope of the consultation

23. A number of issues were raised, during the consultation, which fell outside the scope of this consultation and in some instances outside the Regulator's powers. These included issues, such as, remuneration limits, guidance and social impact reports. These issues will be considered and may be discussed further with interested parties, including the Government.

Copies of original responses

24. Copies of original responses (unless the respondent has requested non-disclosure) are available on request. Please contact Phillip Horrell on 02920 346228 and leave a voicemail message or e-mail cicregulator@companieshouse.gov.uk for further information.

Next steps

25. To help her to reach a conclusion on the most appropriate approach to take in light of this consultation, the Regulator is also discussing the findings with stakeholders, and looking at other related evidence. If the Regulator concludes that a change in the limits is justified, she will seek the approval of the Secretary of State before any change is announced. If any changes are to be made, it is intended that an announcement would be made in January to allow for the changes to come into force in April 2010.

SECTION 2 - SUMMARY OF RESPONSES

Group 1 – The impact of the Dividend Caps

The impact of the two dividend caps on equity finance

1. Currently, the aggregated cap restricts the distribution of profits to a maximum of 35% and the dividend per share cap limits the return for the investor to a maximum dividend per share of 5% above the Bank of England base rate.

2. *A majority of respondents (69%)* indicated that the dividend caps currently provide adequate protection of community assets and viewed the caps as essential to the protection of community assets. However, some respondents from each of the groups (see page 13) regardless as to their view of whether they felt the current dividend cap was adequate and/or essential implied that the caps could be too restrictive and affect investment (see question 12, annex C).

3. *A majority of financiers and investors (66%)* felt that the interrelationship between the two dividend caps unduly limits incentive to those that might make an equity investment. They reasoned that investors look for simplicity and the rules limiting returns were too complex. Two respondents answered that the caps did not unduly limit investment but did not provide further comment. The remaining two respondents indicated they were unsure of the interrelationship (see question 9, annex C).

4. *42% of non-CIC social enterprises* indicated that that the interrelationship between the dividend per share cap and the aggregated dividend cap did have a bearing on their decision to form as a CIC, on the basis that the combination of the two caps was too restrictive to attract investors. On the other hand, 33% of the respondents felt that it would have no bearing on their decision. One organisation, noted the findings of the 2003 Bank of England report that social enterprises make only limited use of equity finance. The remaining three respondents provided comments only which indicated that while the interrelationship between the caps was poorly understood, the aggregated cap was the reason stated for forming a CIC (see question 3, annex C).

5. *Half of CICs and non-CIC social enterprises (eleven respondents)* thought the double cap on dividends did unduly restrict their ability to raise adequate finance because of the poor rate of return. This reflects the responses in paragraph 2 above. Eight respondents pointed out that it did not unduly restrict their ability to raise finance; one of whom took the view that grant funding might be affected if the balance swings too far in the direction of financial over social returns. The remaining three respondents did not indicate a preference either way, but one commented that the understanding of the CIC form was considered a greater barrier (see question 5, annex C).

The impact of the aggregated dividend cap on equity investment

6. Currently, the aggregated cap restricts the distribution of profits to a maximum of 35%

7. *A majority of financiers and investors (75%)* indicated that the aggregated dividend cap did not unduly limit incentives to those that might make an equity investment. They thought that

35% of distributable profit (the aggregated cap) seems reasonable. Two respondents thought that it does unduly limit investment and there was a suggestion that the aggregated cap should be raised to 49%. The remaining respondent felt the social benefit should be greater than any personal gain (see question 8, annex C).

8. Among non-CIC social enterprises, views were polarised. Half felt that the aggregated dividend cap was too low and would influence their decision to form as a CIC. A significant number of the other respondents (42%), however, did not see the level of the cap as affecting their decision; they argued that it should not be increased as it protects the social values of the CIC. The remaining respondent did not indicate a preference either way, but suggested that the aggregated cap was less of a barrier than the dividend per share cap (see question 2, annex C).

The impact of the dividend per share cap on equity investment

9. Currently, the dividend per share cap limits the return for the investor to a maximum dividend per share of 5% above the Bank of England base rate.

10. A large majority of financiers and investors (92%) indicated that the dividend per share cap unduly limited incentives to those that might make an equity investment. They reasoned that the cap was too complex and restrictive (see page 17). The remaining respondent did not agree it was limiting but did not comment further (see question 7, annex C).

11. 50% of the non-CIC social enterprises respondents indicated that the dividend per share cap would influence their decision to form as a CIC. In particular, they viewed the cap to be too restrictive to attract investors. On the other hand, four of the respondents (33%) thought it would not have a bearing. One of these took the view that the marketing and promotion of the CIC model was more of an issue and that a change in the level of the cap would dilute the social aims of the CIC. One of the remaining two respondents suggested there was some misunderstanding of equity investment and the CIC models generally (see question 1, annex C).

Group 2 – The impact of the performance-related interest cap

12. Currently, the interest cap only applies where performance related interest is paid by a community interest company. The cap limits the amount of interest to a maximum of 4% above the Bank of England base rate.

The level of protection of assets provided by the interest cap

13. A majority of respondents (68%) noted that the limit on the level of returns to debt financier does provide adequate protection of community assets. Some felt an increase to the cap could dilute the social benefits delivered. Others thought it currently provides adequate protection but limits potential leverage. Five respondents indicated that the cap did not provide adequate protection at present. They provided comments which suggested the cap was pitched too low and that guarantees are often required. The remaining four respondents did not express a preference either way; however, they acknowledged that the cap provided a more than adequate level of protection, but expressed their concerns that the cap was too protective and they were also of the view that the cap may reduce potential leverage. In the words of one representative organisation: “charities are not subject to any cap when agreeing performance related interest on loans” (see question 13, annex C).

The effect of the interest cap on debt financing

14. Currently, the cap limits the amount of interest to a maximum of 4% above the Bank of England base rate.

15. *A majority of investors and financiers (69%)* thought that the interest cap unduly limited incentive to those who might consider debt financing. They considered that the rate was too low and did not adequately compensate for the level of risk, which is difficult to calculate with a fluctuating base rate. Two respondents who commented without indicating their preference were unsure whether the level of the interest cap was correct. The remaining two respondents answered in the negative; one did not comment further the other was concerned that CDFI's have to lend at a higher rate and so private investment would be needed, thus losing the opportunities to keep the money in the sector and access specialist support (response to question 10, see annex C).

16. *A majority of non-CIC social enterprises (67%)* took the view that the interest cap did have a bearing on their decision to form a CIC. They argued that the cap is too low and there is no clarity in the way it is applied over the life of a loan. Three respondents (25%) within this group answered in the negative; and one respondent indicated that a change to the level of the cap would have no bearing on social entrepreneurs' desire to establish community interest companies. The remaining respondent commented that "the impact of the performance related interest cap is little understood" (see question 4, annex C).

17. *A majority of CICs and non-CIC social enterprises (55%)* indicated that the interest cap would not unduly restrict their ability to raise adequate finance. Amongst the comments received, one observed that performance-related interest is rare; and another that changing the cap could prejudice start-up investment financing from other sources. Six respondents (30%) thought the interest cap would restrict access to finance, one of which thought the rate was too low and another that it could be a barrier as it is perceived as only viable for short-term financing. The remaining three respondents did not indicate a preference either way, but suggested the cap should be simplified (see question 6, annex C).

Group 3 – Principles applying to the dividend and interest caps

The impact of the 1% differential on equity financing

18. *A large majority of investors and financiers (73%)* stressed that the 1% differential would unduly limit incentives to take an equity investment in a CIC. Their view was that such a step would not sufficiently reflect the additional risk involved in this type of investment. In contrast, although in a minority, two of the investors/financiers (18%) considered that it did not unduly limit investment. The remaining respondent made a key point that the demand was geared towards loans as opposed to equity as CICs are start up small and medium sized enterprises. The respondent also highlighted the issue of ceding ownership and equity finance being poorly understood as relevant factors in the financing choices of CICs (see question 11, see annex C).

Preferred options if the caps are calculated by reference to a base rate

19. *A majority of respondents to this question (58%)* argued that the Bank of England base rate should be the preferred option for calculating the caps because it is simple, widely known and relatively stable. A significant number of respondents (29%) disagreed with this view and suggested other options including: the 10-Year Gilt; 1-Year LIBOR; or a fixed rate and a basic formula. The remaining five respondents (13%) did not indicate a preference, but one suggested either the Bank of England base rate or LIBOR, another suggested a minimum rate and possibly a maximum rate (see question 14, annex C).

Suggested principles for the dividend caps

20. Currently, the aggregated cap restricts the distribution of profits to a maximum of 35% and the dividend per share cap limits the return for the investor to a maximum dividend per share of 5% above the Bank of England base rate (see question 15, annex C). The following principles were suggested:

- A fair return for the risk involved suggested by 4 respondents
- A balance between community benefit and encouraging investment suggested by 3 respondents
- Ensure no individual or group of individuals receive disproportionate income for their investment suggested by 1 respondent

Suggested principles for the performance related interest cap

21. Currently, the cap limits the amount of interest to a maximum of 4% above the Bank of England base rate (see question 16, annex C). The following principle was suggested:

- A balance between encouraging investment and the principle that assets and profits should be devoted to the benefit of the community suggested by 1 respondent

Additional information provided within the scope of the consultation

(See question 17, annex C)

- No change to requirements indicated by 6 respondents
- Change the level of the caps indicated by 3 respondents

ANNEX A – LIST OF RESPONDENTS

CIC CLS	CIC CLG
Bristol Films CIC	A and BC Theatre CIC
Culture and Sport Glasgow (Trading) CIC	Afrika Eye CIC
Debatewise CIC	Association of Amateur Sports Clubs and Community Interest Fundraisers (ACASC/ACIF) CIC
E-Inclusion Recycling CIC	Gardens Gallery CIC
Equity Entrepreneurs Education CIC	Going for Independence CIC
Ereshaw Sound CIC	Lionheart Radio and Media CIC
First Home Buyers Guide CIC	Minehead Eye CIC
Frensham Village Shop CIC	Motiv CIC
Green Dawn Action CIC	Odiham Interactive CIC
Lowena CIC	Parent and Child Empowerment Organisation CIC
Public Health Action Support Team CIC	Park Community Centre CIC
Ryburgh Community Enterprise CIC	Preen CIC
The Healthy Hub CIC	Save It CIC
The Strawberry Line Café CIC	Shoebox Theatre CIC
The Thornhill Centre CIC	Somerset Co-operative Services CIC Osmaston
The Threshold Cohousing Centre CIC	The World in Winter CIC
The Walled Garden Workshop CIC	Trash Factory CIC
Tidnor Wood CIC	Woofability CIC
Waterside After Schools Clubs CIC	
West View Project CIC	
Total 20	Total 18

SE Support Organisations	Financier or Investor
Advantage West Midlands	Adrian Ashton
Baker Brown Associates	Asset Based Finance Ltd
Bates Wells & Braithwaite	Big Issue Invest
Central Business Services	Bridges Ventures
Development Trust Association	CAN Mezzanine
Kiara Training College	Equity Plus Ltd
London Borough of Tower Hamlets	Futurebuilders England
Morrow and Morrow	Resonance Ltd
RISE	The Lankelly Chase Foundation
Social Economy Consultancy	The Social Enterprise Loan Fund
University of Huddersfield	Unity Trust Bank plc
Wrigleys Solicitors	
Total 12	Total 11

Representative Organisations	Social Enterprises
Charity Law Association	C-Mee
CIC Association	Co-operative and Mutual Solutions Ltd
Scottish Social Enterprise Coalition	Disability Action
Social Enterprise Coalition	Local Care Direct
Social Firms UK	The National Energy Foundation
Total 5	Total 5

ANNEX B – CONSULTATION QUESTIONS

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 an organisation of evidence about the dividend and performance related interest caps.

Group 1 – The impact of the Dividend Caps

The impact of the two dividend caps on equity finance

Question 12 to all respondents	Yes	No	Neutral	Total number of responses
Q.12. Do you consider the limit to the level of return on investment to equity investors (the dividend caps) provides adequate protection of community assets?	22 69% ²	6 19% ³	4 12% ⁴	32

1. Majority of respondents (69%) indicated the limit to the level of return on investment to equity investors provides adequate protection of community assets. This view was supported by comments, such as, “The dividend caps are essential to protecting community assets and ensure a proper level of reinvestment in CICs” and “The caps are seen as a powerful protection of community assets”. Although, some respondents suggested that the caps are too restrictive with comments such as “limitation provides too much protection for the assets and too little incentive to invest for community purposes”.

2. About 19% of respondents indicated that it would not provide adequate protection. The responses focused on the perceived imbalance between risk and return. This view was supported by comments such as “A limit on returns is certainly desirable, but the present limit appears to be so low as to prevent even modest returns on a risk investment”.

3. The remaining respondents (12%) did not indicate a preference. Many provided comments which again focused on the caps being too restrictive. This view was supported by comments, such as, “We think the limit on the level of return is too protective and may reduce investment in CICs”.

² This group comprised of six Investor/Financiers; five representative organisations; three social enterprise support organisations; one CIC CLG; four CIC limited by shares under schedule 3; and three social enterprises.

³ This group comprised of one Investor/Financier; three CIC CLS schedule 3 and two CIC CLG.

⁴ This group comprised of one representative organisation; two Investor/Financiers and one CIC CLG.

Question 9 to Equity Investors and Debt Financiers	Yes	No	Neutral	Total number of responses
Q.9. 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?	8 66%⁵	2 17%⁶	2 17%⁷	12

4. Majority of respondents (financiers and investor) (66%) indicated that the interrelationship between the two dividend caps unduly limits incentive to those that might make an equity investment. This view was supported by comments, such as, “Investors look for simplicity. It is complex enough to price risk, social impact and potential profitability without complex rules limiting return” and “Investors looking to invest in any organisation want to see clearly how their potential return can be generated”. There was no comment from those that answered in the negative (17%). The remaining respondents (17%) were unsure about the interrelationship between the two caps.

Question 3 to non-CIC Social Enterprises	Yes	No	Neutral	Total number of responses
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?	5 42%⁸	4 33%⁹	3 25%¹⁰	12

5. 42% of non-CIC social enterprises who responded supported the view that the interrelationship between the dividend per share cap and the aggregated dividend cap would have a bearing on their decision to form as a CIC. This view was supported by comments, such as, “In combination they make a very off-putting package” and “the dividend yield cap is unduly restrictive on CIC financing and should be lifted”. 33% answered in the negative, and one commented that the Bank of England report indicated that social enterprises make only limited use of equity finance. The remaining 25% of respondents did not indicate a preference either way, but a view was expressed that the interrelationship between the caps was only understood in a limited way and it was the aggregated cap that was cited as the reason for forming a CIC.

⁵ This group comprised of seven Investor/Financiers and one representative organisation.

⁶ This group comprised of two Investor/Financiers.

⁷ This group comprised of one Investor/Financier and one representative organisation.

⁸ This group comprised of one representative organisation; two social enterprise support organisations; one social enterprise and one CIC CLG.

⁹ This group comprised of two representative organisations; two social enterprises.

¹⁰ This group comprised of two representative organisations; and one social enterprise.

Question 5 to non-CIC Social Enterprises and CICs	Yes	No	Neutral	Total number of responses
Q.5. Do you consider that the double cap on dividends unduly restrict your ability to raise adequate financing of business start-up and growth?	11 50% ¹¹	8 36% ¹²	3 14% ¹³	22

6. A majority of CIC and non-CIC social enterprises respondents (50%) indicated that the caps on dividends did unduly restrict their ability to raise adequate finance. This view was supported by comments, such as, “It is an additional disincentive’ ‘We have found no one who is willing to invest because of the dividend cap’ and “Especially at today’s rates”. It was also suggested that the dividend caps restrict tax efficiencies.

7. 36% of respondents indicated that the caps on dividends would not unduly restrict their ability to raise adequate finance. This view was supported by comments, such as, “I believe the standard yield cap still affords a risk premium to the investor” and “grant funding, might be affected if the balance swings too far in the direction of financial over social returns”.

8. The remaining respondents (14%) did not indicate whether they considered that the dividend caps would unduly restrict their ability to raise adequate finance, but one respondent suggested “understanding of the CIC form by banks and investors is a greater barrier than the specifics of the dividend caps”..

¹¹ This group comprised of two representative organisations; three CIC CLG; two CIC CLS schedule 3; three social enterprise support organisations and one social enterprise.

¹² This group comprised of one representative organisation; one social enterprise; five CIC CLS schedule 3 and one CIC CLG.

¹³ This group comprised of two representative organisations and one CIC CLS schedule 3.

The impact of the aggregated dividend cap on equity investment

Question 8 to Equity Investors and Debt Financiers	Yes	No	Neutral	Total number of responses
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?	2 17% ¹⁴	9 75% ¹⁵	1 8% ¹⁶	12

9. Majority of financiers and investors (75%) indicated that the aggregated dividend cap does not unduly limit incentive to those that might make an equity investment. This view was supported by comments, such as, “As an investor we would therefore expect a social enterprise to have in place some form of reinvestment policy and the 65% level assumed in the dividend cap is reasonable” and “A 35% cap is in line with appropriate best practice”. Of the respondents (17%) who considered that it does unduly limit incentive, there was a view that “The aggregated cap should be raisedto 49%”. The remaining respondent commented that social value should be greater than personal gain.

Question 2 to non-CIC Social Enterprises	Yes	No	Neutral	Total number of responses
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?	6 50% ¹⁷	5 42% ¹⁸	1 8% ¹⁹	12

10. 50% of non–CIC social enterprises who responded indicated that the aggregated dividend cap would have a bearing on their decision to form as a CIC. This view was supported by comments, such as, “raise the dividend cap to 49% of distributable profits” and “social enterprises planning community share issues we have advised found this to be a significant obstacle to them using the CIC structure”. 42% answered in the negative and the view was expressed that it should not be increased as it safeguards the social values of the CIC. The remaining respondent did not indicate a preference either way, but suggested the aggregated cap was less of an issue than the dividend per share cap.

¹⁴ This group comprised of two Investor/Financiers.
¹⁵ This group comprised of seven Investor/Financiers and two representative organisations.
¹⁶ This group comprised of one Investor/Financier
¹⁷ This group comprised of one representative organisation; three social enterprise support organisations; one social enterprise support organisation and one CIC CLG.
¹⁸ This group comprised of four representative organisations; and one social enterprise.
¹⁹ This group comprised of one social enterprise.

The impact of the dividend per share cap on equity investment

Question 7 to Equity Investors and Debt Financiers	Yes	No	Neutral	Total number of responses
Q.7 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?	11 92% ²⁰	1 8% ²¹	0 0% ²²	12

11. Majority of financiers and investors (92%) indicated they considered that the dividend per share cap unduly limits incentive to those that might make an equity investment. This view was supported by comments, such as, “at the current base rates, the return is too low” and “such a rate does not come close to covering the investors risk plus operating cost, let alone any reasonable profit margin to support our own sustainability”. Also, the dividend per share was felt to be too complex and a major barrier to investment. This view is supported by comments, such as, “Setting a dividend cap that can change over time depending on a relatively unrelated datum point means investors not only have to price the operational risks of the business but also risk of fluctuating bank rates” and “It is too complicated a model and complexity is a major barrier to investment”. The only Investor/ Financier (8%) to answer in the negative did not comment further.

Question 1 to non-CIC Social Enterprises	Yes	No	Neutral	Total number of responses
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?	6 50% ²³	4 33% ²⁴	2 17% ²⁵	12

12. 50% of non-CIC social enterprises who responded indicated that the dividend per share cap would have a bearing on their decision to form as a CIC. This view was supported by comments, such as, “the reward for investment in a CIC should relate to the risk of that investment” and “the restriction on financing does not justify the benefit of becoming a CIC”. 33% answered in the negative and it was suggested that it was more the marketing and promotion of the CIC model rather than the dividend caps that needed attention. A concern

²⁰ This group comprised of two representative organisation and nine Investor/Financiers.

²¹ This group comprised of one Investor/Financier.

²² No responses in this category

²³ This group comprised of one representative organisation; two social enterprise support organisations; two social enterprises and one CIC CLG.

²⁴ This group comprised of one representative organisation; one social enterprise support organisation; and two social enterprises.

²⁵ This group comprised of two representative organisations.

was also raised that there would be a dilution of the social aims if the cap was raised. The remaining 17% of respondents did not indicate a preference either way, but it was suggested that a lack of understanding of equity investment was seen as more of a factor rather than the size of the dividend cap. Also, it was suggested that an increased understanding of the CIC models, as protecting community assets, would increase take-up.

Group 2 – The impact of the performance-related interest cap

The level of protection of assets provided by the interest cap

Question 13 open to all respondents	Yes	No	Neutral	Total number of responses
Q.13 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?	19 68% ²⁶	5 18% ²⁷	4 14% ²⁸	28

13. Majority of respondents (68%) indicated that the limit on the level of returns to debt financiers does provide adequate protection of community assets. This view is supported by comments, such as, “members would oppose increasing the current limits as this risks diluting the social benefits delivered by the community interest company model”, but this view was tempered by financiers’ comments, such as “The cap may provide adequate protection of community assets but it certainly limits the potential to leverage”.

14. Of those that answered in the negative (18%), comment suggests the level appears to be too low to attract investment and guarantees are often required.

15. The remaining respondents (14%) provided comment only. The comments provided were similar to those provided by the group that answered “yes” to the question, this group provided comments, such as, “It provides a more than adequate level of protection ... ensuring that the community assets are not liquidated” “effectively irrelevant and simply hinders debt financing” and “the performance related interest cap should be removed entirely ... a CIC is obliged to enter into all transactions at market rate CICs are not subject to a cap on normal interest rates...charities are not subject to any cap when agreeing performance related interest on loans.....we believe the government’s intention in creating the CIC was a vehicle with the feature that ‘most of the profit’ is reinvested for the benefit of the community”.

²⁶ This group comprised of seven Investor/Financiers; three representative organisations; two CIC CLG; two CIC limited by shares under schedule 3; three social enterprises; two social enterprise support organisations.

²⁷ This group comprised of one Investor/Financier; one representative organisation; one CIC CLS schedule 3 and two CIC CLG.

²⁸ This group comprised of three representative organisations and one social enterprise support organisation.

The effect of the interest cap on debt financing

Question 10 to Equity Investors and Debt Financiers	Yes	No	Neutral	Total number of responses
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?	9 69%²⁹	2 15.5%³⁰	2 15.5%³¹	13

16. Majority of investors and financiers (69%) indicated they consider that the interest cap unduly limits incentive to those who might consider debt financing. This view was supported with comments, such as, “Especially in today’s market as debt financiers have a cost of wholesale capital priced at around 3 to 4% over base rate in the City Markets” “the mechanics of the calculation where base rates fluctuate often and the particular circumstances arising from the current low interest rate environment, makes this figure restrictive” and “the cap could act as a disincentive to long term loans”.

17. The respondents who did not indicate their preference, but provided a comment (15.5%), such as, “some were unsure about this, while other felt the cap was about right for a loan”.

18. The remaining respondents (15.5%) indicated that they did not consider it would unduly limit incentive to those who might consider debt financing. Only one respondent commented, as follows “Many CDFI lenders need to lend at higher rates and so we would be forced to use private lending organisations and so lose the opportunities to keep the money within our sector.....and also access the specialist support that such lenders are often able to offer”.

²⁹ This group comprised of eight Investor/Financiers and one representative organisation.
³⁰ This group comprised of two Investor/Financiers.
³¹ This group comprised of one Investor/Financiers and one representative organisation.

Question 4 to non-CIC Social Enterprises	Yes	No	Neutral	Total number of responses
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?	8 67% ³²	3 25% ³³	1 8% ³⁴	12

19. Majority of non-CIC social enterprises (67%) indicated that the interest cap would have a bearing on their decision to form a CIC. This view is supported by comments, such as, “it is an unwelcome limitation” and “especially in today’s rates environment, B + 4% is unobtainable”. It was suggested that limitations to debt finance disproportionately affect social enterprises ability to start up and to grow and that the restriction seems arbitrary. This group has a higher number of representative bodies compared to the other groups of respondents (see footnotes).

20. Of those that answered in the negative (25%), a representative organisation was of the view that “Changes in the relationship to the rates would not impact on social entrepreneurs desire to establish community interest companies”. There were no comments from the other respondents.

21. The remaining respondent (8%) commented “the impact of the performance related interest cap is little understood”.

³² This group comprised of two representative organisations; three social enterprise support organisations; two social enterprises and one CIC CLG.

³³ This group comprised of one representative organisation and two social enterprises.

³⁴ This group comprised of one representative organisation

Question 6 to CICs and non-CIC social enterprises	Yes	No	Neutral	Total number of responses
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?	6 30% ³⁵	11 55% ³⁶	3 15% ³⁷	20

22. Majority of CIC and non-CIC social enterprise (55%) indicated that the interest cap would not unduly restrict their ability to raise finance but eight provided no further comment. A CIC CLS schedule 3 suggested that “PR contracts are rare.” A representative organisation recognised “that some investors are likely to be deterred.....as they are unlikely to get as large a return from investment”, but “changing the cap...could risk prejudicing start-up investment financing from other sources” and that “recognising social returns is a more dynamic way of donating, this can only be achieved if the social aims remain paramount and a strong cap is retained”. A CIC CLS schedule 3 commented “We have no difficulty in raising fixed loans at 3% above base rate”.

23. The respondents (30%) who indicated it would restrict their ability to raise finance supported this view with comments, such as, ”it is an additional disincentive” and “external investors are dissuaded ...because of the poor return on investment” and “At present the performance related interest cap is only perceived as viable for short-term financing”.

24. The remaining respondents (15%) who did not indicate their preference, but provided a comment had mixed views. Suggestions included that the cap should be simplified; a maximum level be introduced; and the cap should be removed completely. “Could the interest cap on loans be limited to a maximum level to limit how much interest is paid if the base rates goes up to a high level” and “the cap...should be lifted provided any performance related interest paid out in total does not exceed the aggregated cap”.

³⁵ This group comprised of one representative organisation; one social enterprise; two social enterprise support organisations; one CICs CLS schedule 3 and one CIC CLG.

³⁶ This group comprised of two representative organisations; two social enterprises; four CIC CLS schedule 3 and three CIC CLGs.

³⁷ This group comprised of two representative organisations and one CIC CLG.

Group 3 – Principles applying to the dividend and interest caps

The impact of the 1% differential on equity financing

Question 11 To Equity Investors and Debt Financiers	Yes	No	Neutral	Total number of responses
Q.11. 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?	<p>8</p> <p>73%³⁸</p>	<p>2</p> <p>18%³⁹</p>	<p>1</p> <p>9%⁴⁰</p>	<p>11</p>

25. Majority of investors and financiers (73%) supported the view that the one percent more by way of return on equity unduly limits incentive to invest in a CIC. This view was supported by comments, such as, “A 1% premium for a performance related loan is unlikely to reflect the additional risk” and “1% difference is so marginal it has no impact”.

26. 18% answered in the negative and the only comment received suggested the 1% gap does not provide adequate incentive to equity investors.

27. The remaining respondent (9%) provided comment only and suggested that the drivers for taking loans opposed to equity is that the CIC form is new and most CICs are start up small and medium sized enterprises; there is also the issue of ceding ownership and there is also a lack of understanding of the safeguards and implications of equity.

³⁸ This group comprised of seven Investor/Financiers and one representative organisation.

³⁹ This group comprises of two Investor/Financiers

⁴⁰ This group comprised of one representative organisation.

Preferred options if the caps are calculated by reference to a base rate

Question 14 to all about the Bank of England Base rate	Yes	No	Neutral	Total number of responses
Q14. Do you consider the Bank of England base rate should be the preferred option for calculating the caps?	22 58% ⁴¹	11 29% ⁴²	5 13% ⁴³	38

28. Majority of respondents to this question (58%) indicated that the Bank of England base rate should be the preferred option for calculating the caps. This view was supported by comments, such as, “Most deposit accounts adjust their interest rate relative to the BoE base rate” and “ The Bank of England base rate should be the preferred option.....It provides certainty and simplicity, as it is widely known and relatively stable”. It was suggested a collar and/or cap on the base rate should be applied or alternatively it should be tied to an inflation index” and “there needs to be development of this cap into a compound interest based mechanism”.

29. About 29% of respondents indicated that the Bank of England base rate should not be the preferred option. This group had quite a low number of representative bodies compared to the other two groups (see footnotes). Comments include “The more realistic measure should either be based on 10 year Gilt yields or 1 Year LIBOR or Cost of 1 Year Wholesale Funds in the London market” or “Use the redemption yield on 10 year Gilts” or “a fixed rate, and a basic formula” or “It may be the best option, so long as there is a ‘floor’.

30. The remaining respondents (13%) did not express a preference, but commented “in ‘normal’ conditions base rate may provide a suitable benchmark and that LIBOR is likely to reflect market conditions better, but even these can, of course be subject to considerable fluctuation”. Also, it was suggested “Most felt there ought to be a minimum rate and possibly a maximum rate”.

⁴¹ This group comprised of four Investor/Financiers; four representative organisations; three social enterprise support organisations; one social enterprise; six CIC CLG and four CIC limited by shares under schedule 3 .

⁴² This group comprised of four Investor/Financiers; two social enterprise support organisations; two CIC CLS schedule 3; two social enterprises and one CIC CLG.

⁴³ This group comprised of two representative organisations; two social enterprise support organisation and one Investor/Financier

Question 15

Principles suggested for the Dividend Caps within the scope of the legislation

The numbers in brackets refer to a respondent.

31. A fair return for the risk involved suggested by 4 respondents

- A decent rate of return for investors (69)
- Risk-based premium approach (70)
- Minimum pricing to cover risk and cost of evaluating risk (66)
- A fair rate of return that is substantially less than the value of the social return enabled by the investment (66)

32. A balance between community benefit and encouraging investment suggested by 3 respondents

- A balance between encouraging investment and the principle that assets and profits should be devoted to the benefit of the community (45) (56)
- The rate of return on capital should not exceed that which is necessary to obtain and retain that capital (71)

33. Ensure no individual or group of individuals receive disproportionate income for their investment (43)

Question 16

Principles suggested for the Interest Cap within the scope of the legislation

The numbers in brackets refer to a respondent.

34. A balance between encouraging investment and the principle that assets and profits should be devoted to the benefit of the community (45)

Question17

Additional Information within the scope of the consultation

The numbers in brackets refer to a respondent.

35. No change to requirements indicated by 6 respondents

- Even if the caps are raised neither aim of protecting community assets or raising investment for social enterprises is likely to be achieved (4)
- The CIC as it stands was the perfect model. The current dividend caps limit expectations of returns (46)
- Our experience is that investors are more interested in the social return than the financial return and we believe therefore that the suggestion that caps limit investment is more of a perception than a reality (54)
- Arguments for removing the dividend cap seem to be based on an erroneous identification of “social enterprise” with “community interest company”....Removal of the cap would massively devalue the status for the vast majority of CIC registered social enterprises (57)
- Feedback suggests that the CIC model is generally liked and it is hoped that this organisational model would continue to grow (69)

- For our own activities the caps are less important than the ability to be seen to be acting in the community interest and being structured as a transparent commercial operating company (37)
36. Change the level of the caps indicated by 3 respondents
- My experience is that at around 10% on dividend payments people see as fair (60)
 - Interest rates should be set based on the market context balanced by the risk of the investment proposition. If there is to be a cap then the Bank of England base rate or LIBOR seem the obvious links, however perhaps a collar and cap arrangement may be more appropriate, so there is a minimum lending rate and a maximum (63)
 - The general feedback suggests a maximum dividend cap of 15% could fit into their current strategies and would be potentially attractive to their pool of investors (68)

ANNEX D – IMPACT OF ANY CHANGE

Which of the CIC models would be impacted by a change?

1. There are three types of community interest companies:
 - a. Private limited by guarantee without a share capital.
 - b. Private limited by shares or limited by guarantee with a share capital⁴⁴ under schedule 2 of the CAICE Act 2004⁴⁵ (cannot pay a dividend to private investor only an asset-locked body such as a charity).
 - c. Private or public company limited by shares or by guarantee with a share capital under schedule 3 of the CAICE Act 2004.
2. A change to either of the dividend caps will only affect category c. above. This category represents 20% of community interest companies.
3. A change to the interest cap would affect all community interest company considering a performance-related loan.

When would a change come into force?

4. Any change would not be retrospective.
5. The applicable share dividend cap (the percentage above the Bank of England base rate) is the cap that applied when the share was issued, or the company became a community interest company. This means that a change in the share dividend cap will only apply to shares issued, or shares in a company that became a community interest company, after the change came into effect.
6. The Bank of England base rate is calculated by reference to the rate as it had effect at the beginning of the first day of that financial year.
7. The applicable aggregated cap will be the aggregated cap which had effect in relation to that company on the first day of the financial year of which the dividends are declared.

⁴⁴ There are still a few “companies limited by guarantee with a share capital”. It has not been possible to form these since 1981.

⁴⁵ The Companies (Audit, Investigations and Community Enterprise) Act 2004

