

EXPLANATORY MEMORANDUM TO
THE CHARITABLE INCORPORATED ORGANISATIONS (INSOLVENCY AND
DISSOLUTION) REGULATIONS 2012

2012 No. 3013

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 These Regulations make provision relating to the insolvency and dissolution of charitable incorporated organisations 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 None.

4. Legislative Context

4.1 The Charities Act 2006 amended the Charities Act 1993 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 Charities Act 2011 (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 These Regulations make provision for the dissolution of a CIO either through a bespoke dissolution procedure or through the insolvency and dissolution procedures set out in the Insolvency Act 1986 (the IA). The IA is applied, with appropriate technical modifications, to CIOs. The Regulations also make provision for the restoration to the register of a dissolved CIO in certain circumstances.

4.4 These Regulations form part of a package of secondary legislation needed to complete the legal framework for CIOs and enable implementation. The intention is to make all of the statutory instruments 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 attached to this Memorandum)

4.4.2 The Charitable Incorporated Organisations (Consequential Amendments) Order 2012, which amends the Company Directors Disqualification Act 1986 to apply it to the charity trustees of a CIO, and amends the Employment Rights Act 1996 to enable employees of insolvent CIOs to claim payments from the National Insurance Fund. It also provides certain rights of appeal to the First-tier Tribunal (Charity) in consequence of these Regulations. The Order is 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 Regulations extend 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 Regulations:

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

7. Policy background

7.1 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 trustees of unincorporated structures, the charity trustees of a CIO benefit from limited liability, so the CIO framework must offer safeguards and protections to third parties engaging in business with a CIO.

7.2 Many such safeguards and protections already exist for charitable companies that are insolvent or being wound up under the IA, and the policy decision was taken at an early stage to make use of same the tried and tested insolvency and dissolution procedures. The alternative would have been to create a bespoke series of insolvency and dissolution procedures, which would to a large degree replicate existing IA procedures, but would create a new body of law specifically for CIOs. This was quickly ruled out as unnecessary given that the existing IA procedures could easily be modified to apply to CIOs.

7.3 However, it was considered useful to include a bespoke and relatively simple voluntary dissolution procedure, outside of the IA regime, for winding up a CIO that has made provision for its liabilities. The Regulations also make provision for the Charity Commission to dissolve a CIO which is not in operation, is no longer a charity, or is being wound up.

7.4 The Regulations make provision to ensure that any remaining assets of a CIO which is dissolved otherwise than under the IA are applied for similar charitable purposes to those of the dissolved CIO. Finally, the Regulations also make provision for a dissolved CIO to be restored to the register of charities in certain circumstances.

7.5 In general terms, insolvency will occur where a CIO is unable to pay its debts as they fall due, or where its total liabilities outweigh its total assets. The trustees of a CIO can be exposed to civil and criminal liability if they allow the CIO to continue to trade when it is insolvent. The Charity Commission's guidance (CC12) "*Managing Financial Difficulties and Insolvency in Charities*" provides trustees with a useful resource (<http://www.charity-commission.gov.uk/publications/cc12.aspx>).

7.6 Part 1 of the Regulations makes general provision on the interpretation of the Regulations, including in relation to criminal offences that apply by virtue of these Regulations.

Application of the Insolvency Act 1986

7.7 Part 2 of the Regulations (including Schedule 2) makes provision for the full range of IA procedures that apply to registered companies to also apply to CIOs, with appropriate technical modifications.

7.8 In summary, the relevant procedures are:

- Rescue procedures:
 - Administration
 - Voluntary Arrangement
 - Administrative Receivership
- Liquidation procedures:
 - Members' Voluntary Liquidation
 - Creditors' Voluntary Liquidation
 - Compulsory Liquidation

7.9 **Administration** (Part 2 of the IA, including Schedule B1) is an insolvency procedure that provides a CIO with some breathing space enabling the administrator (an insolvency practitioner), acting in the interests of the creditors, to attempt to rescue the CIO in whole or in part as a going concern, to secure a better result for the CIO's creditors than would be likely if the CIO were simply wound up, or to realise property in order to make a distribution to one or more secured or preferential creditors.

7.10 A CIO can (under Part 1 of the IA), make a proposal to creditors for a **Voluntary Arrangement (VA)**. An insolvency practitioner is appointed to supervise the agreement, and the creditors may agree to accept a reduction in their debt and/or a delay in payment. A VA can also be pursued during administration by the administrator as a means of rescuing the CIO as a going concern.

7.11 Some CIOs may also be able to benefit from a "moratorium" where a VA is proposed. A moratorium provides a breathing space to give the CIO time to put a rescue plan to its creditors. It

prevents the CIO's creditors from proceeding against the CIO during the relevant period, whilst allowing the charity trustees to remain largely in control of the CIO. Where a CIO is in administration it is already protected, and does not need to apply for a moratorium.

7.12 A moratorium may be available to a CIO that is not already in administration and meets at least two of the following criteria:

- a turnover of less than £6.5 million;
- a balance sheet total of less than £3.26 million;
- less than 50 employees.

7.13 **Administrative Receivership** (Part 3 of the IA, including Schedule B1) is unlikely to be of relevance to many CIOs. The Enterprise Act 2002 amended the IA (Chapter 4 of Part 3), preventing the appointment of an administrative receiver under any security created after 15 September 2003, subject to certain exceptions (which will not apply to many CIOs – other than Registered Social Landlords).

7.14 If the above rescue mechanisms are not possible, then liquidation and winding up must be considered.

7.15 Members of a CIO can place the CIO into liquidation. Where the CIO is solvent, this is a **Members' Voluntary Liquidation** (Chapter 3 of Part 4 of the IA). Where the CIO is insolvent this is a **Creditors' Voluntary Liquidation** (Chapter 4 of Part 4 of the IA) which gives the creditors certain additional rights, such as a choice in the appointment of the liquidator. The procedure for the members placing the CIO in voluntary liquidation is set out in Chapters 1 and 2 of Part 4 of the IA. The liquidator (an insolvency practitioner) is responsible for winding up the CIO, settling its liabilities, and (if there are any remaining assets) applying to the court or Charity Commission for a Scheme to secure the application of those assets.

7.16 **Compulsory liquidation.** The court (either the High Court or the relevant county court) may be petitioned to wind up a CIO (Chapter 6 of Part 4 of the IA). The circumstances in which the court may wind up a CIO are set out in section 122 of the IA. Those who may apply to the court to wind up a CIO are set out in section 124, and include creditors owed more than £750, the CIO or its charity trustees. The court will appoint a liquidator (which may be the Official Receiver) to manage the winding up of the CIO.

7.17 Chapter 9 of Part 4 of the IA deals with dissolution after winding up. Within three months of receiving the liquidator's final report (on a voluntary liquidation) or the Official Receiver's notice that the winding-up is complete (on a compulsory liquidation), the Commission must remove the CIO from the register of charities. The CIO is dissolved when it is removed from the register.

7.18 Chapter 10 of Part 4 of the IA deals with malpractice during insolvency and liquidation, and provides that, in certain circumstances, the actions of a CIO charity trustee can lead to criminal liability. There is also the potential for a court to make a charity trustee personally liable for fraudulent (section 213) or wrongful (section 214) trading.

Dissolution otherwise than under the Insolvency Act 1986

7.19 Part 3 of the Regulations provides procedures for the dissolution of a CIO otherwise than under the IA. Under this regime, a solvent CIO can apply to the Charity Commission for voluntary dissolution or the Charity Commission can dissolve a CIO of its own volition in certain circumstances. These are designed to be simpler procedures than those under the IA, and the expectation is that they will be more commonly used than the IA procedures.

7.20 The charity trustees may make an application for dissolution to the Charity Commission on behalf of the CIO (regulation 5). The application must include: a copy of the members' dissolution resolution (passed in accordance with the procedure set out in the Regulations); a declaration by the charity trustees that the debts and liabilities of the CIO have been settled or provided for in full; and a charity trustees' statement setting out the way in which the CIO's property has been or is to be applied on dissolution in accordance with the CIO's constitution.

7.21 The Charity Commission must not dissolve a CIO until three months after it has published notice that it has received an application to dissolve the CIO. If anyone shows cause why the CIO should not be dissolved, the Commission must not dissolve the CIO.

7.22 It is an offence for the charity trustees of the CIO to make an application for dissolution if they have not settled or provided in full for the liabilities of the CIO, or if they have not taken any steps required by the CIO's constitution to be taken in relation to its property prior to dissolution. It is also an offence to make an application for dissolution if other IA procedures are already in train, or if an interim manager has been appointed.

7.23 The Regulations set out the restrictions on a CIO's activities once an application for dissolution has been made, and specify what must happen if a CIO receives property after an application has been made. The Regulations also provide that notice must be given to other charity trustees, members and employees of the CIO within seven days of the making of an application. It is an offence for the charity trustees of the CIO to fail to comply with this requirement.

7.24 The Regulations set out the circumstances in which the charity trustees of a CIO must immediately withdraw an application for dissolution. These include where certain IA procedures have commenced, or where the CIO incurs any liabilities contrary to the requirements of regulation 10. It is an offence for the charity trustees of a CIO not to withdraw the application in these circumstances.

7.25 The Regulations require the Charity Commission to dissolve a CIO where it has cause to believe that the CIO is not in operation (regulation 16). The Regulations set out the steps that the Commission must take to contact the CIO, its charity trustees and members before the Charity Commission dissolves the CIO.

7.26 The Charity Commission is required to dissolve a CIO that it considers is no longer a charity. It must give three months' notice of its intention to do so, giving the CIO time to make representations or restructure (regulation 17).

7.27 The Charity Commission is also required to dissolve a CIO that is being wound up but where no liquidator is acting, or the affairs of the CIO have been fully wound up, or the liquidator has failed to make returns for at least six months. Again, the Charity Commission must give three months' notice of its intention to dissolve in these circumstances (regulation 18).

7.28 The date on which a CIO is dissolved is the date when the CIO is removed from the register of charities, and the Charity Commission must publish notice of the date when it dissolves a CIO. The liabilities of charity trustees and members continue to be enforceable after dissolution of a CIO, and the court's power to wind up a CIO remains after dissolution.

7.29 Part 4 of the Regulations makes provision for the application of the property of a CIO on its dissolution through the non-IA procedures of Part 3. On dissolution, remaining property of the CIO (other than property which falls to be dealt with, on dissolution, in accordance with directions made by the CIO before it was dissolved) vests in the Official Custodian (regulation 23). It is held on trust for the same purposes as the CIO had before it was dissolved. The Charity Commission

may, by order, specify the purposes or charities for which the property is held on trust by the Official Custodian (regulation 25), and may, by order, vest property held by the Official Custodian in a charity or charities (regulation 26). This ensures that any property that the CIO has not disposed of prior to its dissolution is applied for the same or similar charitable purposes. Regulation 27 provides for the Official Custodian to disclaim property that is vested in it. The remainder of Part 4 sets out the rules governing disclaimer, and various protections in relation to leasehold land and other parties.

7.30 Part 5 of the Regulations makes provision for the restoration of a dissolved CIO to the register of charities. It sets out the powers of the Charity Commission (regulation 33) and the court (regulation 34) to restore a dissolved CIO to the register of charities. The Regulations provide for circumstances in which the restored CIO is to be given a new name (regulation 37), the effect of the restoration (regulation 39), and the automatic vesting in the restored CIO of property held by the Official Custodian (regulation 40), and the requirement for the Charity Commission to publish notification of the restoration (regulation 38). The Regulations make special provision for accounting and reporting for any financial year spanning the period when the CIO was dissolved (regulation 41).

8. Consultation outcome

8.1 Draft regulations were published for public consultation in 2008-09. Respondents were broadly supportive of the proposals relating to the insolvency and dissolution of CIOs.

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 these Regulations and the implementation of the CIO. The Department for Business Innovation and Skills, and the Insolvency Service, have also been consulted on these Regulations. In addition, the Cabinet Office sought expert insolvency practitioner and charity lawyer review of the Regulations. The responses received have enabled improvements to be made to the Regulations.

8.3 Despite the passage of time since the public consultation, 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 (including the aforementioned review by specialists) and to make changes to the draft Regulations 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 it is currently being updated to include guidance on the insolvency and dissolution of a CIO. The Charity 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 these Regulations, is a permissive regime. It does not impose regulation on any charities other than those that choose to adopt the CIO form. The Regulatory Policy Committee has confirmed that the CIO will not impose any costs on business.

10.2 Most defunct CIOs are expected to opt for the more straightforward non-IA dissolution procedure under Part 3 of the Regulations. Despite this, it was considered important that all the existing IA procedures were also made available to CIOs and their creditors.

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).

10.4 The Regulatory Policy Committee has confirmed that 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 These Regulations do 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 these Regulations. 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.