EXPLANATORY MEMORANDUM TO

THE CHARITABLE INCORPORATED ORGANISATIONS (CONSEQUENTIAL AMENDMENTS) ORDER 2012

2012 No. [DRAFT]

1. This explanatory memorandum has been prepared by the Cabinet Office and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This Order makes certain amendments to primary legislation in consequence of the coming into force of Part 11 of the Charities Act 2011: Charitable Incorporated Organisations.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The provisions in the Order amending the Company Directors Disqualification Act 1986 and the Employment Rights Act 1996 are made under section 75(4) and (5) of the Charities Act 2006 ("the 2006 Act"). By virtue of the saving in paragraph 3(3)(a) of Schedule 8 to the Charities Act 2011 ("the 2011 Act"), this order-making power is exercisable in relation to the 2011 Act provisions concerning charitable incorporated organisations.

4. Legislative Context

4.1 The 2006 Act amended the Charities Act 1993 ("the 1993 Act") to make provision for a new incorporated legal structure for charities, the charitable incorporated organisation (CIO). The 1993 Act has since been consolidated into the 2011 Act.

4.2 Part 11 of the 2011 Act:

4.2.1 introduces the concept of the charitable incorporated organisation (CIO) and makes provision for its constitution, its formation and registration, its name and status (Chapter 1);

4.2.2 makes provision for the powers of a CIO, constitutional requirements, third parties, duties of members and trustees, and regulation about CIO procedure (Chapter 2);

4.2.3 makes provision relating to the amendment of a CIO's constitution, including where the Charity Commission's consent is required (Chapter 3);

4.2.4 makes provision for the conversion of certain bodies to CIOs (not being implemented at this stage), amalgamation of CIOs and transfer of a CIO's undertakings to another CIO (Chapter 4); and

4.2.5 makes supplementary provisions, including powers for the Minister to make further provision for CIOs through regulations (Chapter 5).

4.3 This Order amends the Company Directors Disqualification Act 1986 ("the CDDA") to apply it to the charity trustees of CIOs. The Order amends the Employment Rights Act 1996 ("the ERA") to give employees of an insolvent CIO the same rights to a payment from the National

Insurance Fund as if the employer were an insolvent company. The Order also makes amendments to Schedule 6 to the 2011 Act in order to give a first right of appeal to the First Tier Tribunal (Charity) against certain decisions and orders made by the Charity Commission in respect of the dissolution of CIOs.

4.4 This Order forms part of a package of secondary legislation needed to complete the legal framework for CIOs and enable implementation. The intention is for all the statutory instruments to be made at the same time. The other statutory instruments are:

4.4.1 The Charitable Incorporated Organisations (General) Regulations 2012, which make various provisions related to the formation and operation of CIOs (a draft copy of these regulations is annexed to the Explanatory Memorandum to the draft Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012).

4.4.2 The Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012, which make provision for the insolvency, winding up, dissolution and restoration to the register of CIOs, and are subject to the affirmative resolution procedure;

4.4.3 The Charities Act 2011 (Commencement No. 1) Order 2012, which brings into force most of the relevant provisions of the 2011 Act (the provisions enabling bodies to convert to be CIOs are not being brought into force at this stage). Although the 2011 Act came into force on 14 March 2012, transitory modifications have the effect that Part 11 is not in force until a commencement order is made.

5. Territorial Extent and Application

5.1 The Order extends to England and Wales.

6. European Convention on Human Rights

6.1 The Parliamentary Secretary, Cabinet Office, Nick Hurd has made the following statement regarding human rights in respect of the Order:

In my view the provisions of the Order are compatible with the Convention rights.

7. Policy background

Application of the Company Directors Disqualification Act 1986

7.1 The CDDA sets out the procedures for company directors to be disqualified in certain cases of misconduct under company law. Although the CIO model is intended to be a relatively easy way to set up and run a charity, it does have to be robust enough to inspire public confidence. Unlike unincorporated structures, the charity trustees of a CIO benefit from limited liability. Therefore in principle, there is no reason why a charity trustee of a CIO should not be subject to the same CDDA regime as a director of a company which is a charity (by and large, a disqualification order can only be made where there is a significant and culpable breach of duty by the director – the CDDA uses the concept of a person being "unfit" to act).

7.2 Article 2 of the Order amends the CDDA by inserting a new section to apply it to CIOs. The main implications for CIOs and charity trustees of CIOs resulting from the application of the CDDA are as follows:

7.2.1 In the circumstances set out in the CDDA, a court may make a disqualification order against a person so that for a specified period the person is not to be a company director, CIO charity trustee etc, or take part in the promotion, formation or management of a company or CIO etc. (section 1 CDDA)

7.2.2 In certain circumstances the Secretary of State can instead accept an undertaking from a person that the person will not be a company director, CIO charity trustee etc, or take part in the promotion, formation or management of a company or CIO. (section 1A CDDA)

7.2.3 The court may make a disqualification order against a person who is convicted of an indictable offence in connection with the promotion, formation, management, liquidation or dissolution of a CIO. (section 2 CDDA)

7.2.4 The court may make a disqualification order against a charity trustee of a CIO if it appears he has been guilty of (a) fraudulent trading under regulation 61 of the Charitable Incorporated Organisations (General) Regulations 2012, or (b) of any fraud in relation to the CIO while it is being wound up. (section 4 CDDA)

7.2.5 The court must make a disqualification order where it is satisfied that the conduct of a charity trustee of an insolvent CIO makes him unfit to be concerned in the management of a company or CIO. (section 6 CDDA)

7.2.6 The Secretary of State can apply to the court for an order (or can accept an undertaking instead) where it appears to him to be expedient in the public interest that a disqualification order is made against a person. The official receiver, liquidator, administrator or receiver of a CIO is under a duty to report to the Secretary of State if it appears that the conduct of a charity trustee of a CIO makes him unfit to be concerned in the management of a company or CIO. (section 7 CDDA)

7.2.7 A court or the Secretary of State is to have regard to certain matters when reaching a decision on a disqualification order or undertaking. The matters include failures by a charity trustee to comply with various requirements of the 2011 Act and Regulations made under that Act to do with keeping registers, making annual returns, preparing annual accounts etc. (section 9/Schedule 1 CDDA)

7.2.8 The court can make a disqualification order where a declaration has been made under the Insolvency Act 1986, section 213 (fraudulent trading) or section 214 (wrongful trading), that a person is liable to make a contribution to a company's or a CIO's assets. These sections of the Insolvency Act 1986 apply to CIOs by virtue of the Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012. (section 10 CDDA)

7.2.9 It is an offence for a person to act as a charity trustee of a CIO if he is an undischarged bankrupt etc. (section 11 CDDA)

7.2.10 A person is prohibited from acting as a charity trustee of a CIO if an administration order under section 429 of the Insolvency Act 1986 applies to him. (section 12 CDDA)

7.2.11 A person disqualified under equivalent Northern Ireland legislation will also be disqualified from being a charity trustee of a CIO. (sections 12A and B CDDA)

7.2.12 Where a CIO commits an offence under the CDDA, in certain circumstances the charity trustees of the CIO can be prosecuted. (section 14 CDDA)

7.2.13 A person is responsible for the debts of a CIO where he is involved in the management of a CIO while disqualified by an order or undertaking, or he acts on instructions given by a person he knows to be disqualified. (section 15 CDDA)

7.2.14 The CDDA is already extended to apply to building societies, incorporated friendly societies, registered industrial and provident societies etc, so extending it to CIOs means that a person disqualified due to his conduct as an officer of a building society, for example, will be disqualified from being a company director, a CIO charity trustee, an officer of a friendly society etc. (sections 22A to E CDDA)

7.3 Articles 5, 6 and 7 amend the 2011 Act so that the provisions in that Act disqualifying persons from being charity trustees do not duplicate what is provided for in the CDDA. These provisions (sections 178 to 184) deal with trustees and charity trustees of charities generally, so the exemptions that are already there for charitable companies and company directors are extended to CIOs and the charity trustees of CIOs.

7.4 Section 180 is extended to CIOs and charity trustees of CIOs, so that a person who is bankrupt or subject to a debt relief order, or who is subject to a CDDA disqualification order, is not disqualified under the 2011 Act if leave to act has already been granted under the CDDA. Section 181(5) is amended so that the Charity Commission cannot waive a person's disqualification under the CDDA unless the court has already granted leave for the person to act in relation to another company or CIO. Section 183 is amended so that it is not a criminal offence to act as a CIO charity trustee if the person is disqualified only by virtue of being bankrupt, or being subject to a debt relief order or a CDDA disqualification order. It would instead be an offence under the CDDA.

7.5 The Order applies only in England and Wales, although the CDDA extends to England and Wales, and Scotland. The effect is that a person disqualified under the CDDA in England and Wales for misconduct as a charity trustee of a CIO will also be disqualified from acting as a company director in England and Wales. (By virtue of article 17 of the Company Directors Disqualification (Northern Ireland) Order 2002, a person disqualified under the CDDA for their misconduct as a charity trustee of a CIO will also be disqualified from acting as a company director in Northern Ireland.) A person disqualified under the CDDA (including a person disqualified for their misconduct as a charity trustee of a CIO) will also be barred from acting as a trustee in Scotland and in Northern Ireland by virtue of devolved charity legislation.

Protection for employees of insolvent CIOs under the Employment Rights Act 1996

7.6 The ERA allows for certain debts due to the employee of an insolvent employer to be paid from the National Insurance Fund: section 166 concerns redundancy payments; section 182 concerns other debts including arrears of pay. Both sections apply in the event that the employer is "insolvent" as defined (the definition for the purposes of section 182 is in section 183), but the definition as currently drawn would not allow employees of an insolvent CIO to apply for such a payment.

7.7 The UK is obliged to guarantee employee pay claims upon the insolvency of an employer under European Directive 2008/94/EC. The ERA implements this obligation. Articles 3 and 4 of this Order extend sections 166 and 183 to CIOs, so ensuring that the employee guarantee will include employees of CIOs.

Appeals and applications to the Tribunal

7.8 CIOs will have access to all of the existing rights of appeal and application to the First Tier Tribunal (Charity) that are available to charities generally, and to CIO-specific rights, as set out in Schedule 6 to the 2011 Act. The Order makes provision for eight new specific rights of appeal or application to the First Tier Tribunal (Charity) in consequence of the Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012.

7.9 Article 8 of the Order amends the 2011 Act by inserting into Schedule 6 (Appeals and applications to the Tribunal) the power for the Tribunal to review and change the following decisions or orders of the Charity Commission in connection with the dissolution of a CIO:

7.9.1 etc A decision to grant an application for the dissolution of a CIO. The Tribunal may quash the decision and (if appropriate) remit the matter to the Commission.

7.9.2 A decision not to grant an application for the dissolution of a CIO. The Tribunal may quash the decision (and if appropriate) remit the matter to the Commission, or direct the Commission to grant the application.

7.9.3 A decision to dissolve a CIO which it has reasonable cause to believe is not in operation. The Tribunal may quash the decision and (if appropriate) remit the matter to the Commission.

7.9.4 A decision to dissolve a CIO the Commission considers is no longer a charity. The Tribunal may quash the decision and (if appropriate) remit the matter to the Commission.

7.9.5 A decision to dissolve a CIO which is being wound up. The Tribunal may quash the decision and (if appropriate) remit the matter to the Commission.

7.9.6 An order specifying the charitable purposes, charity or charities for which the Official Custodian holds on trust the property of a dissolved CIO. The Tribunal may quash the order in whole or in part and (if appropriate) remit the matter to the Commission; or substitute for all or part of the order any other order which could have been made by the Commission; or add to the order anything which could have been included in an order made by the Commission.

7.9.7 An order vesting property of a dissolved CIO held by the Official Custodian in a charity or charities. The Tribunal may quash the order in whole or in part and (if appropriate) remit the matter to the Commission; or substitute for all or part of the order any other order which could have been made by the Commission; or add to the order anything which could have been included in an order made by the Commission.

7.9.8 A decision to restore or not to restore a dissolved CIO to the register. The Tribunal may quash the decision and (if appropriate) remit the matter to the Commission; and/or direct the Commission to rectify the register.

8. Consultation outcome

8.1 Draft regulations were published for consultation in 2008-09. One of the consultation questions asked; "*Do you agree that the disqualification provisions in the Company Directors Disqualification Act ...should apply to people who have administered insolvent CIOs?"* 86% of respondents to the question agreed with the proposed approach.

8.2 The Cabinet Office has worked closely with the Charity Commission in preparing the CIO framework and secondary legislation needed to complete it. The shared aim has been to ensure that it is as straightforward as possible to set up and run a CIO, whilst ensuring the necessary protections are in place to protect public confidence in the CIO model. The Commission supports this Instrument and the implementation of the CIO. The Department for Business Innovation and Skills, and the Insolvency Service, have also been consulted on this Order. The responses received have enabled improvements to be made to the draft Order.

8.3 Despite the passage of time, a further consultation is not considered necessary, given the strong support from the charity sector for the implementation of the CIO. The lapse in time between the public consultation and bringing forward the Secondary Legislation has largely been due to detailed work required on the insolvency and dissolution regime for CIOs and to make changes to the draft Order to address Charity Commission operational process and resource concerns.

9. Guidance

9.1 The Charity Commission has published detailed guidance on the CIO on its website: http://www.charitycommission.gov.uk/Start_up_a_charity/Do_I_need_to_register/CIOs/default.aspx
This includes general information on the CIO, how to set up a CIO, the requirements for running a CIO, and for closing down a CIO. The Commission has also published two model constitutions for CIOs:

9.1.1 the Foundation model is for CIOs whose constitution provides that the same persons are to be its voting members and its charity trustees;
9.1.2 the Association model is for other CIOs i.e. those that will have voting members other than (or in addition to) its charity trustees.

10. Impact

10.1 The CIO framework, including this Order, is a permissive regime. It does not impose regulation on any charities other than those that choose to adopt the CIO form.

10.2 The application of the CDDA to the trustees of a CIO will mean that a person can be disqualified from acting as a company director because of his actions as a charity trustee (it will also prevent those disqualified from acting as a company director from acting as a trustee of a CIO). However, in principle it is right that, in return for the benefits of limited liability, the CDDA provisions apply to trustees of CIOs (as they already do to the directors of charitable companies).

10.3 The impact on the Justice system is expected to be minimal. It is rare for civil or criminal cases to involve organisations or individuals specifically in their capacity as charities or charity

trustees. There is no reason to expect any increase in the number of criminal prosecutions (charities and charity trustees are seldom prosecuted under existing legislation). In relation to civil cases, there is unlikely to be any impact on the High Court, which has a particular role in relation to charities. There are already rights to challenge certain decisions of the Charity Commission in relation to CIOs in the First-tier Tribunal (Charity). Although the extension of these rights to decisions relating to the dissolution of CIOs may give rise to an increase, it is considered likely to be in low single figures annually.

10.4 The Regulatory Policy Committee has confirmed the CIO will not impose a cost on business. A validation impact assessment for the CIO has been prepared and is annexed to this Memorandum.

11. Regulating small business

11.1 This Order does not apply to small business.

12. Monitoring & review

12.1 Lord Hodgson of Astley Abbotts has undertaken a statutory review of the Charities Act 2006. Whilst the review did consider organisational forms, including the CIO, a full assessment of the CIO was not possible as the CIO had not been implemented when the review completed. Lord Hodgson did recommend swift implementation of the CIO.

12.2 There is a policy commitment to review the impact of the CIO framework within three years of commencement of this Order. The assessment will consider whether or not the CIO has met its aims of being relatively straightforward to establish and run.

13. Contact

Ben Harrison at the Office for Civil Society, Cabinet Office, Tel: 020 7271 6282 or email: ben.harrison@cabinet-office.gsi.gov.uk can answer any queries regarding this instrument.