

dti

ENTERPRISE FOR COMMUNITIES:
PROPOSALS FOR A COMMUNITY
INTEREST COMPANY

Report on the public
consultation and the
government's intentions

October 2003



HM TREASURY

Home Office





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Introduction

Background to the proposals

The concept of the Community Interest Company (CIC) was originally outlined in the Cabinet Office Strategy Unit report "Private Action, Public Benefit", published in September 2002.¹

Following a positive response to that report, the DTI, in association with Home Office and HM Treasury, launched a technical consultation on CICs, "Enterprise for Communities: proposals for a Community Interest Company" (available at <http://www.dti.gov.uk./cics>), on 26 March 2003. The Government requested comments on the proposals by 18 June 2003.

The consultation responses and the Government's intentions

The Government received 134 formal responses to the consultation, and is grateful to all those who responded and who participated in consultation events. A list of those who submitted responses is attached at Annex A.

The Government has considered the responses carefully. This document summarises the comments made by respondents, and indicates the Government's intentions on each of the consultation proposals.

In summary, the Government welcomes the strong support that the consultation has demonstrated for its proposals, and intends to proceed with legislation to establish the Community Interest Company as soon as Parliamentary time allows. The Government intends that the key features of the CIC will be largely as proposed in the March 2003 consultation paper. However, in view of the consultation responses and further consideration of the technical issues, the Government intends to clarify and in some respects amend the detail of the proposals, as described in this report.

¹The Government response to the Strategy Unit report is available at <http://www.homeoffice.gov.uk/docs2/charitiesnotforprofits.pdf>



HIGH-LEVEL SUMMARY OF THE PROPOSALS, THE RESPONSES AND THE GOVERNMENT'S INTENTIONS

PROPOSAL	TOTAL RESPONSES	% support	% oppose	% neutral	GOVERNMENT INTENTIONS
1) Community Interest Company	122	77	9	14	Legislate for CICs when Parliamentary time allows
2) Community interest test	81	69	6	25	Establish a test, which should be objective, transparent and wide
3) Political parties and campaigning	59	95	2	3	Establish exclusions as proposed in the consultation paper
4) Changes to purposes	62	77	10	13	Regulator should approve any changes to objects in a CIC's constitution
5) Use of shares	86	68	12	20	CICs limited by shares should be able to pay dividends on 'investor shares'
6) Cap on dividends	71	76	1	23	Dividends will be capped by the regulator; cap will be as flexible as possible
7) No uncapped dividends	66	78	3	19	Uncapped dividends should not be payable
8) Community interest report	84	81	6	13	There should be a requirement to report on issues relevant to CIC status
9) Stakeholder consultation	88	43	32	25	No legal compulsion; CICs to report on activity, regulator will issue good practice guidance
10) Limits on investor control	74	69	9	22	Investors should be able to influence CICs but not control them
11) Transfer of assets	62	89	-	11	CICs should be able to transfer assets to other organisations with an asset lock
12) Regulator's functions	a) 57 b) 58 c) 53	81 81 85	3 5 2	16 14 13	The regulator should have the functions outlined in the consultation paper
13) Regulator's powers	58	89	2	9	The regulator should have (or have access to) the powers outlined in the consultation paper



Proposals, responses and the Government's intentions

Proposal 1: There should be a new type of company, the Community Interest Company (CIC) (paragraph 15)

1.1 Of the total of 134 formal responses to the consultation, 122 commented on this proposal, of which 77% supported the proposal, 9% opposed it and 14% commented but made no firm recommendation for or against.

1.2 These figures are consistent with the response to the outline proposal on CICs in the Cabinet Office Strategy Unit report of September 2002, "Private Action, Public Benefit". The recommendation on the creation of the CIC in that report prompted 114 responses, of which 84% were positive, 10% negative and 6% neither for nor against. The response to the more detailed, technical proposals in the March 2003 CIC consultation paper indicates that there is real support for the CIC among those interested in legal forms for social enterprise.

1.3 Respondents suggested that this new type of company, with the features proposed, could potentially benefit a range of organisations, particularly those looking to work for community benefit within the relative freedom of the non-charitable company form, but with a clear assurance of not-for-profit-distribution status.



1.4 Illustrative quotes:

"It will be a valuable addition to the range of legal forms available for social enterprise" **Social Enterprise Coalition**

"It fills a gap in the range of legal forms that are currently available. The CIC will combine the well-understood company model with a test of community benefit and a simple and transparent mechanism to lock profits into the company. As such the CIC will be a useful tool for many organisations undertaking social enterprise activities." **National Council for Voluntary Organisations**

"We do feel that CICs offer an additional and useful mechanism for those wishing to support and develop the social enterprise sector" **Association of Charitable Foundations**

"There is a need for an easily understood legal form which entrenches 'not-for-profit' community interest principles" **Community Matters**

"We would welcome legislation to set up this legal form. It is essential that

DTI clearly targets the CIC legal form on the organisations that would benefit from adopting it."

Association of Chief Executives of Voluntary Organisations

"SEL welcomes the creation of a social enterprise specific company form that clearly recognises the social nature of these organisations whilst directly nurturing their enterprising activities" **Social Enterprise London**

"We welcome the introduction of the CIC since it expands the choice of legal forms for the social enterprise sector. The easy asset lock the CIC will provide is a highly desirable element of the proposed plans.. The CIC model will be of relevance to many organisations in the entire third sector and to some socially driven companies in the private sector, and not just to 'social enterprises'" **New Economics Foundation**

"The CIC will be particularly useful for social enterprises which do not wish to be democratic but wish to avail themselves of external capital" **Wrigleys solicitors**



1.5 Some of those respondents who did not support the proposal expressed concern that the CIC would increase the number of legal forms, and thus cause additional complexity or confusion. Several responses suggested that in comparison with ordinary companies, CIC status would not offer sufficient benefits to outweigh the additional regulation it will involve.

1.6 Illustrative quotes:

“Introduction of this company will confuse an already complicated area for those wishing to create an association framework be it as an incorporated or unincorporated entity” **Village Retail Services Association**

“If any confusion does exist amongst investors, it is difficult to conclude how the introduction of the CIC (with its test and regulation) will ameliorate this confusion” **Social Enterprise Network**

“We believe the proposals provide an expensive and excessively regulated option when compared to other existing vehicles” **Scottish Council for Voluntary Organisations**

1.7 A significant number of those who responded positively to the proposal, including many of the organisations quoted above, raised a number of important points about CICs in relation to:

- the branding of the wider social enterprise sector;
- the potential impact of the CIC on other legal options;

- the provision of advice and information about the sector; and
- the fiscal environment for social enterprise.

These issues, and the Government’s response to the points raised, are summarised in sections 14-17 of this report.

The Government’s intentions

1.8 The Government is encouraged by the confirmation of strong support for the CIC concept which this consultation has demonstrated. We intend to move ahead with legislation on CICs as soon as Parliamentary time allows, as the Secretary of State for Trade and Industry announced in July 2003.

1.9 The consultation, like that on the Cabinet Office Strategy Unit report, demonstrates that there are concerns within the social enterprise sector about the range of legal options for incorporation. Nonetheless, the consultation has confirmed that there is a clear demand for the CIC, and that other legal options (notably charitable status and the Benefit of the Community IPS (‘IPS Bencom’) are also important because of very diverse nature of social enterprises. The Government therefore considers that these concerns are best addressed by improving the information and advice available to those considering their legal options – see also sections 15 and 16 of this report.



Proposal 2: A regulator should apply a 'reasonable person' test of community interest (para 17), and should issue guidance on the test (para 19)

2.1 The Government received 81 responses commenting on this proposal. 69% of these responses supported the proposal, 6% opposed it and 25% commented but made no firm recommendation for or against.

2.2 A number of respondents stressed the need for the proposed 'reasonable person' test to be clear, robust and flexible to reflect the changing needs of the community and so as not to exclude wider groups. A small number thought that the community should be consulted to determine if the objectives of proposed CICs were for the public good.

2.3 Eight respondents made comparisons between the 'reasonable person' test of community interest and the 'public benefit' test in charity law. Some felt that the proposed CIC test was too close to the charitable test and may cause confusion. Most were in agreement that the CIC regulator would need to interpret the reasonable person test more widely and flexibly than the 'public benefit' test.

2.4 Several respondents remarked that the criteria for the test would need to be transparent to ensure a consistent approach. Many of those who supported the proposal specifically stated in their response that guidance was required on what constitutes community interest. It was suggested that guidance should give examples of CICs that would pass the test (for instance, could a CIC benefit a

community overseas?), and that social enterprise experts should be involved in drawing up guidance on the test.

2.5 Those opposed to the proposal were primarily concerned that the reasonable person test could be too onerous and would dissuade people from applying for CIC status. Several respondents commented that the reasonable person test was too subjective. Others suggested that the test was unnecessary, since a decision to lock assets into the CIC would in itself show that the organisation is acting in the community interest; and that to avoid a long registration process the regulator could take a reactive approach, intervening in a registration only where there were concerns about a CIC.

2.6 Illustrative quotes:

"Careful thought will need to be given to the test in order not to exclude some of the wider groups or individuals who may be interested in setting up a new business as a CIC. It would be appropriate to ensure that there is considerable flexibility in how the test is conducted." **Business Link Lincolnshire and Rutland and Business Link for Leicestershire**

"The 'reasonable person test' is supported as giving the necessary flexibility to deal with definition and the position set out in the paper on the community interest test appears logical and supportive to the image of social enterprise. The regulation needs to be transparent to ensure a consistent approach." **Cornwall Enterprise** ▶▶



"It is vital that the community interest test criteria are broader and more flexible than the public benefit test to which charities are subject, otherwise eligibility for the CIC legal form will be unnecessarily restricted. However, relaxing the criteria excessively will damage the CIC 'brand' and undermine the good name of social enterprise."

Association of Chief Executives of Voluntary Organisations

"We would recommend the community interest test is dropped in the interest of simplicity, cost and flexibility" **Charity Law Association**



The Government's intentions

2.7 The Government notes the broad support expressed in consultation for the proposed community interest test, and the view that it should be transparent, objective and distinctly wider than the charity law test of public benefit.

2.8 In view of this, the Government intends to apply a test, along the lines set out in the consultation paper. This is intended to be:

- Objective – the regulator will consider whether a reasonable person could regard an applicant's purposes as in the community interest, not whether the regulator itself regards them to be so.
- Transparent – the regulator will be required to publish guidance on the test, and there will be a process for appeals against its decisions.

- Materially wider than the charitable test of public benefit, because of the 'reasonable person' mechanism. Overseas objectives will be eligible for consideration.

2.9 As far as possible the test will make use of declarations at the time of application, and this is expected to help to keep the application process streamlined. Each CIC will have discretion on how much information to give on its purposes at the time of application. Where flexibility is desired, this need only involve a declaration of intent to pursue the benefit of a community. However, CICs will have the option of giving more information and/or of defining their objects in detail in their constitution. The latter, in particular, may help to persuade funders and grant-givers that the CIC will remain focused on particular purposes, since the regulator will have to approve any change to the objects and stakeholders will have to be notified of it (see proposal 4).



**Proposal 3:
Political parties should not be able to become CICs or to set up CIC subsidiaries, and organisations whose purposes are support for a political party, or political campaigning, should be unable to become CICs (para 18)**

3.1 The Government received 59 responses commenting on this proposal. 95% of the responses supported the proposal on political parties, 2% opposed it and 3% commented but made no firm recommendation for or against.

3.2 However, 9% of those who supported the proposal on restrictions on political parties also questioned the need for the restrictions to extend to political campaigning generally. It was argued that there can sometimes be a fine line between community activities and political campaigning, and that the latter can clearly be seen as for the public good. A suggestion was made that the regulator should take a pragmatic view of campaigning which is not directly designed to pursue party political purposes.

3.3 Of those who made detailed comments, several thought that the CIC regulator should draw on existing charity law and Charity Commission practice in determining what is a political purpose, and that the CIC legislation should not be any more restrictive than these.

3.4 A couple of respondents agreed to the proposal provided that the definitions of political activity are flexible and can accommodate changes in society over time. A similar number

suggested that religious groups should be excluded from CIC status, in the same way as political groups; for instance, it was argued that this could be an area of concern for investors.

3.5 Illustrative quotes:

"SEC is in agreement with this. It should be in line with current rules for charities in respect of campaigning organisations."

Social Enterprise Coalition

"The CIC model should allow organisations to campaign on specific policy issues but not to support political parties or be one. In this area, current charitable guidelines are appropriate. The CIC legislation should not be more restrictive than these."

New Economics Foundation

"WCVA agrees with the proposals to exclude political parties and supporting organisations from the CIC regime...However, it is urged that the Regulator take the practical and pragmatic view to campaigning which is not directly designed to pursue party political purposes.

A lead should be taken from the difficulties that the Charity Commission have experienced in this area and the relaxations outlined in the Strategy Unit report."

Wales Council for Voluntary Action



The Government's intentions

3.6 The Government notes the general support for its proposal to exclude political parties from adopting CIC status, and from establishing CIC subsidiaries. It intends to incorporate these exclusions in legislation.

3.7 The Government also notes and agrees that in some cases political campaigning is hard to distinguish from community activity. The Government's intention is that as with charity law, the proposed exclusion on CICs being formed for the purpose of political campaigning should not preclude political campaigning in furtherance of the CIC's other legitimate purposes. As several respondents noted, charity law and Charity Commission practice is likely to be relevant here. The Government has recently accepted the recommendation, in the Cabinet Office Strategy Unit report "Private Action, Public Benefit", that the Charity Commission should publish revised guidance on this area (see "Charities and Not-for-profits: A Modern Legal Framework", July 2003, available from www.homeoffice.gov.uk).

Proposal 4: Once a CIC is registered, the regulator would need to approve any proposals for changes to its purposes (para 21)

4.1 The Government received 62 responses commenting on this proposal. 77% of the responses supported the proposal, 10% opposed it and 13% commented but made no firm recommendation for or against.

4.2 Of those that made more detailed comments, several respondents stressed that the process of approving changes should be relatively simple and in keeping with the 'light touch' regulatory regime proposed in the consultation paper. Others commented that the process should not be made expensive, especially for smaller organisations, and asked for more detail and guidance on when approval would be necessary.

4.3 Some respondents expressed concern that the potential requirement for a CIC to consult its stakeholders prior to proposing to change its purposes (as described in section D of the working paper "The CIC Regulator", published on the DTI website (www.dti.gov.uk/cics) as part of the consultation) seemed overly onerous and in practice could be difficult to achieve.

4.4 A handful of respondents suggested that only fundamental changes to the community interest objectives should be referred to the regulator, leaving the onus on stakeholders to monitor the ongoing activities of the company. There were concerns that seeking approval for changes in trading could hinder entrepreneurial activity and result in an overly bureaucratic process. Some of these respondents questioned whether CICs would be bound by ultra vires rules.



4.5 A small number of respondents thought that the proposal was too similar to the Charity Commission approach, and that CICs should not be subject to the same level of regulation

as charities. It was argued that CICs should have the same freedom as other non-charitable companies to change their objects when required.

4.6 Illustrative quotes:

“Changes to CICs’ purposes should be approved by the regulator, and stakeholders should be notified of them, but this must not be, in general, a problematic or lengthy process.” **Association of Chief Executives of Voluntary Organisations**

“Yes, provided that this was a simple process (such as with the Registrar of Companies) and neither complicated (as with Charities), long-winded (as with Friendly Societies) or expensive (either!). It should be simple, easily-done, quickly approved and not requiring the use of a solicitor.” **Liverpool City Council**

“We feel that the Regulator should have the power to approve proposed changes to a CIC’s purposes. However, we do not feel that a CIC should be obliged to undertake prior consultation with its stakeholders before changing its purposes. Such an obligation would be at odds with the light touch regulation within which the CIC is to operate and would in practice be difficult to meet given the possible extent of “stakeholder” interest.” **Farrer & Co.**

“It could hinder entrepreneurial activity to have to seek approval for changes in trading/economic activity. It is suggested that approval is only necessary for major changes to the community interest objectives of the CIC.” **Community Development Finance Association**

“We agree, but point out that it is important to allow businesses to diversify their activities without constant constitutional changes and without running the risk of being found to have acted ultra vires.” **Co-operatives UK**

“There is a certain illogicality and unfairness if CICs need a regulator’s permission to change their objects but other community entities do not (e.g. not-for-profit guarantee companies).” **Jordans Ltd**

“Perhaps a less heavy handed way would be for CICs to inform the regulator of a change and if the regulator thought the change inappropriate they then take action with the CIC gathering more information, and deciding if the change could go ahead.” **Enterprising Communities, Voluntary Action Cumbria**



The Government's intentions

4.7 The aim of this proposal is to give CICs freedom to change their purposes to meet changing needs, while providing a measure of protection to stakeholders – including those such as philanthropic lenders/donors – who would be unlikely to welcome a fundamental shift of purposes, and would, at the least, wish to be aware of such a change.

4.8 The Government notes that while broadly supportive of the proposal, a number of respondents have expressed concerns both about the potential bureaucracy of the process and about the proposal, set out in the Regulation working paper, that the regulator should have powers to delay approving material changes to a CIC's objects until the CIC can show that it has taken steps to notify stakeholders of the proposed change. The working paper itself noted that this requirement could result in delays in approving reasonable changes to objects.

4.9 As noted above in respect of proposal 2, it is intended that CICs should have considerable flexibility in the extent to which they detail their purposes in their objects. At one extreme, they may choose to specify in great detail the nature of their activities in their objects. This may be appropriate if, for instance, a CIC wishes to demonstrate to potential funders that it has narrowly defined purposes. However, those CICs that wish to ensure maximum freedom of operation will be able to insert general trading objects in their constitution. For the purposes of the community interest test, they will be required to augment these with a community interest statement, but that in itself may be only a statement of intent to pursue the benefit of the community.

4.10 The Government believes that this approach should address the concerns voiced by some respondents about the potential bureaucracy and inflexibility of this proposal. If a CIC chooses to establish itself with very broad objects (e.g. trading objects), it will not need to seek the regulator's approval even of quite major changes in its activities, since these will be within the scope of its objects. However, where a CIC has established itself, and won stakeholder support, on the basis of quite narrowly defined objects, it seems reasonable that the regulator should be able to delay approval to changes of those objects until the CIC can demonstrate that it has taken steps to alert stakeholders to the change. This will give stakeholders in such CICs a reasonable assurance that they will be alerted to any significant change in purposes. It should be stressed that the requirement here will only be to show to the regulator that reasonable steps have been taken to inform stakeholders. It will not be necessary to show that all potential stakeholders have been notified, or that they have agreed to the change.



**Proposal 5:
CICs should be able to issue tradable fixed or capped rate shares, and to pay dividends to the holders of these shares up to a fixed percentage above base rate, LIBOR or another appropriate benchmark (para 27)**

5.1 The Government received 86 responses commenting on this proposal. Of these, 68% were in favour of the proposal, 12% opposed it and 20% were neutral.

5.2 Many who commented in more detail on this proposal were enthusiastic about the potential to issue shares and thought that the ability to do so would allow financing in a clearly defined and transparent manner. It was thought by some that this would be a key attraction of the CIC, as it would open up access to greater sources of finance. A small number of responses argued that CICs could be exempted from the prospectus requirements of public share offerings. It was also suggested that CIC shares should be made compatible with approved employee share and share option plans.

5.3 Most of the respondents who favoured the ability of CICs to issue shares and pay dividends, thought these should be capped in some way to protect the finance of the CIC, meet the statutory requirement for an asset lock and still attract some investors. The ability of CICs to set the rate of return was considered essential by many.

5.4 A small number of respondents thought that capping the rate of return may be too restrictive, limiting the effectiveness of the CIC model and proving a disincentive to commercial investors. It was suggested that such

investors may be deterred because capped CIC shares would entail the same risk of loss as normal equity, but without the prospect of high returns to commercial investors if the CIC prospers. Taken together with the proposed limitations on the voting rights of CIC investor shareholders (see proposal 10), this could make CICs shares less attractive than debt investment. Some respondents felt that the attraction of such shares might be primarily symbolic, as demonstrating a share in the 'ownership' of a CIC providing a social return.

5.5 A handful of respondents expressed concerns that shares are perceived to be used solely for commercial business and allowing CICs to issue capped shares may compromise the social values of the social enterprise sector. Those opposed to the principle were of the view that stakeholders should invest in a CIC for social responsibility reasons and that they should not receive a return on their investment.

5.6 Two umbrella groups raised concerns on behalf of their members that they may lose support from stakeholders if they were to issue shares, since important stakeholders may be less inclined to help the organisation if profits which they helped to produce are being paid in dividends to private investors.

5.7 Some respondents questioned how much equity CICs would actually be able to raise through issuing fixed or capped rate shares as the CIC by definition would produce a low return. It was suggested that such investment in CICs would be for philanthropic purposes, rather than for a return on investment, and that investors would be unwilling to provide venture capital to newly formed social enterprises.



5.8 Illustrative quotes:

"This would be beneficial to allow financing in clearly defined (and publicly transparent) manner."

Bulwell Hall Community Garden Ltd

"Most but not all of SEC's members are in agreement that CICs should be able to issue shares which pay dividends. However, some are concerned that certain types of social enterprise could lose support by paying dividends (Some social enterprises rely on charitable grants to help with their start up costs and some win customers or extra voluntary support on the basis that no profits are paid to private investors)." **Social Enterprise Coalition**

"Consideration should also be given to giving CICs the same exemptions from the Public Offer of Securities Regulations as apply to IPSs"

Co-operative and Mutual Solutions

"If development trusts were to establish themselves as CICs which issue shares we risk loss of support from vitally important stakeholders (not least grant making trusts, volunteer staff, voluntary Board members) who may be less inclined to donate money or time if they feel a proportion of the wealth they help to produce will end with private investors." **Development Trusts Association**

"CFDG supports the ability of CIC's to raise equity. Such ability could potentially offer social enterprises huge growth potential. One social

entrepreneur told CFDG that he and his fellow entrepreneurs are in great need of equity. Banks are often unwilling to lend to such enterprises, so new sources of finance would be greatly welcomed. However, there are doubts about how much equity CIC's would actually be able to raise." **Charity Finance Directors' Group**

"There are mixed feelings amongst our members as regards capped rate shares and dividends. Some feel that capping the rate of return would be over restrictive and prevent access to some financial instruments and therefore not help to increase investment. Others agree with the need for a cap, but stress that it must be highly flexible and in line with market rates, or even above market rates as social enterprises are still an unproven market to mainstream equity and therefore will need a boost initially." **Community Development Finance Association**

"The facility for CICs to issue tradable fixed or capped rate shares, and to pay dividends up to a fixed percentage above the base rate, will provide access to greater sources of finance for the CIC, and is welcome. However, it will challenge traditional views of community interest in that shares may be purchased/sold by those with no community interest; and that any surplus paid out in dividends will be taken out of the community." **Judge Institute of Management, University of Cambridge**



The Government's intentions

5.9 The Government notes that while there is general support for the proposals that CICs should have the option of structuring themselves as companies limited by shares, and issuing 'investor shares' that could pay a capped dividend to investors, there is uncertainty about the level of investment that this structure would be likely to generate.

5.10 During the consultation period the Government discussed this point with a number of experts in the financing of social enterprise. It has also considered the findings and recommendations of the Bank of England's May 2003 report "The Financing of Social Enterprises" (available from www.bankofengland.co.uk), which was published during the consultation period. That report observed that commercial equity is little used at present by social enterprises, largely because they are more focused on their social objectives than on maximising financial return.

5.11 The Government has concluded that since the financing market for the sort of philanthropic 'patient capital' that many CICs will seek is still in the early stages of development, it would be wrong to restrict CICs' future finance-raising options at this stage by leaving no scope for capped equity in the CIC legal structure. The Government therefore proposes to structure legislation so as to allow CICs to issue suitably capped investor shares, while recognising that demand for such shares may initially be limited. The level of demand will be influenced by the way in which the cap is set – proposal 6 below. The Government intends that the cap should be set at a level which will allow

CICs to access investment, without undermining their focus on community benefit.

5.12 The Government notes the concern expressed by some respondents that the use of dividend-bearing shares by CICs could be at odds with the values of the sector, but does not believe that this justifies ruling out the option of using such shares. Social enterprises already use a range of innovative techniques to raise finance in pursuit of their objectives, and it is important that the legal structure of the CIC does not impose unnecessary restrictions on such innovation. Where a social enterprise wishes to use the CIC form but also wants to make it clear that it will not consider issuing shares, it will of course have the option of incorporating as a CIC limited by guarantee, or as a CIC limited by shares but specifying in its constitution that no dividend will be paid on shares.

5.13 The Government is grateful for the range of technical comments and suggestions made by respondents in relation to the use of equity for CICs. The Government is sympathetic to the suggestion that CIC shares should be compatible with approved employee share and share option ownership plans, and is exploring the technical implications of this. The Government is also considering the suggestion that CICs might be exempted from some of the disclosure provisions relating to public offerings of shares. The Government will report its conclusions in these areas in due course.



**Proposal 6:
The cap on returns on such shares should be set at a level that optimises CICs' access to finance while maintaining a sufficient lock on profits and assets to give comfort to philanthropic lenders. The Government will work with investors and social enterprises on arrangements for the cap (para 28)**

6.1 71 responses commented on this proposal, of which 76% supported it, 1% opposed it and 23% commented but made no firm recommendation for or against.

6.2 Those who opposed the proposal altogether were concerned that any cap could damage the ability of CICs to gain access to finance – see proposal 7.

6.3 Many of those who supported the proposal pointed out that great care would be needed to create the right balance between encouraging investment and preserving assets for the community interest, and that the Government should create more awareness and understanding of CICs to encourage companies to invest. Respondents called for more work to be carried out to explore the issue of the cap further, and for the Government to take account of the views of the social enterprise sector when setting the cap. Several respondents felt that an independent committee of experts should be formed to make recommendations on the cap and to review it from time to time. Some representative groups welcomed the suggestion of working with the Government on arrangements for the cap.

6.4 Many responses also commented on the need for flexibility in the setting of the cap. It was stressed that to optimise access to finance, the cap will need be able to change quickly to reflect changes in base rates in line with market conditions.

6.5 Several of those who supported the proposal commented that the level of the cap should be agreed at registration. It was suggested by one respondent that the rate should be fixed in the constitution of the CIC so that outside influence to increase return levels could not be exerted. One respondent suggested that the financial returns offered by Community Development Finance Institutions (CDFIs) and social venture funds could offer a potential benchmark for any cap. Others commented that the maximum rate should take account of the scope for tax relief on investment via CDFIs, through the Community Investment Tax Relief (CITR).

6.6 Responses put forward a range of views on the structure of the cap:

- Capped dividend of 5% above the base rate.
- Set each year by reference to an average/median market index. Maximum rate should be the index's average median rate +5%.
- Cap as a percentage of total profits, rather than a percentage of capital invested, as described in paragraph 20 of the consultation working paper on finance.
- Link to an index not a proportion of profits.
- Fixed margin above a standard interest rate e.g. base rate or LIBOR.
- Not LIBOR as it is debt based.



6.7 On balance, the preference was for returns set at the lower end of what could be achieved in the market. This was considered appropriate as it was thought that the success of CICs would depend on public trust and support at a range of levels. It was felt that this support could be undermined if investors are seen to be gaining disproportionately. If the initial cap proved too low to attract investment into CICs, the cap could then be raised in a controlled way without undermining trust in the CIC form.

6.8 Conversely, a small number of respondents argued that the initial cap should be relatively high, to give a financial rather than philanthropic incentive to investors. These suggested that although the principle of a cap is consistent with the CIC concept, setting it at the lower end of the scale would limit the effectiveness of the CIC model, by preventing access to certain types of investment that would be available to other forms of enterprise.

6.9 A small number of responses asked whether the cap that existed at the time of issue of a given share would then apply in perpetuity to that share, or whether issued shares would be affected by changes to the cap after the date of share issue.

6.10 Several respondents suggested that a similar formula to that applying to interest on investments for Industrial & Provident Societies (“a rate not greater than that required to obtain or retain capital”) could be appropriate.

6.11 Some 5 responses argued that rather than setting a cap per share, there should be a limit on distributions defined as a percentage of overall profits, as described in paragraph 31 of the consultation paper, and in paragraph 20 of the consultation working paper on finance (www.dti.gov.uk/cics).

6.12 Illustrative quotes:

“SEC agrees that further work needs to be done in relation to the mechanism for capping returns. In our consultations concerns have been raised that although it is necessary to protect the social nature of the enterprise, a rigid fixed cap may severely limit the opportunities for social enterprises to grow and compete in the market. One approach suggested is rather than using a fixed percentage, a test such as “a rate not greater than that required to obtain or retain capital” might be used. (This is currently the case in FSA guidance on Industrial and Provident Societies) This would require appropriate mechanisms for regulation but could allow greater flexibility.” **Social Enterprise Coalition**

“There is agreement that if there is a cap it should optimise access to finance. As stressed above any cap should be able to change quickly in line with market conditions. It is felt that an independent committee of experts should agree the cap level or at least make recommendations on the level to the regulator.” **Community Development Finance Association**



“The cap concept will prevent CICs accessing certain of the investment instruments that their SME counterparts can call on, i.e. cumulative preference shares, participating loans (e.g. where the loan is entitled to a “profit” share) etc. This will limit the effectiveness of the CIC model and its attractiveness to investors.” **Local Investment Fund**

“As with Industrial & Provident Societies, there should be a limited return on capital. In the case of IPSs this is interpreted as the rate of interest required to attract and maintain the investment. It is sometimes expressed as a fixed margin above a standard interest rate e.g. base rate or LIBOR). Applying these formulae to CICs would be a further contribution to the equality of treatment that we argue for. We are also sympathetic to the suggestion that the cap could be on the total distributed profit rather than the return to an individual investor. This should be available, along with other flexible ways of putting the limited return principle into practice.”

Co-operatives UK

“For larger private investors who may look to invest in a social enterprise, the Group believes that the capped return on shares will put off many larger investors. Generally Novas-Ouvertures is of the view that all profits should be returned back into meeting the community and public interest of the social enterprise.”

Novas Ouvertures Group

The Government's intentions

6.13 The Government notes the general support expressed in consultation for the proposal that the cap should be set so as to strike a balance between maximising access to finance and maintaining the credibility of the asset lock. It intends to structure legislation on this basis, giving the CIC regulator the role of setting the cap within a structure to be laid down in legislation. The regulator will also be required to listen to the views of the social enterprise sector in carrying out its functions, including the setting of the cap. The Government will consider what formal arrangements, if any, should be made to ensure that the regulator has access to appropriate advice from the sector when setting the cap.

6.14 The Government is grateful for the many constructive suggestions offered by consultees on how to go about structuring and setting the cap. The detailed workings of the cap will not be set out in primary legislation; the Government will set the structure of the cap in secondary legislation, and the CIC regulator will be responsible for setting the cap in a way that will balance need to encourage investment with the primacy of community interest. The regulator will take the views of the social enterprise sector into account in setting the cap.

6.15 In terms of setting the structure of the cap, the Government notes that the views expressed in consultation point towards:

- Linking the cap to the Bank of England base rate, so as to reflect changes in market conditions.
- Enabling the regulator to change the amount by which the cap exceeds the base rate relatively quickly if this should prove necessary.



- Providing that the cap applying at the date of issue of any given share should continue to apply to that share in perpetuity, to avoid the prospect of future changes in the cap affecting the anticipated yield of shares.

6.16 The Government notes and will consider further the suggestion that a statement of principle, such as that applying to returns on investment in IPSs, may be appropriate for the cap on CIC shares. In practice it may be that this will need to be translated into a given rate above base rate in any case.

6.17 Although a cap based on a percentage of profits or revenue, rather than on capital invested, would be likely to make investment in CICs more attractive to commercial investors seeking high returns, the Government is not convinced that it is appropriate. This is for the reasons set out in the consultation paper and finance working paper; such a cap would potentially allow very high returns to investors, contrary to the concept of the asset lock, and could give a single commercial investor a significant financial interest in a CIC. However, the Government intends that CIC legislation should be sufficiently flexible to allow a cap based on profits or revenue to be introduced at a later date, via secondary legislation, if it appears in the light of experience that this is necessary to attract investment into CICs and will be acceptable in terms of the asset lock.

Proposal 7: CICs should not be able to issue shares that pay an uncapped dividend (para 31)

7.1 66 responses commented on this proposal, of which 78% supported the proposal, 3% opposed it and 19% commented but made no firm recommendation for or against.

7.2 The majority of respondents who supported the proposal that CICs should be able to issue tradable capped shares, also supported the proposal that CICs should not be able to issue shares that pay an uncapped dividend. Many responses commented that issuing shares that pay an uncapped dividend would run contrary to the CIC asset lock.

7.3 Some of those who opposed the proposal commented that there might be circumstances where uncapped dividends may be in the community interest, if the community itself is to benefit from the higher level of investment that uncapped dividends may attract. Others felt that CICs should have flexibility to attract all types of investment, and that this could not be achieved if a cap on dividends was in place. A small number of those who made no recommendation for or against expressed similar concerns, and concluded that more thought and debate was needed on the issue. A few responses argued that investors in CICs should be rewarded financially for their social commitment.



7.4 Illustrative quotes:

"The issue of uncapped dividends would run contrary to the community interest purpose of CICs, as reflected in their lock on assets and profits."

Association of Chief Executives of Voluntary Organisations

"Yes, I strongly agree. Also, there should be a requirement for CICs to build up a level of reserves from profits/surpluses BEFORE they can pay dividends. This model, which is widespread in Europe helps to avoid some of the under-capitalisation problems of social enterprises and avoids the accusation of profit-seeking (especially where 'surpluses' in the early years derive from public subsidy)" **Liverpool City Council**

"CICs must have the flexibility to attract all types of investment; there may be circumstances where uncapped dividends are appropriate if the community itself is able to benefit from a higher level of investment that uncapped dividends may attract" **South West of England Regional Development Agency**

"There are mixed views on this with some of our members advocating that shares and dividends should not be capped and others agreeing that they should" **Community Development Finance Association**

"There should not be a total bar on this, but it should require the approval of a special majority of the voting rights to do so." **Institute of Directors**

The Government's intentions

7.5 In view of the consultation responses on this proposal and proposals 5 and 6, the Government does not consider that uncapped dividends on CIC investor shares are appropriate. However, the Government agrees that the capping arrangements should not unnecessarily rule out investment which might have a significant benefit for the community. This will be taken into account when developing the capping mechanism (proposal 6 above).



Proposal 8: CICs should submit short annual reports on the action they have taken to pursue their public or community benefit objectives, and to involve stakeholders (para 32)

8.1 84 responses commented on this proposal, of which 81% supported the proposal, 6% opposed it and 13% commented but made no firm recommendation for or against.

8.2 Many of those who supported the community interest report proposal commented that it was an important part of the CIC structure. It was seen as something that will encourage CICs to concentrate on their community benefit objectives, and would promote accountability to stakeholders. A number of consultees suggested that the report might be an appropriate way of ensuring transparency on issues such as the remuneration of CIC directors.

8.3 Of those who commented in detail, many stressed that it was vital to minimise the regulatory burden imposed by the reporting requirement. A number highlighted the risk that if this is not done, it would reduce the take-up of the CIC form. A small number of responses suggested that no additional report was needed since existing company reporting and auditing requirements could fulfil the same purpose. A couple of respondents suggested that smaller CICs should have a reduced reporting requirement. Conversely, a few responses expressed concern at the scope for abuse of a light-touch reporting system.

8.4 Illustrative quotes:

"It is important that the community interest report does not impose an arduous encumbrance on the CIC. It is envisaged that some CICs will be fairly small, and extra burdens on a small business could cause them to re-consider the structure of the company." **PRIME**

"Transparency of directors' remuneration would be an appropriate requirement on a CIC .. There would be nothing to lose from making directors' remuneration public." **Development Trusts Association**

"[Transparency requirements] could over burden CICs to the point that no one will want to take up the new model." **Charity Law Association**

"The provision of such information should be left for the CIC to provide in the directors' report, under existing company requirements." **Institute of Chartered Accountants of Scotland**

"Under these proposals, [it would] be the individual CIC's self-assessment rather than any attempt at impartial evaluation of community benefit. We believe this may be a weakness." **Action with Communities in Rural England**



8.5 Several responses noted links between the proposal and the development of social auditing. It was remarked that the CICs reporting requirement could prove a catalyst for the development of social audit, and that the reporting requirement could be expanded to a requirement to carry out social audits. However, most responses that touched on this point concluded that social auditing should not be a mandatory requirement for CICs, because of the cost and complexity of the process.

8.6 Illustrative quote:

"The development of this area should link to wider work on social auditing that CICs and other forms of social enterprise should be encouraged to carry out." **Social Enterprise Coalition**



The Government's intentions

8.7 The consultation responses confirm the Government's view that the proposed reporting requirement will add value by recording and publicising what CICs have done to pursue the community interest. The Government therefore intends to introduce such a requirement.

8.8 The responses also demonstrate the importance of ensuring that the reporting requirement is no more complex than is needed to achieve the policy aim of transparency. The requirement will be set out in secondary legislation, so will not be decided by the regulator. The regulator will however produce guidance on how to complete the report.

8.9 It is expected that, as proposed in the consultation paper, the contents of the report will include a short narrative on activity in pursuit of community benefit and on how the CIC has involved its stakeholders.

8.10 In view of the responses to the consultation, the Government also considers that in the interests of ensuring transparency on key areas of potential stakeholder concern, such as the remuneration of CIC directors, it would be reasonable for the report to contain limited additional information on those items. The Government will seek to ensure that any additional reporting requirements are straightforward, do not duplicate existing requirements in company law, will impose a minimal burden on CICs and will not be a deterrent to the use of the CIC form.

8.11 Since the report is intended to contain only the necessary information on the community benefit work of each CIC, the Government does not think that a reduced reporting requirement for smaller CICs is needed.

8.12 The Government agrees that there are potential links between the community interest report and the wider development of social audits. The DTI Social Enterprise Unit is helping to take forward thinking on social audit, and is aware of the potential for CICs to make connections between such audits and this reporting requirement. In common with most of the consultees who commented on this issue, the Government does not think that the relatively complex and still-developing tool of social audit is itself currently an appropriate basis for the CIC reporting requirement.



**Proposal 9:
CICs will be encouraged to involve stakeholders in their enterprises. The Government invites views on whether a statutory requirement for CICs to seek the views of their stakeholders, with an exemption for small CICs, would be appropriate (para 35)**

9.1 88 responses commented on this proposal. Of these, 43% supported the idea of a statutory requirement, while 32% opposed it, and 25% commented on it but made no firm recommendation for or against.

9.2 This proposal generated a much more mixed reaction than any other proposal in the consultation paper. This reflected the complexity of the arguments for and against a statutory requirement, which the consultation paper recognised in seeking views.

9.3 Many of those who favoured a statutory requirement argued that it would ensure stakeholder involvement in CICs. Those who made this case included a number of major umbrella groups from the social enterprise and related sectors. Among those who favoured such a requirement, there were mixed views on whether there should be an exemption for smaller CICs, with some respondents pointing out that a definition of 'small' such as the Companies Act threshold quoted in the consultation paper would effectively exempt most small social enterprises of the kind likely to adopt the CIC form.

9.4 Illustrative quotes:

"Stakeholder involvement is central for successful social enterprises .. all CICs should be required to involve stakeholders" **Social Enterprise Coalition**

"These stakeholders must include the local community" **Development Trusts Association**

"Forcing CICs to use stakeholder governance structures would have been too rigid, but a simple requirement to consult with stakeholders should help emphasise that CICs are a different type of organisation" **Institute for Public Policy Research**

"We do not believe there should be any exemption for small CICs from seeking the views of their stakeholders, as empowering both disabled and other employees is .. a key priority for social firms" **Social Firms UK**

"We believe that such consultation should reflect the size of the CIC and that there also needs to be a balance between performance and accountability. We suggest there is therefore an argument for scaleablility in such consultations." **Association of Charitable Foundations**

"There should be no exceptions, with even the smallest CICs required to show some effort to involve stakeholders. We recognise, however, that the Government may wish to make the CIC form available to entrepreneurs who have little interest in stakeholder involvement. What is important, therefore, is transparency." **Co-operatives UK**



9.5 Those who argued against a statutory requirement largely did so on the grounds that such a measure would be unnecessary, burdensome or difficult to enforce. Respondents that took this position included some umbrella groups, social enterprise practitioners and professional bodies and advisers.

9.6 Illustrative quotes:

[A requirement] "would run contrary to the 'light touch' regulation that the Government intends for CICs, making them an unattractive option for social entrepreneurs"

Association of Chief Executives of Voluntary Organisations

"WCVA has reservations about the proposal .. and does not feel that the small CIC exemption will necessarily overcome this. It is felt that statutory stakeholder requirements should only be applied on a sector specific basis by way of specific regulation." **Wales Council for Voluntary Action**

"Formalising arrangements for consultation with stakeholders is unnecessary and could lead to tensions and conflicts of interest." **The Training Exchange**

"A statutory requirement would not be appropriate .. the intention of the proposal, however, is sound and stakeholder consultation could usefully be the subject of Best Practice guidelines" **ECT Group Ltd**



"Unless stakeholders are discrete and easily available just how can you obtain their views practically?"

Bulwell Hall Community Garden Ltd

"A hindrance to the effective operation of a CIC"

Farrer & Co



9.7 Several respondents, particularly among those who expressed no strong view for or against the proposal, noted the links between stakeholder involvement and governance, and the need for the CIC structure to take this into account. Some also noted that equivalent requirements do not apply to other legal forms, including companies limited by guarantee and industrial & provident societies, or to charities, although in some cases governance provides a way for such organisations to identify stakeholder views. Some wider issues around CIC governance are considered further in section 21 of this report.

9.8 Illustrative quotes:

"Different types of social enterprises have different relationships with their stakeholders .. if it were made statutory to seek stakeholder views, these differences would need to be taken into account and the mechanisms for seeking views should not be prescriptive".

Community Development Finance Association

"There is always the possibility of a latent tension in any community organisation that truly represents all stakeholders" **Local Investment Fund**



The Government's intentions

9.9 As noted in the consultation paper, the Government expects that CICs will display a strong focus on the needs of their stakeholders. Against that background, the Government has considered the strongly contrasting views expressed by consultees very carefully.

9.10 As many of the consultation responses indicate, there is a widely held view that stakeholder involvement is one of the characteristics of social enterprise, and that CICs should therefore be required to seek the views of their stakeholders. The Government expects that in almost all cases CICs will take appropriate steps to engage with their stakeholders.

9.11 However, the consultation has also borne out the suggestion in the consultation paper that a statutory requirement for CICs to seek the views of their stakeholders could raise genuine technical and practical difficulties. A significant number of respondents have argued that a statutory requirement would be a difficult to frame, complex to observe, and would be seen as unnecessary and as a deterrent by potential users of the form. Furthermore, CICs will generally engage with their stakeholders even in the absence of a legal requirement to do so.

9.12 In view of the clear practical difficulties and the lack of a consensus about the need for a statutory requirement, the Government does not propose to introduce one. The Government believes that the requirement that CICs should report annually on the extent of their engagement with stakeholders (proposal 8), together with the provision for the

Regulator to issue guidance on good practice in engaging stakeholders and balancing their views, should achieve most of the benefits that could be obtained by a statutory requirement, but at a significantly lower cost in terms of practical difficulty and regulatory burden.

9.13 Where a CIC does not make efforts to engage with its stakeholders, the community interest report will invite it to explain its reasons for not doing so. In effect, CICs will be encouraged either to comply with good practice in this area or to explain why they have not done so. The Government does not propose to introduce a legal requirement for CICs to give a detailed explanation in these reports of any decision not to follow good practice, as it would be difficult to impose a meaningful requirement without placing an undue burden on CICs. However, where a CIC decides to do nothing to involve its stakeholders and to offer no explanation for this in its report, the public nature of the report means that this decision will be clearly apparent to the community the CIC serves.



**Proposal 10:
There should be limits on the powers that investors may have to control the activities of CICs. The Government seeks views on the appropriate restrictions (para 37)**

10.1 74 responses commented on this proposal, of which 69% supported it, 9% opposed it, and 22% commented but made no firm recommendation for or against.

10.2 Those supportive of the proposal included many major social enterprise umbrella groups. Several responses, both for and against the proposal, argued that investor members should have some say on decisions which have a direct impact on them, and pointed out that in general investors can provide valuable advice and input to social enterprises. Some consultees have also noted that restrictions along the lines proposed in the consultation paper would not prevent investors acquiring indirect control over a CIC, e.g. by appointing directors to the board.

10.3 Those responses that opposed the proposal – many of them from a legal advisory background – highlighted the potential for restrictions on investors' rights to reduce both the availability of investment and the efficiency and flexibility of CICs. However, others felt that the proposed policy of 'influence but not control' for investors might be acceptable to the kind of social investor that would be interested in putting money into a CIC. Indeed, some argued that control by such investors would pose little practical risk to the social objectives of CICs.

10.4 The consultation paper invited views on the appropriate level of restrictions on the voting rights of investor shareholders. The responses that gave views on this offered a range of ideas:

- less than 20% of the total;
- 20-25%;
- less than a third;
- less than 50% of the total, and without the power to dismiss directors or alter the constitution of the CIC through special resolutions;
- no votes for investors, but ability to appoint up to a third of the board.

10.5 Illustrative quotes:

"Although investors in CICs have a right to protect their investments, this must be weighed against the community benefit purposes for which CICs are intended to operate"
Association of Chief Executives of Voluntary Organisations

"Safeguards should be in place to ensure that decisions which either directly affect [investor] members or their rights, must be open to scrutiny/challenge by them"
Wales Council for Voluntary Action

"This .. could be a severe disincentive to investment. If the management of a CIC is incompetent and endangering the security of the investors' investment, surely it is appropriate that the investors should be able to intervene and replace the management? .. We would urge the Government to reconsider this point" **Charity Law Association**



“Investors will be looking for some rights and influence and may be deterred from investing without some influence over direction. Giving them voting rights up to a limited percentage might satisfy this need for influence without allowing them to dictate direction, and therefore have control over the organisation.” **Community Development Finance Association**

“For CICs to work, the whole development has to be outcome focused. It is hard to see how investors will be attracted to CICs without some say in the performance of the CICs in which they are investing.” **Crime Concern**



10.6 Several of those who supported the proposal argued that there is a particular need for effective controls on CIC directors' remuneration. Some suggested that this issue might best be addressed through transparency requirements rather than investors' rights; this is discussed further in the context of proposal 8 above.

The Government's intentions

10.7 The basis of this proposal is that genuine investor control would not be consistent with CICs having pursuit of community benefit as their primary goal. The broad support for the proposal in consultation bears that out. The Government therefore intends to restrict the ability of those whose interests are primarily financial to take control of CICs, along the lines described in the consultation paper, and in keeping with

the policy principle that investors should be able to have influence but not control over CICs.

10.8 We recognise that the use of such restrictions may affect the availability of equity investment in CICs (see also proposal 5 above). As part of the wider process of ensuring that there are no unnecessary barriers to investment in social enterprises, the Government will therefore monitor the effect that the restrictions have in practice. The detailed restrictions will be set out in secondary legislation and could be changed relatively easily if necessary.

10.9 Having considered those consultation responses that addressed the technical level of restriction, the Government intends to limit investor voting rights to below 25% of the total, as suggested in technical note 8 in the consultation paper. This would mean that investors would not have the power to block special resolutions agreed by ordinary members. However, there will be scope for investors to be given greater voting rights on matters which specifically affect the value of their shares, as outlined in technical note 8.

10.10 The Government will also consider anti-avoidance measures to prevent investors obtaining indirect control of a CIC. We think that helpful defences would include: preventing persons with a financial interest in a CIC from appointing or removing a controlling majority of the board; and making transfers of non-dividend full voting shares (and guarantee membership for CICs limited by guarantee) subject to approval by the company's directors, to prevent investors buying up full voting shares against the wishes of the board.



Proposal 11: CICs should be able to transfer surplus assets to another CIC or charity, subject to certain conditions (para 40)

11.1 62 responses commented on this proposal, of which 89% supported it and none opposed it. The remaining 11% commented on the proposal but made no firm recommendation for or against.

11.2 While respondents were generally highly supportive of the proposal, several sought clarification of what 'surplus assets' meant in this context and, in particular, whether a CIC would have to prove that assets were entirely surplus to its requirements before it could transfer them to another suitable organisation. It was noted that if this is the case, it will be difficult for organisations such as charities to use CICs as trading arms. It was also suggested that CICs should be able to transfer assets to an IPS Benefit of the Community Society (Bencom) as well as to a charity or another CIC. A number of responses referred to the potential tax implications of transfers from one CIC to another.

11.3 Illustrative quotes:

"The paper says that a CIC may shed profits when it has accumulated more assets than it needs to fulfil its own objects, but alternatively, could a CIC be allowed to shed profits to a relevant charity before it has achieved this surplus. This would perhaps make setting up a CIC more attractive to charities if they were able to gift assets to themselves earlier on." **Charity Finance Directors' Group**

"We would ask the Government to clarify that on the distribution of surplus assets by CIC to another CIC there should be no stamp duty or corporation tax payable on the distribution." **Charity Law Association**

11.4 Respondents had a range of views about the mechanics of approving transfers of assets. Several respondents believed that the proposed requirement for the regulator to approve any transfer to an organisation not listed in the CIC's constitution was unnecessary. Some argued that the additional requirement to notify stakeholders of such transfers would provide sufficient safeguards against inappropriate asset transfers. Others suggested that decisions on transfers should be left to the members of the CIC in accordance with its constitution, with the regulator perhaps giving formal approval if a constitution did not permit transfers. In contrast, one respondent suggested that the proposed mechanism was insufficient to protect the interests of stakeholders.



11.5 Illustrative quotes:

“Members and stakeholders must be notified and the regulator will only become involved if there are objections.” **Age Concern England**

a sufficient safeguard in respect of such transfer without the involvement of the regulator. CICs should be free to transfer their locked in assets or surpluses to other suitable organisations, it could be to another CIC, a charity or a Bencom” **Wrigleys solicitors**

“The duty to notify stakeholders and obtain regulator agreement to transfer surplus assets to another CIC or charity does not fully protect those who only wanted to contribute to that particular organisation.” **Office for Public Management**



The Government's intentions

11.6 In view of the responses the Government intends to allow the transfer of assets from CICs to other organisations that themselves have an asset lock and an orientation towards public or community benefit, as proposed in the consultation paper. The Government agrees that as well as charities and other CICs, potential beneficiaries could include IPS Bencoms with an asset lock. HM Treasury is currently consulting on measures to put such an asset lock in place for Bencoms.

11.7 Subject to the proposed controls (beneficiary organisation listed in donor's constitution, or transfer notified to stakeholders and agreed by regulator), the Government agrees that it should be possible for CICs to transfer assets to another suitable organisation without having to demonstrate that the assets in question are 'surplus'. This would help charities to use CICs as trading arms should they wish to do so.

11.8 The Government has considered the argument that the regulator's approval should not be needed for asset transfers that are agreed by the members of a CIC in accordance with its constitution. On reflection, we still believe that the need for the regulator's prior consent to an asset transfer to an organisation not listed in the CIC's constitution is a helpful safeguard for the interests of those stakeholders who are not members of the CIC. Routine transfers to organisations listed in the CIC's constitution will not of course be subject to this requirement.



Proposal 12:

The regulator should exercise the following functions:

a) check that applicants for CIC status will be not-for-profit companies working in the community interest;

b) review community interest reports, which will be published; and

c) ensure that the residual assets of wound-up CICs continue to serve the public or community benefit. (para 41)

12.1 There were slight variations in the responses on each of the proposed functions:

	a) Check applicants	b) Review reports	c) Monitor residual assets
Total no. of responses	57	58	53
Support (%)	81%	81%	85%
Oppose (%)	3%	5%	2%
Comment only (%)	16%	14%	13%

12.2 Some of the responses dealt not only with the proposal as stated in the consultation paper, but also with the more detailed information on the regulation proposals contained in the working paper "The CIC Regulator", published on the DTI website (www.dti.gov.uk/cics) in March 2003 as part of the consultation.

12.3 While a large majority of the responses supported the proposed regulatory functions, a number of them raised questions about the proposed 'light touch' regulatory approach. Most of these concerns related to the regulatory burden, and the risk that this would reduce the attractiveness of the CIC form. A smaller number of respondents doubted that a light touch approach would deliver the key aim of

regulation for CICs, which is to build and maintain public confidence in the integrity of the CIC form. Two responses suggested that there is no need for a regulatory regime for CICs, since the necessary functions could be undertaken by existing bodies such as Companies House.

12.4 Illustrative quotes:

"What will be the check and balance to the power of the regulator? I was delighted to hear the emphasis on a light touch, but will there be appeal procedures if the regulator appears to be departing from this principle?" **Groundwork UK**

"The regulator could find that they may soon have to take a proactive approach to regulation if the integrity of the brand is to be maintained, and this will have an impact on resources and on the relative advantage of the CIC from the point of view of a prospective social enterprise." **Institute for Public Policy Research**

"We believe it is legitimate to pose the question whether the risks associated with a light touch registration process and regulation will fulfil the need for the CIC to be a really robust entity. We are well aware that a balance needs to be struck." **Co-operative Group**

"If CIC status is likely to be self-selecting with no discernable financial gain then the need for a regulator of any kind is questionable." **London Borough of Havering**



12.5 On the detail of the regulatory functions, responses raised a number of questions about the way in which the Regulator will define and measure the community interest when carrying out its functions. These questions are closely linked to proposal 2, the community interest test. The importance of guidance from the Regulator on these matters was highlighted. One response questioned the need for CICs to report on their pursuit of community interest.

12.6 Illustrative quotes:

“There was a strong request from our members for the regulator to provide model Memorandum & Articles of Association and to issue guidance on the community interest test and the reporting requirements. These will help to lessen the burden on CICs in terms of the cost and time of registering and reporting.”
Community Development Finance Association

“We do not agree that community interest reports should be prepared or published. This level of accountability is unrealistic and is not the norm within private sector activities.”
The Training Exchange



The Government's intentions

12.7 The Government notes the wide support for the proposed functions, and intends to give the regulator all of the functions described in the consultation paper.

12.8 The Government agrees that it will be vital for the functions to be carried out with a genuinely light touch. We intend to ensure that the key elements of the CIC structure, and the Regulator's remit, are structured so that this happens. For instance, we are considering whether it would be appropriate to give the Regulator statutory objectives, e.g. to target its activity and follow principles of good regulation. The regulator will also be expected to issue public guidance on matters relating to its functions, including material such as model CIC constitutions. The Government intends to carry out further analysis of the functions and workload of the regulator, including benchmarking with other relevant regulators, to ensure that the CIC regulator will be adequately resourced to fulfil its role.



Proposal 13: The regulator should have powers to investigate complaints that CICs are not complying with the obligations of CIC status, and to take action where necessary (para 43)

13.1 58 responses commented on this proposal, of which 89% supported the proposal, 2% opposed it and 9% commented but made no firm recommendation for or against.

13.2 As with proposal 12 on the regulator's functions, some of the responses addressed the more detailed information contained in the working paper "The CIC Regulator", as well as the consultation paper itself.

13.3 Several responses noted that certain aspects of the regulator's investigative functions would need further development. Areas where further clarification was seen as necessary included: the sanctions that would be available to the regulator; the costs of dealing with regulatory investigation; and the links between this function of the regulator and the investigative role which the DTI's Companies Investigation Branch has in respect of all companies. It was also suggested that the investigative role of the regulator could be complemented by giving the members of CICs enhanced access to information.

13.4 Illustrative quotes:

"Whilst our members generally agreed that the regulator should have the powers to investigate complaints, there is a need first to define what would happen if a CIC failed to comply with the Community Interest test and what sanctions would be taken against those that failed to report adequately. There is also a need to outline how sanctions might affect lenders and investors including their rights as against public sector clawback rights over assets."

Community Development Finance Association

"The costs of any legal action must not fall on the CIC." **Cornwall Enterprise, Cornwall County Council, Cornwall Rural Community Council**

"We have concerns over how these powers will interrelate to and be exercised compared with the other wider company regulatory and investigatory powers which will apply to CICs (exercisable by Companies House, the DTI investigations section etc)."

Jordans Ltd

"The DTI has a section for complaints against companies, there is no requirement for a new regulator." **Ronald Duncan**



The Government's intentions

13.5 The consultation working paper on the CIC Regulator set out detailed proposals on the expected investigative role of the regulator, the sort of activity or failure by a CIC that might lead it to take action, and the powers that it would have to do so. In view of the consultation responses, the Government believes these proposals are broadly appropriate.

13.6 In respect of the regulator's powers to impose sanctions on CICs that are failing to meet their statutory obligations, the Government intends that these should be applied in such a way that the community interest will not suffer unnecessarily. The emphasis will be on protecting assets for the community benefit in cases of abuse.

13.7 The Government has decided that the regulator should not have its own powers to carry out full investigations of CICs. Instead, the regulator will have a power to require information from CICs, and will if necessary be able to disclose this to DTI's Companies Investigations Branch which will consider whether to carry out a statutory investigation.

13.8 The working paper on the CIC Regulator described the proposed system for appeals against the regulator's decisions. The Government intends to introduce a system along the lines proposed in the working paper, in order to allow affected parties to appeal against the regulator without having to resort to judicial review.



Other issues raised in consultation responses

In addition to obtaining views on the 13 proposals discussed above, the CIC consultation also aimed to identify other issues relevant to both the CIC proposal and the Government's wider strategy for social enterprise. Some of the wider issues for the Government's social enterprise strategy and related work have been fed back directly to the parts of Government responsible. The issues discussed below were raised in formal consultation responses and relate directly to the CIC proposal to a greater or lesser degree.

Section 14: Branding for social enterprise

Summary of issue and comments

14.1 There were 22 responses on the issue of branding and CICs. A couple of responses questioned whether the Government had explored methods of achieving the benefits of the CIC brand other than through legislation. Around half specifically cautioned against CICs becoming the only brand for social enterprise. These respondents believed that there was a risk that the introduction of the CIC would marginalise other social enterprises that had not adopted the CIC form, leading to a situation where CICs become 'the' brand for social enterprise. Respondents pointed out that the strength of the sector is in its diversity and that measures which unwittingly pushed organisations into adopting a particular form would ultimately be to the detriment of the sector. It was



suggested that the introduction of the CIC should, instead, be used to promote all forms of social enterprise.

14.2 The role of branding was also raised in the context of advice and support for the sector, and public procurement. These issues are discussed in sections 16 and 20 of this report.

14.3 Illustrative quotes:

" SEC does not wish to see the CIC portrayed as a universal legal brand for social enterprise. This would undermine the very valuable social enterprises that use other legal forms such as Industrial and Provident Societies or Charities engaging in trading." **Social Enterprise Coalition**

" There are considerable doubts surrounding one of the main aims of CICs, that it will encourage a renewed interest in and brand surrounding social enterprise. Legislating for a new legal form appears a strange method for government to advertise a sector of the economy." **Institute for Public Policy Research**

" The social enterprise 'brand': It is very important that the new CICs should not reduce the legitimacy of current forms or become the only recognised form of social/community enterprises. The launch and marketing of the CIC will need to be carefully handled in order to avoid misconceptions around preferential treatment for CICs by grant makers and investors." **Development Trusts Association**

The Government's intentions

14.4 The CIC consultation document suggested that CICs would " help create a strong new brand for social enterprise" . The Government has considered whether some kind of accreditation or best practice scheme could deliver the benefits which the CIC is intended to provide. While such a scheme could help to establish a social enterprise brand, it would not in itself deliver other key benefits of the CIC, such as a simple, transparent and assured asset lock.

14.5 The CIC is intended to feed into, rather than lead, the work to raise the profile of social enterprise across the board. However, some in the social enterprise sector have expressed concerns that the Government may wish to make CICs the leading or sole legal form or 'brand' for social enterprise. This is not the case. As the consultation paper says, the diversity of the social enterprise sector means that a single or dominant legal form is not appropriate. As discussed in section 15 below, the CIC is intended to expand the range of legal options available to social enterprises, complementing the existing options rather than replacing them.

14.6 The Cabinet Office Strategy Unit report " Private Action, Public Benefit" recommended the introduction of the CIC and a separate look at the feasibility and value of a branding scheme for social enterprise. As reported in the Government's response to the Strategy Unit report (" Charities and Not-for-profits: A Modern Legal Framework" , July 2003, www.homeoffice.gov.uk), the latter recommendation received 32 responses of which 69% were in favour. The Government set out its intention to



investigate the development of a branding scheme and a quality standard for the sector in "Social Enterprise: a strategy for success" (available via www.dti.gov.uk/socialenterprise). The DTI's Social Enterprise Unit is responsible for taking forward this action and work will commence when the proposed legal changes, including the introduction of CICs and updating IPS Bencom and charitable status, are more advanced and can be taken fully into account.

14.7 The Government intends to launch and promote CICs in a way that will fully recognise the role of other legal options, and put the CIC in context. This work will also take account of the need to improve advice and information on legal forms for social enterprise – see section 16 of this report.

Section 15: Choice of legal forms

Summary of issue and comments

15.1 The consultation paper (paras 5-9) set the CIC proposals in the context of the legal options already available to social enterprises. Many of the consultation responses commented on the potential impact of CICs on those options.

Industrial and Provident Societies (IPS)

15.2 28 responses raised concerns on the potential impact of CICs on the IPS form. Respondents highlighted that there was scope for confusion between IPSs and CICs. Around a third of these argued that the aims of the CIC could be achieved through modernisation of the IPS form or an amalgamation of the two forms. Others felt that the forms should be clearly differentiated to provide alternatives for social enterprises. Respondents also asked that the CIC form should be available to organisations that wish to adopt co-operative principles.

15.3 One specific area of concern was the possible advantages CICs may have over the IPS form in terms of cost and burden of regulation, and respondents called for equality of treatment for the CIC and IPS forms in this and other aspects. A small number of respondents also highlighted the potential impact of CICs on section 1(2)(b) of the IPS Act 1965, which requires applicants to have special reason for not being a company. It was suggested that this could make it difficult to register as an IPS once CIC legislation is passed.



15.4 Illustrative quotes:

"If the CIC succeeds in encouraging new forms of social enterprise which are recognised in law as being of social benefit, it will be welcomed .. In common with other bodies within the co-operative sector however, we consider that much the same might have been achieved by modernising the Society for the Benefit of the Community under Industrial & Provident Societies legislation."

**Industrial Common Ownership
Finance Ltd**

"The effect of creating the CIC may have a detrimental effect upon the continuing use of societies as a legal form" **Cliff Mills, Cobbetts solicitors**

"Experience suggests that there is widespread ignorance among lawyers, accountants and bankers about industrial and provident societies. While that remains the case, a CIC structure duplicating the Bencom I&P may well be justifiable." **Ian Snaith, University of Leicester**

"In order to avoid these pitfalls and ensure a genuine choice of legal forms it is essential that there be equality of treatment between CICs and, in particular, Industrial & Provident Societies." **Co-operatives UK**

"The issues of cost and regulation for IPSs needs to be addressed alongside the introduction of the CIC so as not to unfairly affect the traditional model for the co-operative sector. It may also be worth considering bringing the CIC and IPS regulators together." **New Economics Foundation**



Charities

15.5 38 responses addressed potential issues for the charitable sector arising from the introduction of CICs. Whilst some agreed that the CIC was a genuine alternative to charitable status, others expressed concern that the distinction between CICs and charitable status was not clear enough, and that there was potential to confuse both members of the public and funders. A few responses queried whether it would be legally possible to achieve the proposal in the consultation paper that CICs should not have charitable status even if their objects were entirely charitable. There were also some comments about the fiscal implications of not allowing CICs to be charitable (see section 17 of this report).

15.6 Some respondents identified the use of CICs as trading subsidiaries for charities and other social enterprises as an opportunity for the sector. Nine respondents commented on the proposed mechanism for charities to convert to CICs, suggesting that conversion would not be straightforward and would require guidance from the CIC regulator.

15.7 Many of those who commented on these issues suggested that CICs should be introduced in parallel with the current updating of IPS law and/or the planned revision of charity law.



15.8 Illustrative quotes:

"We suggest that the review of charity law as outlined in "Private Action, Public Benefit" needs to take place as a parallel process."

Social Enterprise East Midlands

*"If social enterprises which are charities could set up a CIC as a subsidiary or as part of a group structure, then CICs are more likely to be relevant to our membership (and possibly many others in the wider social enterprise sector & the voluntary sector)." **Development Trusts Association***

*"Existing charitable companies limited by guarantee should be able to exchange charitable status for CIC registration and regulation, and more guidance will need to be provided on how this may be achieved." **Scott Bader Commonwealth Ltd***



commitment to the IPS sector in supporting the (recently enacted) Co-operatives and Community Benefit Societies Private Member's Bill and in accepting 6 of the 7 recommendations in the Strategy Unit report. The Government is currently examining the options for taking forward this agenda. The development of CICs is not taking place to the detriment of modernising the IPS form; the Government is committed to both.

15.11 As the CIC consultation paper noted, IPSs and CICs are not intended to do the same thing; both have particular strengths which make them useful for particular purposes. IPSs are particularly relevant for those who wish to commit their organisation to co-operative principles, embedding a democratic, 'one member one vote' approach in their rules and governance, while the CIC will be more relevant for those who wish to use the flexibility of the company form to tailor their governance arrangements in other ways.

Will the CIC be available to co-operatives?

The Government's intentions

Industrial and Provident Societies

15.9 The Government firmly believes that CICs and IPSs both have an important role to play in the future development of social enterprise. The Government's view on the specific points raised in relation to IPSs during the consultation is as follows.

Why not modernise IPSs rather than introduce the CIC?

15.10 The Government does not intend to replace the industrial and provident society form. It has demonstrated its

15.12 The Government is aware that many co-operatives already incorporate as companies, and is discussing with the co-operative movement the potential for a co-operative CIC model. Since the CIC, like the IPS Bencom, is designed to be orientated on the interests of a community that is wider than the members of the organisation, it seems likely that the CIC will not always be the most appropriate form for those 'bona fide co-operative' mutual organisations that exist primarily to benefit their own members. For instance, those co-operatives that wish to have the option of distributing surpluses to their members would need to consider



whether this is consistent with the CIC asset lock. However, the co-operative movement has indicated that the CIC form may be appropriate for some bona fide co-operatives, and the Government will work with the movement to ensure that those co-operatives whose purposes are consistent with the principles of the CIC can use the form.

Equality of treatment and impact on IPS legislation

15.13 The Government recognises the concern within the sector about the need for equality of treatment between legal forms, and the potential impact of CICs on IPS legislation. We will take this into account both in developing the CIC and in reforming IPS law. The Financial Services Authority, in consultation with HM Treasury, will be taking forward work on legal and registration issues for IPSs in the light of the CIC proposal.

Charities

15.14 The Government recognises the concerns expressed about the impact of CICs on charitable status. We do not think that this is likely to be a problem for the charitable sector in practice, mainly because charities are a very strong 'brand', distinct from CICs and with high public recognition. The detailed proposals on aspects of the CIC such as the community interest test (proposal 2 in this report) should help to differentiate CICs further from charities. As noted in the consultation paper, CICs will not have the benefits or burdens of charitable status. It has been agreed with the Charity Commission and the Attorney General that where a CIC's objects are entirely charitable, it should nonetheless be deemed not to be a charity for legal purposes.

15.15 The Government intends to make it possible for CICs to convert to charitable status, since it is quite possible that an organisation which begins life as a CIC may subsequently decide that it would be more appropriate for it to adopt charitable status.

15.16 Similarly, we intend to allow conversion from charitable status to being a CIC, subject to the approval of the Charity Commission in England and Wales (the position in Scotland is more complex and will be affected by the planned forthcoming revision of Scottish charity law). However, the Government expects that there will be only very limited demand for conversion from charitable to CIC status, and this has been borne out by responses to the consultation. It should be emphasised that if a charity does convert to CIC status, its assets at the time of conversion will remain applicable only to its original charitable purposes, as they must at present if a charitable company becomes non-charitable.



Section 16: Advice and information

Summary of issue and comments

16.1 41 responses to the consultation commented on the need for the Government to promote CICs and to put in place a strong support and advice network for all social enterprises.

16.2 Respondents identified several risks associated with the introduction of the CIC. Many suggested that a lack of information about the form for those intending to set up social enterprises and their advisors would result in low awareness and uptake of the form. Respondents highlighted concerns that the proposed introduction of the Charitable Incorporated Organisation (CIO), as a new form of incorporation for charities, could further add to the confusion about appropriate legal forms. The CIO proposal was accepted by the Government in its response to the Cabinet Office Strategy Unit report ("Charities and Not-for-profits: A Modern Legal Framework", July 2003, www.homeoffice.gov.uk).

16.3 Illustrative quotes:

"An advice and support network would need to be established to help these companies. This could be managed through organisations such as Business Links or Local Learning and Skills Councils. At present neither of these organisations has any understanding of not for profit activities or any expertise in dealing with them." **The Training Exchange**



"The launch and marketing of the CIC should be carefully handled in order to avoid misconceptions around preferential treatment for CICs by government, the public sector, grant makers and investors." **Yorkshire and Humber Regional Forum**

"We wonder if in addition to the proposed regulatory body, there is a potential for setting up a training and support agency designed to build the capacity of local people to develop and manage CICs." **Crime Concern**



The Government's intentions

16.4 Business support and training is a key strand of the Government's social enterprise strategy, which is being implemented by the DTI's Social Enterprise Unit. Since April 2003, all Business Link operators have been required to show in their business plans how they will support the start-up and development of social enterprises. In addition the Social Enterprise Unit has part-funded and supported a number of training events in collaboration with various other organisations.

16.5 Information on legal options is an important part of this, and the work to establish CICs will feed into this wider workstream. The CIC regulator will also have a role to play in issuing guidance and helping social enterprises, funders and others to understand whether CIC status is right for them.



Section 17: The fiscal environment

Summary of issue and comments

17.1 CICs will be subject to the same fiscal regime as normal companies. There were comments on the fiscal environment from 43 respondents. Several commented on the need to ensure that CICs can access funds that other social enterprises can access, such as those being channelled through CDFIs with the encouragement of Community Investment Tax Relief.

17.2 A large majority of these respondents suggested that the CIC form would be made much more attractive by the provision of direct tax incentives for CICs or potential investors in CICs. A significant number suggested that CICs should receive the same range of tax benefits as charities. Others proposed, for example, that CICs might be made exempt from corporation tax as many would not make much profit due to the nature of their operations.

17.3 The argument for tax incentives was made on two lines. First, many argued that the additional regulatory requirements for CICs over other companies would result in many social entrepreneurs continuing to favour the existing company model unless the CIC form received a direct fiscal advantage. Several responses from Scottish organisations suggested that the uptake of the CIC form in Scotland could be poor without charitable tax incentives. Second, it was suggested that CICs would deserve some tax relief as they will be committing their assets to working for the good of the community.

17.4 Illustrative quotes:

“CDFIs aside, there are no proposed tax incentives when investing in a CIC. Investors in CICs should be eligible for tax incentives such as those afforded to Enterprise Investment Schemes (for example, relief from Capital Gains Tax to be granted if shares are held for a qualifying period of five years or more).” **Farrer & Co**

“The key issue that came up again and again was that of taxation: the CICs will not bring any fiscal advantages and would not be attractive to registered charities who are benefiting from tax exemptions. The DTI needs to address this issue as a matter of urgency.”

Development Trusts Association

“What is not clear is what incentive there is for existing social enterprises, using the CLG model for example, to switch to becoming a CIC. There is obviously no fiscal incentive attached to it and a switch would involve a range of transaction costs” **Coin Street Community Builders**

“There will be no special tax breaks for CICs under the present proposals and this is being used as the rationale for light-touch regulation. Whilst CICs should not enjoy the tax benefits that are afforded to charities there may be an argument to say that limited tax concession would encourage social entrepreneurship.” **Wales Council for Voluntary Action**



"We feel the scheme is unbalanced as it does not contain incentives to match these increased costs and regulatory burdens, and which could have been expected to make the scheme more attractive to potential "switchers". We do not believe that there will be many organisations in Scotland who will be attracted by the once and for all switch in their corporate governance to become CICs." **Scottish Council for Voluntary Organisations**

"They ought to be able to claim tax reliefs at least (both business rates as charities do and corporation tax relief (as occurs in e.g. the Netherlands and Germany for registered CIC-type companies)). This could be graded according to the amount of community benefit offered by the organization." **Liverpool City Council**



The Government's intentions

17.5 The Government is considering carefully the various technical points about fiscal matters that were raised during the consultation, in order to ensure that the introduction of the CIC will be of real practical value to the social enterprise sector. For instance, it is clearly important that CICs should be able to take advantage of the measures which the Government has already introduced to promote community enterprise, particularly in deprived areas. As noted in the consultation paper, these schemes include the Community Investment Tax Relief (CITR) and measures applying to Enterprise Areas. The Government intends that where relevant, CICs should be able to draw on

funds raised by Community Development Finance Institutions through the CITR scheme.

17.6 The Government has noted the wider points raised in consultation about the fiscal environment for CICs. As a general point, the Government does not believe that CICs should be provided with tax incentives of the kind available to charities. As this report confirms (proposal 2 above), the test of eligibility for registration as a CIC is intended to be materially wider than the charitable test of public benefit, and the Government expects that CICs will be used primarily for non-charitable social enterprise activity, generally involving trading, and often competing with commercial organisations that do not enjoy tax incentives.

17.7 As well as potentially distorting competition, the granting of charity-style tax incentives to CICs would reduce the clarity of the distinction between charities and CICs, and this could lead to a need for tighter regulation of CICs than is currently proposed, in order to reduce the risk of the CIC form being abused. This would reduce the value and distinctiveness of the CIC as a relatively lightly regulated vehicle for non-charitable social enterprise activity.

17.8 The Government accepts that in the absence of such tax incentives, it is unlikely that a large number of existing social enterprises, which have already achieved a satisfactory form of incorporation, will choose to convert to CIC status. As noted elsewhere in this report (para 14.5), CICs are intended to complement the existing legal options, and not to become the only legal form used by social enterprises. However, the Government will continue to consider the fiscal implications for CICs as they develop.



Section 18: Access to Grant Funding

Summary of issue and comments

18.1 Thirteen responses commented specifically on the issue of whether CICs would be able to access grants. These responses highlighted the importance of grants to many social enterprises especially in the start up phase of the organisation. Respondents suggested that CICs should be able to access grants from the public, charitable and private sectors. As such they commented that it was vital that these bodies understand what a CIC is.

18.2 It was noted that there will often be legal or policy reasons why a charitable foundation may be reluctant to fund a CIC or other non-charitable social enterprise, but respondents urged that such funding should be encouraged. The scope for CICs to raise funds through programme-related investment was highlighted by several consultees.

18.3 A small number of responses raised concerns about the possibility of CICs competing for funds with charities.

18.4 Illustrative quotes:

“While most trusts will not be able to fund CICs because they will not be registered charities, it is possible that trusts could invest in them for a return less than a commercial return, and the Charity Commission accepts social enterprise as an investment. However we recognise as with many new charities, it is likely that it is the small and start-up CICs that will need grant money initially and yet it may be that trusts will be unable to help. For those trusts who are able to support CICs, the key issue may be how comfortable are the board or trustees of a trust with an application from a CIC; how far they feel they could support it; and whether they are the only funders who could so support.” **Association of Charitable Foundations**

“If – and only if – the proposed CIC structure is seen as fundable by the charity and public sectors, it might make a major contribution to social firm development. If however, there remain legal or other impediments to funding social firms from these sources, the CIC structure could become largely irrelevant.” **Social Firms UK**

“In practice CICs may be in competition with charities for grant funding or philanthropic investment or as recipients of companies’ corporate social responsibility budgets.” **National Council for Voluntary Organisations**



The Government's intentions

18.5 The Government recognises the importance of grants for many social enterprises, and agrees that CICs should have the widest possible access to grants. During the consultation period we have engaged with public, charitable and private funders to identify how to facilitate access to grants for CICs and other social enterprises. Shortly after the consultation ended, the DCMS published a National Lottery Funding Decision Document (July 2003, www.culture.gov.uk) which confirmed that "the new [lottery] distributor will be empowered to support applications from the burgeoning community and social enterprise sector. This will include working with CICs".

18.6 The consultation responses demonstrate that not all sources of grant funding will be willing or able to engage with CICs, but the Government will continue to seek to identify potential sources of grant funding for CICs, and to ensure that such sources are aware of the CIC. The Government has also developed a new web-based directory of business support to help social enterprises locate these funding bodies. The directory can be found at www.businesslink.org.

Section 19: Debt arrangements

Summary of issue and comments

19.1 Thirteen consultation responses commented specifically on the ability of CICs to raise debt in the commercial markets on the same terms as other companies. Several responses raised the possibility that debt repayments could be used to avoid the asset lock. One respondent suggested that the availability of assets as collateral for debts could invalidate the asset lock, whilst another suggested that physical assets should be given special protection in the event of bankruptcy or insolvency. Two respondents highlighted potential difficulties in using assets transferred from public bodies as collateral for debt.

19.2 Six responses commented on the proposed insolvency regime for CICs. The Government proposed that CICs should be subject to the insolvency regime of conventional companies, subject to the regulator having control of the distribution of residual assets. A couple of the responses suggested that existing insolvency legislation and procedures would be sufficient to safeguard residual assets in the community interest. Some respondents also suggested that IPS Bencoms could be suitable beneficiaries of residual assets once legislation is enacted to provide for an asset lock for the Bencom form.



19.3 Illustrative quotes:

“The danger is that a company could use the assets to raise debt finance without members/beneficiaries being aware of this, and then find that if company collapsed the assets supposedly safe within the asset lock are in fact owned by the banks or other creditors. If this happens to a number of CICs this could well have the effect of discrediting the concept within both the social economy and the wider finance sector.” **Northumberland County Council**

“Claw back provisions can make it difficult for organisations to use assets as collateral. The ability of organisations to raise capital against assets with contractual controls has not been addressed in the CIC proposals and is a key factor inhibiting the take up of debt finance in the social enterprise sector.” **Yorkshire and Humberside Regional Forum**



The Government's intentions

19.4 While noting the concerns expressed about the possible use of debt to avoid the requirements of the asset lock, the Government believes that the combination of normal company law, and the regulator's proposed ability to investigate and act on concerns, should be sufficient to address this. The mechanism to be used to cap dividends on shares will also contain anti-avoidance provisions to ensure that debt with equity-type characteristics, such as interest payments linked to company performance, cannot be used to undermine the asset lock.

19.5 Most of those responses that commented on the ability of CICs to use assets for collateral confirmed the Government's view that this will be a valuable flexibility. However, this does mean that where there is a wish to safeguard specific physical assets so that they remain locked into a CIC, this will have to be done contractually as at present.

19.6 The Government intends that the insolvency regime will be essentially the same as for normal companies, except that the CIC regulator will take responsibility for ensuring that any residual assets go to an appropriate CIC or charity – or to an IPS Bencom, once the Bencom asset lock is in place. The Government intends that this additional provision should not have any material impact on the other parts of the insolvency process.



Section 20: Public procurement, public services and other relationships with government bodies

Summary of issue and comments

20.1 Eight responses touched on the issue of public procurement. While this was cited as an area where CICs could have a significant impact, respondents also warned of the danger of public bodies viewing CICs as being a convenient way of delivering services via social enterprises.

20.2 A few responses noted the statement in the consultation paper that CICs are not intended to provide essential public services. While some welcomed this, others expressed disappointment, or concern that this might limit the ability of CICs to engage with providers of such services.

20.3 A couple of responses mentioned the potentially positive impact of CICs in enabling social enterprises to obtain discretionary rate relief. Currently many social enterprises are eligible for discretionary rate relief but find that the application process can be laborious. Some responses also suggested that the presence of an asset lock might help to facilitate the process of asset transfer from local authorities.

20.4 Illustrative quotes:

"If CICs were to become the standard Social Enterprise brand, particularly in the area of Public procurement it is conceivable that this could have the effect of actively discouraging entrepreneurial behaviour within the social enterprise economy."

Northumberland County Council



"For us CICs are about additional community enterprise and not the contracting-out agenda of mainstream public services" **The Children's Society**

"It is disappointing that the DTI's consultation paper makes it clear that unlike Public Interest Companies, CICs are not designed for the delivery of public services .. IPPR has some concerns about the potential gap between the stated aims and the likely impact of a new Community Interest Company. However, we are by no means hostile to the idea, and believe that overall the main proposals should be supported."

Institute for Public Policy Research

"The Government does not intend that CICs should deliver essential public services. However, some of these services – such as education services and services for the elderly – are already beginning to adapt current organisational forms where possible and could benefit from some of the elements proposed for CICs" **Office for Public Management**

"Services to hospitals and schools are in our opinion entirely appropriate areas for community enterprise and we believe it would be inconsistent with the flexibility of the model to rule out any specific area of activity"

ECT Group Ltd

"This (asset lock) could be of great benefit where assets are owned by a local authority that is anxious that any public sector investment is not transferred into individual gain."

Yorkshire Forward



The Government's intentions

20.5 To some extent these issues relate to branding (section 14 of this report). The Social Enterprise Unit is already working on measures to increase social enterprise involvement in public procurement, and it is intended that CICs will fit in with this work. To increase expertise on procurement within social enterprise, a toolkit will be launched at the end of October 2003 with practical advice on how to compete for and win public sector business. Complementary work is going forward to increase understanding of social enterprise and its potential within the public sector, focusing initially on improving local government procurement. Work is also under way on facilitating asset transfers from the public sector, and the Government will ensure that this takes account of the development of the CIC. Similarly, the Government will update its guidance for local authorities on discretionary rate relief to reflect the introduction of CICs.

20.6 As stated in the consultation paper, the Government does not intend that CICs should deliver essential public services in core sectors such as hospitals and schools. The consultation paper also noted that CICs might be used to complement core Government services in areas such as childcare provision, social housing, leisure and community transport. For instance, in public services where non-core ancillary services may be provided by third parties, it will be possible to use CICs to provide such services.

Section 21 : Internal Governance

Summary of issue and comments

21.1 Eighteen responses commented specifically on the issue of the internal governance of CICs. Suggestions were made on both the role of members and directors. On members, five responses suggested that CICs should adopt democratic governance structures, with some advocating the adoption of the co-operative movement principle of 'one member, one vote'. Another response suggested that open or democratic structures could be counter productive in the governance of CICs.

21.2 Several responses also suggested that directors should have a duty to regard the community interest purpose of CICs in their decision making. Other respondents suggested that CIC should have defined numbers, and possibly structures, of directors. The structure of the board of directors could be used to incorporate key stakeholders, such as users.

21.3 Illustrative quotes:

"Company law allows a company in some instances to have just one director and a secretary. Whilst this might be acceptable for very small companies we feel that the agenda of CICs will require a higher minimum number of directors, both to inform a properly formed community interest agenda and propose links and stakeholders in communities. In our view directorship representations will need to be coherent with the community interest agenda of the CIC." **The Children's Society**



“Arguments have been made during the consultation process in favour of open membership and “democratic” structures. We are strongly of the view that this would be counter-productive for many organisations. There are a wide variety of customer influencing mechanisms which are more appropriate to us than a restrictive membership structure.” **Harvest Housing Group**

“The directors will have a duty to act in the best interest of shareholders because that is laid down in company law but we would suggest that in the case of a CIC the duty to act in the best interest of shareholders should be tempered by a duty to achieve a reasonable balance between meeting the purposes of the CIC and the interest of its shareholders.” **Charity Law Association**

“We would .. recommend that members be given a greater capacity to access information about the operation of a CIC than is customary with normal companies ... We would recommend that that standard model [constitution] should include a residual right for 10% of the members (as opposed to those holding 10% of the voting rights) to call the directors to account and in particular to supply any information that the members reasonably require from the directors which they do not certify was commercially confidential.” **Charity Law Association**



“CICs should be legally required to have a minimum number of three Directors, putting them on a par with charities, rather than private companies which need have only one director and a company secretary; governance arrangements should build on established good practice developed in the voluntary and community sector, rather than look to the commercial sector as a model” **National Council for Voluntary Organisations**



The Government's intentions

21.4 The flexibility that company law provides in terms of governance is an important part of the CIC model. For instance, CICs will be able to adopt ‘one member one vote’ rules in their constitution if they wish, but will not be required to do so. The Government does not wish to restrict this freedom unnecessarily, and is not convinced that additional rules on governance are needed for CICs, given the additional transparency requirements that they will have to meet, and the role of the regulator. This will include providing advice on good practice in governance to CICs and those considering setting up a CIC.

21.5 If a CIC or its directors are found not to be pursuing the community interest, the Government intends that the regulator should be able to take practical steps to compel them to do so. As set out in paragraph 43 of the consultation paper, the measures open to the regulator will include removing directors and, where necessary, applying to the courts to have a CIC wound up.



Contact details

Further copies of this document can be obtained from the DTI Publications Orderline (tel 0870-150-2500, fax 0870-150-2333, quoting reference URN 03/1344).

There is an electronic copy of the document on the DTI Website at <http://www.dti.gov.uk/cics>

Written responses (excluding those where confidentiality is requested) may be viewed by appointment with the DTI's Community Interest Companies Team.

For further information on Community Interest Companies, please contact:

Patrick Barry
Community Interest Companies Team
DTI
1 Victoria Street
London SW1H 0ET

Telephone: 020 7215 6947
Email: CICS@dti.gsi.gov.uk



Annex A:

Index of respondents to the consultation

- Action for Market Towns (AMT)
- Action with Communities in Rural England (ACRE)
- Age Concern England
- Agents for Change
- Anglia Giving
- Anthony Collins Solicitors
- Association of Charitable Foundations (ACF)
- Association of Charity Independent Examiners (ACIE)
- Association of Chartered Certified Accountants (ACCA)
- Association of Chief Executives of Voluntary Organisations (ACEVO)
- Baxi Partnership Ltd
- BIBIC
- Big Life Company
- Birmingham & Solihull Social Economy Consortium
- Boielle, Paul
- Bristol City Council
- Bulwell Hall Community Garden Ltd
- Business Link for Essex
- Business Link for London
- Business Link Lincolnshire & Rutland and Business Link for Leicestershire
- Cambridgeshire Learning Disability Partnership (LDP)
- Central Council of Physical Recreation (CPPR)
- Charity Finance Directors' Group (CFDG)
- Charity Law Association
- CIPFA Commissioning Joint Committee
- Clarke Willmott Solicitors
- Coin Street Community Builders
- Community Business Scotland (CBS) Network Ltd
- Community Development Finance Association (CDFA)



- Community Investors
- Community Matters
- Co-operation and Mutuality Scotland
- Co-operative & Mutual Solutions (CMS)
- Co-operatives UK
- Cooperative Community Action
- Co-operative Group
- Cornwall Enterprise, Cornwall County Council, Cornwall Rural Community Council
- Countryside Agency
- Courtneidge, John
- Crime Concern
- Development Trusts Association (DTA)
- Doncaster Communities In Partnership (DCIP)
- Duncan, Ronald
- ECT Group Ltd
- Enterprise Fund Ltd
- Enterprising Communities, Voluntary Action Cumbria
- Farrer & Co
- Field Fisher Waterhouse
- Flintshire Local Voluntary Council
- Forth Sector
- Gateshead Council
- Gazebo
- Generating Enterprise Together
- Global To Local Ltd
- Green-Works
- Groundwork UK
- Harvest Housing Group
- Herefordshire Partnership
- Housing Corporation
- Industrial Common Ownership Finance Ltd
- Institute for Public Policy Research (IPPR)
- Institute of Chartered Accountants of Scotland (ICAS)
- Institute of Chartered Secretaries and Administrators (ICSA)
- Institute of Directors (IOD)
- Jordans Ltd
- Judge Institute of Management, University of Cambridge
- Kids' Clubs Network
- Kirklees Metropolitan Council Community Enterprise Team
- Lawrence Graham solicitors
- Law Society
- Leicestershire Early Years Development and Childcare Partnership
- Liverpool City Council
- Lloyds TSB Bank
- Local Investment Fund
- London Borough of Havering
- Magpie Recycling Co-op Ltd
- McCallum, Bill
- Merton Multicultural Co-operative Ltd (MeMu)
- Micentre
- Mills, Cliff (Cobbetts solicitors)
- National Council for Voluntary Organisations (NCVO)
- National Housing Federation (NHF)
- Neath Port Talbot Council for Voluntary Service



- New Economics Foundation (NEF)
- Northumberland County Council
- Nottinghamshire County Council
- Novas Ouvertures Group
- Office for Public Management
- One North East
- Organic Wastes Management Ltd
- Oxford City Council
- Oxfordshire Co-operative Development Agency
- Owens, Paul
- Payne, Nick
- Pentreath Industries Ltd
- Phillips, Stephens
- Pickrell, Simone
- PKF
- PRIME
- Renew Trust
- Rochdale Social Enterprise Initiative
- Samaritans
- Samphire Management
- Sari (UK) Ltd
- Scott Bader Commonwealth Ltd
- Scottish Council for Voluntary Organisations (SCVO)
- Scottish Executive
- Scottish Social Enterprise Coalition (SSEC)
- Selby District Council
- Sheffield Hallam University
- Social Enterprise Coalition (SEC)
- Social Enterprise East Midlands (SEEM)
- Social Enterprise London (SEL)
- Social Enterprise Network (SEN)
- Social Firms UK
- Solicitors Pro Bono Group
- Somerset County Council
- South West of England Regional Development Agency (SWRDA)
- Snaith, Ian (University of Leicester)
- Sports and Recreation Trusts Association
- Stone King
- Sydney, Tom
- The Children's Society
- The Training Exchange
- Tower Hamlets Co-operative Development Agency
- Village Retail Services Association (ViRSA)
- Wales Council for Voluntary Action (WCVA)
- West Dumbartonshire Council
- Women's Royal Voluntary Service (WRVS)
- Working Links
- Wrigleys solicitors
- Yorkshire and Humber Regional Forum
- Yorkshire Forward
- 3t Community Ltd



Annex B:

The consultation process

The key strands of the consultation process included:

Identifying and contacting stakeholders

The CIC team in DTI compiled a list of some 600 parties who might be interested in the consultation, based on the respondents to Cabinet Office Strategy Unit and DTI Social Enterprise Unit consultations and on contacts of the Home Office Active Community Unit and the Social Enterprise Coalition. The team contacted these stakeholders to alert them to the launch of the consultation, and sent reminders halfway through the consultation period.

Launching the consultation paper

The paper "Enterprise for Communities: proposals for a Community Interest Company" was launched on 26 March 2003 at a major Government conference on social enterprise at the Barbican Centre in London, preceded by a

statement to Parliament. The Secretary of State for Trade and Industry, the Chancellor of the Exchequer and the Home Secretary gave a joint keynote address at the conference. The consultation paper was published simultaneously on the DTI website (www.dti.gov.uk/cics) and was publicised by a press release.

Regional consultation meetings and other events

During the consultation period the CIC team attended a series of public meetings held to discuss the proposals. Meetings were held in Taunton, Guildford, London, Leeds, Preston, Nottingham, Cambridge, Newcastle, Birmingham, Cardiff and Edinburgh. In England these meetings were organised by the Government Offices, in some cases in partnership with Regional Development Agencies and local social enterprise networks. The Edinburgh meeting was organised by the Scottish Council for Voluntary Organisations, Community Enterprise Strathclyde,



Social Enterprise Network Scotland, the Scotland Office and the Scottish Executive. The meeting in Cardiff was organised with the assistance of the Wales Office and Wales Assembly. The meetings were well received, with 80% of attendees who provided feedback rating them as good or excellent, and a further 15% satisfactory. The CIC team is grateful to all those organisations and people who helped to organise and run these meetings, and to those who took the time to participate in them.

Several organisations arranged meetings during the consultation period to allow their members and others to discuss the CIC proposals. The CIC team was pleased to be invited to participate in events organised by: the Social Enterprise Coalition; the National Council for Voluntary Organisations; the Association of Chief Executives of Voluntary Organisations; the Association of Charitable Foundations; the Community Development Finance Association; the Development Trusts Association; Farrer & Co in association with HW Fisher & Co; and Voluntary Action Cumbria.



