

**EXPLANATORY MEMORANDUM TO THE
COMMUNITY INTEREST COMPANY REGULATIONS 2005**

2005 No.1788

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

- 2. Description**

- 2.1. This statutory instrument is concerned with community interest companies, a new type of company provided for in Part 2 of the Companies (Audit, Investigations, and Community Enterprise) Act 2004 (“the 2004 Act”). Community interest companies are to carry out their activities for the benefit of the community. They will be subject to various restrictions on their ability to transfer or distribute their assets (“the asset lock”), and will be supervised by the Regulator of Community Interest Companies (“the Regulator”).

- 2.2 This instrument:

- specifies that companies engaging in certain activities, and companies which are (or are owned or controlled by) political parties or political campaigning organisations, will not be eligible to be community interest companies;
- makes provision about the memoranda and articles of association of community interest companies, and other documents to be sent to the registrar of companies by those wishing to form a community interest company or convert an existing company into a community interest company;
- specifies the limits which apply to community interest companies’ payment of dividends and other distributions to shareholders and to their payment of performance-related rates of interest on debts or debentures;
- varies the normal procedures for distributing a company’s assets in cases where a community interest company is wound up;
- specifies the contents of the annual “community interest company report” which community interest companies will be required to produce;

- makes provision in relation to the appointment, remuneration and removal of managers of a community interest company's property and affairs by the Regulator;
- provides for the payment of fees in connection with certain of the Regulator's functions under the 2004 Act; and
- makes rules for the conduct of appeals against decisions of the Regulator to the Appeal Officer for Community Interest Companies ("the Appeal Officer").

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

3.1. None.

4. Legislative background

- 4.1 Under the 2004 Act, many of the details of the legislative framework applying to community interest companies are to be contained in secondary legislation. In a number of key areas, the Act states a basic proposition about community interest companies (for example, that an "excluded company" company may not be a community interest company) and leaves it to regulations to flesh this out (for example, by prescribing what an "excluded company" is). Without this instrument, significant parts of the regulatory regime for community interest companies would be missing.
- 4.2 A draft of this instrument was first published by the Department of Trade and Industry in February 2004 so as to inform Parliamentary debate on Part 2 of the 2004 Act. (The Companies (Audit, Investigations and Community Enterprise) Bill was introduced first in the House of Lords, and had its Committee stage there from 16 to 29 March 2004.)
- 4.3 It will be possible to form community interest companies (or convert an existing company to a community interest company) from 1 July 2005, when the provisions of Part 2 of the 2004 Act will come fully into force. The intention therefore is that this instrument should also come into force on 1 July 2005.
- 4.4 This is the first use of any of the powers to make regulations in Part 2 of the 2004 Act. There are no current plans to make other regulations under Part 2.
- 4.5 The Government undertook during debate in Parliament on the 2004 Act to consult on draft Regulations before laying them before Parliament. A three-month consultation on the draft regulations closed on 4 January 2005 and the regulations have been amended in light of the responses received.

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 The Minister for Industry and the Regions and Deputy Minister for Women and Equality, Jacqui Smith, has made the following statement regarding Human Rights:

In my view the provisions of the Community Interest Company Regulations 2005 are compatible with the Convention rights.

7. Policy Background

- 7.1 The 2004 Act set out the legislative framework for the community interest company, a new, purpose-built company form for social enterprise. Social enterprises, broadly defined, are businesses that trade for a social purpose. They are active in a wide range of areas, from childcare and social housing to renewable energy and fair trade. The Cabinet Office's September 2002 "Private Action, Public Benefit" Report on the not-for-profit sector identified a need for to provide social enterprises with a new, "off-the-shelf" corporate vehicle, that would combine the flexibility and familiarity of the company form with a strong social enterprise "brand values".
- 7.2 The Government's proposal to introduce the Community Interest Company received strong support (77% of 122 responses) in the March 2003 technical consultation on the policy. Interest in the legislation has largely come from the existing social enterprise sector and associated organisations. There has been limited media and public interest in the policy since the launch of that consultation in March 2003.
- 7.3 This instrument sets out the detailed regulatory regime for community interest companies. There was a further recent public consultation on the draft regulations contained in this instrument which closed on 4 January 2005. There were 13 responses to the consultation, predominately from representative organisations, such as the Social Enterprise Coalition, and those with expertise in dealing with social enterprises in legal or financial areas. These raised a number of concerns predominately relating to provisions allowing community interest companies to issue dividend-bearing shares. The Government having noted these concerns amended the regulations after further consultation with an expert panel containing lawyers, financiers, and representatives of social enterprises. The Government also made a number of smaller changes, including some to drafting, in response to comments received during the consultation. The Government's full consultation response is available at www.dti.gov.uk/cics.
- 7.4 The Government believes legislation to create community interest companies (including this instrument) is an important step in creating an enabling environment for social enterprise in which the sector can grow. Part 2 of the Act, and this instrument, are intended to facilitate the operations of new and existing social enterprises. The Government does not consider that the instrument introduces any changes which are of political or legal importance.

8. Impact

- 8.1 The costs and benefits associated with this instrument were taken into account in the preparation of the Final Regulatory Impact Assessments on the 2004 Act, **a copy of which is attached** (see in particular Appendix 7 on community interest companies).
- 8.2. There is no impact on the public sector as this statutory instrument only applies to companies.

9. Contact

- 9.1 Keith Masson at the Department of Trade and Industry will answer any queries regarding the instrument. Telephone 020 7215 0220, or e-mail K.Masson@dti.gsi.gov.uk.

Jacqui Smith

Jacqui Smith
Minister for Industry and the Regions
and Deputy Minister for Women and Equality

Date 24th February 2005

COMMUNITY INTEREST COMPANIES FINAL REGULATORY IMPACT ASSESSMENT

1. Proposal

1.1 Companies (Audit, Investigations and Community Enterprise) Act - measures to establish a new type of company, the 'community interest company' (CIC).

2. Purpose and intended effect of proposals

(i) The Objective

2.1 The objective is to create a new type of company, the 'community interest company' (CIC), which will be based on existing company law but will have certain additional constraints and features which make it suitable for use in particular by not-for-profit social enterprises. More broadly, the intention is to encourage the development of the social enterprise sector. A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profits for shareholders and owners. Social enterprises are active in a wide range of markets such as waste recycling, local transport, social housing, and the provision of care services to children and the elderly. The decision to become a CIC will be a voluntary one.

2.2 **Devolution.** Company law in Northern Ireland is a transferred matter under the Northern Ireland Act 1998. Company law matters relating to Scotland are reserved to the UK Parliament under the Scotland Act 1998, and those relating to Wales have not been transferred to the National Assembly for Wales under the Government of Wales Act 1998. The provisions concerning CICs would therefore affect the law in England, Wales and Scotland. We have consulted the Scottish Executive and National Assembly for Wales and their view and our view is that these provisions relate to reserved matters (or, respectively, to matters which have not been transferred). The Scottish Executive is considering the impact of the CIC proposals on Scottish charity law, which is a devolved matter. A Sewel motion was passed on 4 March 2004.

(ii) Background

2.3 The Government published its strategy for developing the social enterprise sector generally in July 2002: 'Social Enterprise: a strategy for success'. The report undertook to follow up subsequent recommendations on legal forms for social enterprises addressed in the Cabinet Office Strategy Unit Report 'Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector' (September 2002).

2.4 The Cabinet Office Strategy Unit report recommended creating the 'community interest company'. Consultation on this report from September 2002 to December 2002 demonstrated considerable enthusiasm for this recommendation within the sector and a demand for further information. The DTI, in association with the Home Office and Treasury, subsequently launched a 12-week public consultation in March 2003 ("Enterprise for Communities: Proposals for a Community Interest Company"), which presented more detailed proposals on the CIC. In October 2003 the DTI published a report on the consultation and the Government's intentions.

2.5 The main features of CICs as reflected in the measures are as follows:

- Maintaining continuity with existing company law (in particular the Companies Act 1985) so that CICs are constituted as companies limited by guarantee or companies limited by shares (including public limited companies). As such they will be subject to the disclosure and reporting requirements of ordinary companies;
- Adding certain specific requirements on these types of companies, notably:
 - (a) A company will have to pass a “community interest test” before it can be registered as a CIC and will be required to continue to pursue activities in the community interest;
 - (b) CICs will be subject to an asset lock, which prevents the distribution of profits or financial assets to members of a company or investors both during its lifetime and on winding-up. The asset lock will be entrenched by statutory means (with only a limited possibility of issuing shares upon which a capped dividend may be paid). It will be open to CICs limited by shares to issue shares that pay a dividend, but any dividend will be subject to a cap set by the CIC Regulator;
 - (c) CICs must submit an annual “community interest report” to the CIC Regulator, alongside the normal accounts and reports required from all companies. The community interest report will detail, for example, the activities the company has undertaken in pursuit of its community interest aims, and what it has done to involve its stakeholders in its activities.
- Creating the office of an independent Regulator who will be responsible for ensuring that CICs comply with the relevant requirements.

(iii) Risk Assessment

2.6 The purpose of introducing the CIC is to increase choice by adding to the existing forms of incorporation available to social enterprises (such as charitable companies and Industrial and Provident Societies), thus encouraging future growth in the sector.

2.7 The CIC is not intended to replace the alternative forms of incorporation. Instead it will increase the options available to social enterprises, allowing them to choose the form which best suits their particular community interest purposes. Social enterprises will also continue to be able to make use of the existing unmodified forms of company limited by shares and company limited by guarantee. The risks to the social enterprise sector of not setting up a CICs regime are set out in detail in Section 3. They include the possibility that the sector as a whole may be unable to achieve sustainable financing as a result of being unable to use the flexibility of the company form or of a lack of certainty from potential investors that their money will be used for the community benefit. At an individual level some social enterprises may thus be left without a suitable legal vehicle

for achieving their aims; or the lack of an effective asset lock could increase the risk that profits or financial assets may be inappropriately distributed.

2.8 It is intended to provide an effective and proportionate regulatory regime for CICs. There is a risk that if the CIC form is established without adequate regulation, it could lose credibility and therefore fail to achieve its potential in helping to implement the Government's social enterprise strategy.

2.9 The regulatory structure proposed will address the specific risks of:

- Companies with unsuitable purposes becoming registered as CICs;
- CICs failing to act so as to further the community interest;
- CIC assets and/or profits being distributed to shareholders (beyond the permitted limits) or otherwise misused;
- CICs failing to comply with any other statutory requirements.

3. Options

3.1 The following table summarises the options which we have identified, their benefits and the impact on achieving the government's objectives for CICs. They are addressed in the succeeding paragraphs of text. Of these, option 5 is the proposal being taken forward in the Act.

Option	Benefits	Impact
1. Use existing forms of company	<ul style="list-style-type: none">• No further legislation required	<ul style="list-style-type: none">• Sector remains unchanged• Identified need for CICs not addressed• Sustainable financing for the sector not achieved• Identified need for transparent asset lock not achieved

2. Voluntary Codes of Practice for Social Enterprises

- No further legislation required
- Flexibility in developing guidance
- Not legally enforceable
- Variation in consistency of implementation
- No obligation to report
- Limited government ability to promote the growth and development of the sector
- Identified need for transparent asset lock not achieved

3. Combined self-regulation and legislation

- Administered by the sector
- Flexibility in scope of test and reporting
- Limited legislation required
- No obvious locus for self-regulation given the diversity of the sector
- Lack of regulatory definition and variation in implementation

4. Amend existing Charitable and I&PS Law

- Avoid new powers
- Form of community interest test exists
- Asset lock in place for charities
- Strong stakeholder
- Some social enterprises are left without a suitable legal vehicle for achieving their aims
- Existing test for charitable status does not suit all types of social enterprise
- Governance and reporting arrangements for these forms of organisation may not be suitable for all social enterprises
- Unqualified asset lock may not

be suitable for all social enterprises e.g. those which wish to issue investor shares

- Potential of regressive effect on existing organisations within the sector

5. Introduce

Community Interest
Companies as proposed

- Consistency of implementation
- Statutory framework to achieve government objectives
- Protects assets and community interest
- Legislation required
- Regulation gives rise to one-off and recurring central government costs
- Additional statutory regulation placed on CICs but no requirement to become a CIC
- CICs must pay an additional CICs registration fee

(i) Use existing company forms to grow the social enterprise sector

3.2 Currently there is no specific form of incorporation that provides an effective statutory asset lock whilst retaining the flexibility of the company form. Unless special provision is made in the constitution of a company, the company's members are ultimately those who will be entitled to the company's surplus assets (either by way of distribution of profits during the lifetime of the company, or on its winding up).

3.3 Currently therefore, social enterprises have to customise existing company forms if they wish to lock assets into the company. This can be relatively expensive, since it will usually involve legal advice. There is also a lack of certainty: although existing company law permits the entrenchment of asset-lock provisions in a company's constitution, the mechanisms for doing this are complex, technical and not widely understood. There can also be a lack of transparency because such 'community interest' and 'not for profit' companies are not readily identified as such if they are not charitable. Furthermore, current company forms place no statutory obligations on social enterprises to operate in the community interest or to report on their contacts with stakeholders. The combination of these factors can mean that potential investors lack confidence that their money would be used in the community interest. The use of existing company forms to grow the social enterprise sector would therefore fail to meet the Government's policy.

(ii) Developing Voluntary Codes of Practice within the sector

3.4 A voluntary code of practice would avoid the need for legislation and ongoing regulation of the sector. However, the diversity of social enterprise activities makes it difficult for voluntary codes of practice to work effectively, to provide an established legal identity for not-for-profit companies and to ensure compliance with voluntary systems across the sector. The implementation of a voluntary code of practice would not be legally enforceable and would not ensure a transparent asset lock. This would result in variations of consistency in terms of best practice and assurances offered to interested

stakeholders. Therefore voluntary codes of practice would not deliver the strategic benefits underlying the Government's policy.

(iii) Co-regulation

3.5 Co-regulation of the sector would involve self-regulation under which the social enterprise sector would develop and administer its own arrangements, but government would provide some legislative framework for arrangements to be enforced. This approach would have the advantage of enabling appropriate arrangements to be led, generated and administered by the sector. The difficulty is that there is no obvious locus for self-regulation of key CIC features such as the asset lock, given the diversity of the sector's activities. This would be likely to lead to a lack of consistency in regulation.

(iv) Amend existing Charitable and IPS Law

3.6 The Strategy Unit report recommended changes to IPS and charity law alongside the introduction of the CIC. The Government published its response to those recommendations in July 2003 ("Charities and Not-for-profits: a modern legal framework", Home Office), and intends to take forward most of the Strategy Unit recommendations. A draft Charities Bill was published on 27 May 2004.

3.7 However; the proposed changes to charity and IPS law will not provide the anticipated benefits of CIC legislation. For instance, charity law offers an asset lock and a definition of public benefit, but by comparison with the CIC proposals, charitable status is more narrowly defined and charities are more tightly regulated given the fiscal benefits that they attract. IPSs, and particularly the community benefit society, are used as a vehicle by those social enterprises that wish to commit themselves to democratic "one member one vote" structures, and the Government published a consultation document on proposals for an asset lock for community benefit societies in July 2004 ("Regulatory issues for Industrial and Provident Societies", HM Treasury).. The Government is committed to maintaining its support for the co-operative sector and recognises the importance of the IPS as a legal form. However, the constitutional and governance requirements of IPS status are not appropriate for all social enterprises.

3.8 Amending existing legislation in either of these areas to provide an equivalent to the CIC would inevitably reduce the distinctiveness of the existing legal forms, and their value to current users. It would also be likely to constrain the growth of the social enterprise sector since, for instance, the tight regulation associated with charitable status could deter many social enterprises that do not require this level of regulation.

(v) Introduce community interest company legislation

3.9 CICs will complement existing options available to social enterprises for delivering their community objectives, in recognition of the diversity of enterprise activity and the demand for a variety of delivery mechanisms to achieve these objectives. This will result in a new regulatory regime which will apply a community interest test, support the statutory entrenchment of an asset lock (while allowing for a limited degree of

distribution of profits) and promote stakeholder involvement, while increasing the range of legal forms available to enterprises within this diverse sector.

4. Benefits

4.1 The benefits realised will be primarily of a strategic nature, bringing about change in the sector, rather than specific financial benefits to individual CICs.

4.2 Strategic benefits to the social enterprise sector will include:

- encouraging the growth of the sector through the introduction of a simple and transparent not-for-profit company form;
- raising the profile of the social enterprise sector;
- helping non-charitable social enterprise companies to access finance (e.g. loans and grants) by increasing confidence in their social purpose and not-for-profit distribution status;

4.3 Direct financial benefits to the sector will include:

- reducing the costs of establishing organisations to act on a not-for-profit basis in pursuit of the community interest by providing this off-the-shelf company form. We estimate that the minimum cost of seeking legal advice to set up an asset lock would be in the

region of £1,500 - £2,000 (more complex structures would be more expensive); and

- such savings are likely to be passed to stakeholders through reduced transaction costs.

4.4 General benefits to CICs and stakeholders will include:

- encouraging philanthropic investors and others to fund CICs with the confidence that assets will be locked into the company for the community benefit;
- recognising within social enterprises that the CIC will benefit from the flexibility and legal certainty offered by existing company law; and
- creating a CIC form that will improve transparency in CIC operations through the annual production of a community interest report.

Business Sectors Affected

a. Social Enterprise Sector

4.5 The proposals affect the social enterprise sector, which is active in a diverse range of markets and services, referred to above. The nature of and current developments in the sector are reviewed in the Government's report: 'Social Enterprise – a Strategy for success'. Before outlining the likely additional costs it is important to note, as indicated by a variety of consultees, that becoming a CIC would be a voluntary decision that would only be taken if the benefits outweighed the costs.

4.6 There are some tentative estimates of the relative size of the social enterprise sector available. Campbell (2000) [<http://www.ecotec.com/semg/report/>] suggested that the wider social economy accounts for roughly 7.3% of employment in the UK measured as part of a European study. The report further suggests that social enterprises may account

for 10-20% of this. In addition, valuable insights into social enterprise have been obtained through a number of regional and local studies. However, a complete picture of social enterprise across the UK cannot easily be produced by compiling and comparing existing regional studies as they have used differing methodologies and definitions according to their individual remits.

4.7 It is expected that the CIC will initially be used mainly by new enterprises, rather than by existing enterprises which have already customised an appropriate legal form. Take-up is hard to estimate given the lack of data on start-ups in the sector, but our working assumption is that initially there may be between 100 and 300 new CICs registering each year. This figure was considered to be low by some consultees but

no evidence was provided to produce an accurate forecast of the initial uptake.

b. Finance Sector

4.8 The introduction of CICs should complement other work being done in the social enterprise sector to attract sustainable investment, through improved access to obtainable and affordable finance from financial institutions. For instance, there are links between the ability of CICs to issue shares that pay a (capped) dividend to investors and the potential development of the market in “patient capital”, as described in the Bank of England’s May 2003 report on the financing of social enterprises. Over time, this may result in the development of a market in such financial instruments and in improved lending capacity to accommodate the financial needs of the social enterprise sector.

c. Charitable Sector

4.9 The charitable sector has raised concerns regarding the possible restructuring of the existing sector following the introduction of CICs (see section 15 of the October 2003 consultation report). We believe it unlikely that many charities would convert to CICs, because of the resulting loss of tax breaks. Whilst a small number of charitable companies may decide to convert to a CIC, this should not significantly impact on the charitable sector. The CICs proposals are not aimed at redefining or restructuring the existing incorporations within the sector. It is envisaged that CICs will help grow the sector through the introduction of a more flexible form rather than create competition. Competition aspects are discussed in Section 8.

4.10 During consultation, voluntary organisations and charities have raised concerns regarding the possible dilution of funding currently available for charities following the introduction of CICs since they may also compete for existing finance. However, it is envisaged that CICs will help grow the social enterprise sector through the introduction of a more flexible form, and that this may result in increasing the level of funding available to all participants.

4.11 Some charitable foundations can already fund non-charitable organisations and will be able to provide funds to CICs. Our discussions with charitable foundations suggest that the introduction of the CIC will not significantly reduce the funding currently available to the charitable sector, or in any other way affect the charitable sector

disproportionately. This is partly because many foundations are inhibited, for legal or policy reasons, from funding non-charitable organisations. However, it is hoped that over time the introduction of the CIC, with its entrenched asset lock, will encourage at least charitable foundations to finance CICs alongside charitable organisations.

4.12 Most organisations with purely charitable objectives will prefer the charity form rather than the CIC form due to the fiscal benefits available.

5. Issues of Equity and Fairness

5.1 We have identified no groups that will be disproportionately affected by the legislation. However, to ensure that the Regulator does not become involved in debate about whether particular political purposes may be beneficial, it is proposed that political parties and political campaigning organisations will be unable to incorporate as a CIC.

5.2 There are concerns from the co-operative sector about a “level playing field” for CICs and Industrial and Provident Societies in respect of the profile of social enterprises, registration fees, and the cost and timescale of registration (see section 15 of the October 2003 consultation report). 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 proposals.

6. Costs and Income

Identifying Costs

6.1 The regulatory arrangements for CICs will impose costs on central Government, including:

- (i) costs of the Regulator’s staff, an appeals officer, accommodation and services procured;
- (ii) costs of developing and publishing guidance to CICs on their obligations; and
- (iii) operational costs associated with making community interest reports available to the public, and investigating and taking action on complaints.

Quantifying the Costs

a. Operating Costs (including non-recurring)

(i) Recurring staff and infrastructure costs (est. 8 staff) =£390,000 p.a.

(ii) Recurring liabilities (legal costs) =£50,000 p.a.

(iii) Recurring charges from Companies House =£10,000 p.a.

(iv) Non-recurring set-up costs = £515,000 (see 6.3)

Total estimated costs: £400,000 staff and infrastructure running costs and £50,000 estimated legal liabilities per year, and £515,000 one-off.

6.2 Recurring staff costs are the total costs of employment including salaries, pension, and services procured e.g. personnel, facilities, training, accommodation etc. and other

employer costs. Our cost estimate assumes that the Regulator's staff will be co-located with Companies House in Cardiff. Staff costs are estimated based on similar activities undertaken at Companies House for the registration of ordinary companies. We also include staff costs for additional activities for issuing guidance, applying the community interest test, investigating complaints and publishing and reviewing community interest reports.

6.3 Estimated non-recurring set-up costs include:

- i) recruitment and OCPA compliance costs (£65,000), and salaries for a 'shadow' Regulator and skeleton staff in the period before the Regulator opens for business (£75,000); and
- ii) accommodation fit-out, website infrastructure, new bespoke CIC systems, IT equipment costs, other office equipment costs, CIC website (design and equipment), furniture, design and production costs for publication and provision for contracting-out production of some guidance to experts (£225,000); and
- iii) establishing information systems and changing existing (including Companies House) systems (circa £150,000).

This gives a total estimate of set-up costs in the region of £515,000.

6.4 Recurring infrastructure costs include running costs (IT networks, telephony communications) and are included in the recurring staff costs per head.

6.5 Recurring liabilities include funded legal costs, award of legal costs and audits.

6.6 Recurring charges from Companies House includes cost incurred by Companies House to provide basic administrative functions for the initial handling of CICs registrations.

b. Specialist Non-Recurring Costs

6.7 Specialist costs may be incurred through procuring specialist advice in order to enable the Regulator to fulfil its obligations, e.g. to issue guidance.

c. Regulatory Impact Costs

6.8 The Regulator may undertake formal or informal assessments of the regulatory impact of his activities.

d. Costs to Small and Medium Sized Social Enterprises

6.9 It is not anticipated that the proposed regime will have a particular impact on small firms. It is envisaged that financial costs incurred by all firms in the normal set up of a company will remain unchanged with the exception of the additional procedures and costs for registering as a CIC. It is expected that to register a company as a CIC will cost considerably less than the current costs incurred by those companies wishing to set up using an asset lock, who have to customise existing company forms to meet their objectives.

e. Costs to Stakeholders

6.10 The setting up of a CIC should present minimal overheads to those forming the company. Any savings as a result of a less legally complex registration would be likely to benefit stakeholders within the social enterprise concerned, through reduced transaction costs and savings being diverted to other enterprise activity.

f. Regulatory and Community Interest Compliance Costs

6.11 The Regulator will be a distinct, legally independent office, but it is envisaged that the Regulator will be co-located with Companies House in Cardiff. Where possible the Regulator will draw on existing expertise and resources in Companies House and in other bodies such as the Charity Commission and DTI Companies Investigation Branch. It is also envisaged that access to the CICs registration service will be provided via a 'one stop shop' utilising the front office services of Companies House. These arrangements should help to reduce the Regulator's ongoing operational and overhead costs.

6.12 In summary, the main regulatory requirements on CICs likely to affect cost will be:

- (i) Application for registration as a CIC. This will include the process of registering as an ordinary company, with some additional elements, and will be designed as a 'one stop shop' so that applicants do not need to contact both the CIC Regulator and Companies House. The Regulator will apply a community interest test in deciding the application, but given the self-selected constraints of CIC status (lock on profits, regulatory requirements etc) we expect that a large majority of applicants will pass this test easily. An additional fee will be payable for registration as a CIC, on top of the Companies House fee for company registration. In order to avoid deterring potential applicants, it is intended that this will be comparable with the latter fee, currently £20.
- (ii) Filing an annual 'community interest report' with the Regulator, in which each CIC will record the action it has taken in pursuit of its community interest objectives, including the action it has taken (if any) to involve stakeholders in its activities. The report is intended to be short and straightforward. The reporting requirement may impose an annual fee and some administrative costs on CICs, but the information required should be readily available from their own internal governance procedures where these have been formalised.

g. Regulatory Enforcement Costs

6.13 The CIC Regulator will have powers to investigate complaints that CICs are not observing the statutory requirements of CIC status, such as pursuit of community interest, and to take action if such complaints are justified. Such action could include freezing bank accounts, replacing directors or applying to have a CIC wound up.

6.14 These powers will not have any cost impact on CICs provided they observe the statutory requirements. The Regulator will develop guidance to help CICs in meeting these requirements. There will be an appeals mechanism to consider complaints about regulatory decisions. The costs of exercising these powers, producing guidance and considering appeals are included in the overall costs of the Regulator. Following debate

in the House of Lords, the Government has decided to expand the appeal mechanism, to deal with matters of law as well as fact. It is expected that the additional cost of this to Government will be marginal, since it will be offset by the reduced likelihood of the Regulator incurring costs in respect of judicial reviews relating to matters of law.

h. Monitoring and Review Costs

6.15 Given the small size of the Regulator, the Regulator's accounting and reporting arrangements will be linked to DTIs monitoring and reporting arrangements as far as possible. The Act provides for the

Regulator to make annual reports to the Secretary of State, which will be laid before Parliament. The Secretary of State also has powers to require the Regulator to draw up accounts and have them audited by the Comptroller and Auditor General.

Regulatory Income

6.16 Fees will offset some of the costs of the Regulator, although it is not expected that fees will fully cover those costs, at least in the early years of operation. The Government will therefore subsidise the cost of regulation, at least initially.

6.17 Regulatory income will not be quantifiable until such a time as the fee is set. The level of fee will be influenced by the level of funding provided by the DTI.

7. Consultation with small business: the Small Firms' Impact Test

7.1 Small and medium size businesses will be eligible to take advantage of CIC status where appropriate. As the decision to become a CIC is voluntary, there will not be an extra compliance cost. The impact on SMEs who choose to become a CIC will be as outlined above, and should not be disproportionate to the burden involved in setting up an ordinary company. It is envisaged that the majority of new CICs will be start-ups and as such will be SMEs.

7.2 In addition to the public consultation, we consulted with a group of eight social enterprises on the impact of the costs and benefits of the CICs proposals on SMEs. Five of the consultees did not have any relevant comment to make and the remaining three anticipated legal savings on costs but were unable to quantify. Four of the consultees noted that the proposals would result in an increase in administrative cost but regarded this to be small.

8. Competition Assessment

8.1 The introduction of the CIC will affect the social enterprise sector, which is active in a wide range of markets. Examples include waste recycling, local transport, social housing, and the provision of care services to children and the elderly. Within each of these markets, social enterprises are characterised by a high level of diversity, in terms of both economic scale and legal structure.

8.2 The costs associated with CIC status (e.g. to register and fulfil reporting requirements) will only apply to those that choose to use this new type of company - this

will not impose a barrier to those wishing to enter the markets in which social enterprises operate. Those who do not

wish to use the CIC form will have other options available to them, including conventional company forms.

8.3 The CIC will make it quicker and cheaper for aspiring new entrants to the social enterprise sector to incorporate as companies on a not-for-profit basis, thus facilitating entry into a range of markets with the aim of ultimately growing the overall size of the sector. There is, therefore, some potential for increased competition between purely commercial participants and not-for-profit participants within specific markets. A CIC might, among certain potential customers (as with any other form of non-profit-making enterprise) enjoy some competitive advantages over commercial enterprises operating within the same market, due to the absence of a requirement to generate profits for shareholders and owners. However, we have not identified any markets in which the scale of new entry that is likely to be stimulated by the introduction of the CIC would be sufficient to alter the current structure of competition.

9. Enforcement and sanctions

9.1 The Regulator will work closely with Companies House and other government bodies in preparing guidance and ensuring ongoing compliance with CIC statutory requirements. Depending on the nature of their business, a CIC may be affected by other sectoral regulatory regimes.

9.2 As companies CICs will be required to comply with company law, and all the usual sanctions and means of enforcement will apply, for example in the event of a failure to provide reports and accounts in time. Those sanctions will be extended to the requirement, placed on all CICs, to submit an annual “community interest report”.

9.3 In addition the Regulator will have a number of powers designed to ensure that CICs properly pursue community interest purposes, and that their assets are adequately protected. In particular, the Regulator will have powers to:

- obtain information, and direct an audit of a CIC;
- appoint, suspend and remove directors;
- appoint a manager;
- vest assets in an official property holder;
- freeze assets, and restrict transactions and payments;
- apply to the court for the CIC to be wound up;
- bring a legal claim on behalf of the CIC (for instance against directors who are in breach of their duties);
- divest of its ownership a political party which has acquired control of a CIC; and

- give directions as to the disposal of surplus assets on the winding up of a CIC.

9.4 There will also be powers enabling the Regulator to receive information from (and disclose information to) other regulators.

10. Monitoring and Review

10.1 In accordance with the Government's goal of light touch regulation, the CIC Regulator will be obliged to use his supervisory powers only to the extent necessary to maintain confidence in CICs.

10.2 The Regulator will be required to report annually to the Secretary of State who will be required to lay the report before Parliament.

11. Results of consultation

11.1 The results of the 2003 public consultation on CICs are summarised below. They are also documented in detail in the final consultation report which can be found on the DTI website (www.dti.gov.uk/cics/).

(i) Within Government

11.2 The proposals were agreed within Government. We consulted the Cabinet Office, DTI, Home Office, Department of Health, Scotland Office, Wales Office and HM Treasury among others. We have also consulted the Small Business Service and the Office of Fair Trading.

(ii) Public Consultation

11.3 A public consultation was launched at the Social Enterprise Conference on 26th March 2003, and lasted 12 weeks. The consultation was warmly welcomed and received positive feedback.

11.4 The launch of the CIC proposals was followed up by a proactive consultation programme involving one-to-one discussion with sector representatives, specialist group meetings, participation in seminars with representative organisations and a programme of Road Shows throughout the UK. In addition to this we approached a number of representative organisations to involve their members. This included the National Council for Voluntary Organisations, Association of Charitable Foundations, Development Trusts Association, the co-operative movement, Charity Law Association, Social Enterprise Coalition and National Housing Federation.

11.5 In Scotland we approached the Scottish Council for Voluntary Organisations, Community Enterprise Strathclyde, Social Enterprise Network Scotland, Scotland Office and the Scottish Executive to deliver a fully integrated consultation Seminar.

11.6 In Wales we worked with the National Assembly for Wales to make initial contact with the Social Economy Foundation Working Party to raise awareness of the proposals. Following on from this we worked with the Wales Office and National Assembly for Wales to identify potential stakeholders. We then made contact with the Social Economy

Network and Welsh Council for Voluntary Associations to finalise a consultation seminar in Cardiff.

11.7 We received 134 written responses to the proposals. 122 of these commented on the overall proposal to create a community interest company, of which 77% were broadly in favour, 9% were against and 14% were neutral. The objections were, in the main, related to the lack of a perceived need for the additional company form. Details of the consultation responses are set out in the DTI's October 2003 report on the consultation.

12. Summary and Recommendation

12.1 The anticipated costs and benefits of the measures setting up the community interest companies regime are set out in the table below:

Description	Costs	Benefits
Create new type of company to be known as a community interest company (CIC)	Normal company set-up costs with a minor additional registration cost (see below)	Lower costs of forming ready-made not-for-profit company. Estimated at approximately £1,500 to £2,000 per company depending on its complexity. Encourages growth of social enterprise sector

Description	Costs	Benefits
Special registration requirement for CICs: "community interest test"	Extra registration cost anticipated at around £20 initially. But choice to become CIC	Provides credibility that the CIC will benefit the community

CIC assets to be locked so that they can only be used for the community benefit	is voluntary	May help attract finance by increasing confidence of investors that profits and assets will be used for the community benefit
CIC share dividends to be capped	Cost to the company/members but choice to become CIC is voluntary	Provides transparency and maintains confidence that the CIC is serving the community interest
Ongoing additional reporting requirement: "community interest report"	Limited profits for investors, but choice to invest in CIC is voluntary	Provides confidence in the integrity of the system. Will strengthen the profile of the social enterprise sector through guidance etc
Office of independent CIC Regulator	Possible annual fee and some minor admin costs on CICs but the information should be readily available from the companies' own internal resources	
	Requires dedicated regulatory framework which will impose both set up and recurring maintenance costs on central government. We estimate these costs to be in the region of £515,00 for set up and £400,000 a year running costs, plus legal liabilities	

12.2 The creation of the community interest company and the associated regulatory regime has been broadly welcomed by interested parties within the social enterprise sector. As well as establishing this new regulatory office, the measures in the Act will ensure that the Regulator is equipped with the right mix of duties and powers to allow the sector to develop and protect the community interest.

12.3 The creation of this new type of company with its independent Regulator is expected to produce substantial benefits for the sector in the long term.

13. Declaration

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I have read this Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed:

Jacqui Smith MP

Minister for Industry and the Regions and Deputy Minister for Women and Equality

Department of Trade and Industry

Date: November 2004