

CHARITIES (PROTECTION AND SOCIAL INVESTMENT) BILL [HL]

EXPLANATORY NOTES

What these notes do

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3).

- These Explanatory Notes have been prepared by the Cabinet Office in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by Parliament.
- These Explanatory Notes explain what each part of the Bill will mean in practice; provide background information on the development of policy; and provide additional information on how the Bill will affect existing legislation in this area.
- These Explanatory Notes might best be read alongside the Bill. They are not, and are not intended to be, a comprehensive description of the Bill. So where a provision of the Bill does not seem to require any explanation or comment, the Notes simply say in relation to it that the provision is self-explanatory.

Table of Contents

Subject	Page of these Notes
Overview of the Bill	2
Policy background	2
Protection of Charities	2
Social Investment	4
Legal background	5
Territorial extent and application	5
Scotland	6
Wales	6
Northern Ireland	6
Commentary on provisions of Bill	7
Clause 1: Official warnings by the Commission	7
Clause 2: Investigations and power to suspend	8
Clause 3: Range of conduct to be considered when exercising powers	8
Clause 4: Power to remove charity trustees following an inquiry	8
Clause 5: Power to remove disqualified trustee	9
Clause 6: Power to direct specified action not to be taken	9
Clause 7: Power to direct winding up	9
Clause 8: Power to direct property to be applied to another charity	10
Clause 9: Automatic disqualification from being a trustee	10
Clause 10: Power to disqualify from being a trustee	11
Clause 11: Records of disqualification and removal	12
Clause 12: Participation in corporate decisions while disqualified	12
Clause 13: Power to make social investments	12
Clause 14: Reviews of the operation of this Act	15
Clause 15: Short title, extent and commencement	15
Commencement	15
Financial implications of the Bill	15
Related documents	16
Annex A - Power to disqualify from being a trustee	17
Annex B - Territorial extent and application	18

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3)

Overview of the Bill

1 The Bill:

- provides stronger protection for charities in England and Wales from individuals who are unfit to be charity trustees;
- equips the Charity Commission with new or strengthened powers to tackle abuse of charity more effectively and efficiently; and,
- gives charities a new power to make social investments (investments that pursue both a financial and social return).

Policy background

Protection of Charities

- 2 The Charity Commission's statutory objectives include increasing public trust and confidence in charities and promoting charities' compliance with their legal obligations. A significant part of the Charity Commission's compliance work involves identifying and investigating misconduct or mismanagement in charities and taking appropriate and proportionate action in response to protect charity assets.
- 3 The Charity Commission already has a range of investigatory and enforcement powers designed to protect charitable assets where there is serious misconduct or mismanagement. As a civil regulator, the Commission has no powers of prosecution, so if the Charity Commission discovers criminal activities it reports those activities to the police or other appropriate law enforcement agencies. The Charity Commission must not become directly involved in the running of or administration of a charity, although it can under certain circumstances give directions to charity trustees, appoint interim managers to displace the trustees and make remedial schemes.
- 4 Currently, people with an unspent conviction for a criminal offence involving dishonesty or deception are automatically disqualified from acting as a charity trustee until their conviction is spent or they obtain a waiver from the disqualification from the Charity Commission.
- 5 In his 2012 statutory review of the Charities Act 2006 "Trusted and Independent; giving charity back to charities", Lord Hodgson of Astley Abbotts recommended that the Government consider extending the range of offences that automatically disqualify a person from being a charity trustee. The Government accepted his recommendation in its response in September 2013.
- 6 In December 2013 the National Audit Office (NAO) published a report on the regulatory effectiveness of the Charity Commission. The report concluded that the Charity Commission did not do enough to identify and tackle abuse of charitable status, and that this "undermines the Commission's ability to meet its statutory objective to increase public trust and confidence in charities".
- 7 The report found that the Charity Commission "*needs to make greater use of its statutory powers in line with its objective of maintaining confidence in the sector; and develop an approach to identify and deal with those few trustees who deliberately abuse charitable status*".
- 8 The NAO report also identified deficiencies in the Charity Commission's powers and barriers

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3)

to their use. It made a number of recommendations to the Charity Commission and recommended that the Cabinet Office should “assist the Commission in securing legislative changes to address gaps and deficiencies in the Commission’s powers.”

- 9 The Government’s Extremism Task Force also recommended addressing gaps and deficiencies in the Charity Commission’s powers in the specific context of tackling extremism. It recommended “consulting on new legislation to strengthen the powers of the Charity Commission: these powers will help us tackle extremism, as well as other abuses of charitable status such as tax avoidance and fraud.” Subsequently, the Home Affairs Select Committee, in its 2014 report on counter-terrorism also recommended stronger legal powers for the Charity Commission to counter the abuse of charities for terrorist purposes.
- 10 In December 2013 the Government published a consultation on 17 proposals for reform put forward by the Charity Commission and which dealt both with the range of offences resulting in automatic disqualification from charity trusteeship, and gaps and weaknesses in the Charity Commission’s existing powers.
- 11 Consultation feedback indicated broad support for the role of the Charity Commission and for ensuring it has the tools it needs to do its job. Not all of the proposals attracted support from the majority of respondents. A draft Bill was published for pre-legislative scrutiny in October 2014. Ten of the original 17 proposals were taken forward in the draft Bill.
- 12 Parliamentary pre-legislative scrutiny was undertaken by the Joint Committee on the Draft Protection of Charities Bill. The Joint Committee took evidence from a wide range of stakeholders, and published its report on the draft Bill in February 2015. The Joint Committee broadly supported the proposals to give the Charity Commission more powers, however it recommended that effective safeguards must be in place to ensure charities and their trustees are treated fairly by the Commission.
- 13 The Government’s response to the Joint Committee report was published in March 2015. It accepted most, but not all, of the Joint Committee’s recommendations, and the draft Bill was amended accordingly.
- 14 In terms of protection of charities, the Bill:
 - a. adds certain criminal offences to the criteria which automatically disqualify a person from being a charity trustee in England and Wales;
 - b. extends automatic disqualification to senior management positions in charities;
 - c. gives the Charity Commission a new power to disqualify an unfit person in certain circumstances from being a charity trustee or senior manager in a charity for up to 15 years, subject to safeguards;
 - d. enables the Charity Commission to continue to proceed with removal where a trustee resigns after notice of removal has been served;
 - e. gives the Charity Commission a new warning power, enabling it to issue a statutory warning where the Commission considers there is either a breach of trust or duty or other misconduct or mismanagement;
 - f. gives the Charity Commission a new power to direct a charity to be wound-up following an investigation, and after public notice of its intention to act and a period for representations, where that would be more appropriate than attempting to restore the charity to health;

- g. enables the Charity Commission, in the context of a statutory inquiry, to direct that a charity not take certain actions.

15 The Bill also:

- a. makes clear that failure to follow a Charity Commission order or direction constitutes misconduct;
- b. extends the period for which the Charity Commission may suspend a person from charity trusteeship pending removal from a maximum of one year to a maximum of two years;
- c. enables the Charity Commission to exercise its existing scheme-making power in the context of a statutory inquiry where it is satisfied that there has been misconduct or mismanagement or there is a need to protect charity property. Currently both misconduct/mismanagement and need to protect charity property limbs must be met;
- d. enables the Charity Commission to remove a disqualified trustee from a charity where they have not stepped down;
- e. updates the existing power to direct charity property to be applied to another charity to deal with a particular problem;
- f. prevents a person disqualified as a charity trustee who is also an officer of a corporate body that is a charity trustee from participating in discussions and decisions when the corporate body is acting as a charity trustee.

Social Investment

- 16 Certain research indicates that social and environmental impact is becoming more important across the UK economy. It has been suggested that one in three British consumers will pay more for products with a positive social or environmental outcome (*Based on findings of Nielsen's, Consumers who Care Survey 2013*) and 60% of millennials (those born between 1980 and 2005) want to work for organisations with a social purpose (*According to the recent survey of millennials by Deloitte, available at: www.deloitte.com/MillennialSurvey*).
- 17 There are around 180,000 regulated social sector organisations, such as charities, community interest companies and community benefit societies with a combined annual income greater than £39 billion and workforce of more than 800,000 people (*NCVO Almanac 2012, Government estimates from BIS, Small Business Survey, 2010 and ONS, Blue Book, 2011*). In addition, there are an estimated 180,000 enterprises delivering social outcomes that do not take a regulated social form. These enterprises employ 1.5 million people and turnover c. £120 billion per year.
- 18 Growth in this field is being supported by a positive investment market worth around £3 billion in 2014. Whilst savings in ethical banks and credit unions rose by 29% to £1.86 billion in the last three years, the fastest growth was to be found in the smaller direct investment sector, which consists of community share issues, bonds issued by charities and bonds and equity in a small number of socially motivated public companies (*Ethex positive investment report 2014*).
- 19 Registered charitable trusts and foundations have £60bn assets under management and many have social missions that are highly compatible with social investment. This suggests they have the potential to provide the sort of risk capital that can support growth in this field. But to date it is considered that regulatory uncertainty has been an inhibiting factor (only £0.1bn has been socially invested). A new power of social investment would seek to reduce this uncertainty, leading to a subsequent boost to investment (*Association of Charitable Foundations Research Briefing: Charitable Trusts and Foundations' Engagement in Social Investment, 2013*).

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3)

- 20 In his 2012 statutory review of the Charities Act 2006, Lord Hodgson of Astley Abbotts recognised that the current law made it difficult for charities to engage in making social investments. This is because charities are unlikely to have an express power to make social investments, but must instead rely on a combination of their separate powers to spend and their powers to invest for financial returns. He recommended that charity trustees' investment powers and duties be amended to make social investment easier for those charities that wish to undertake it.
- 21 As a result of Lord Hodgson's recommendation the Government asked the Law Commission for England and Wales to review the law, consult and make recommendations. The Law Commission published proposals for public consultation in April 2014. It proposed that charities should be given a new power to make social investments, along with associated duties when making or reviewing social investments.
- 22 The proposals were well supported by charities and the wider social investment sector, and the Law Commission reported in September 2014 recommending legislation to create a new social investment power and duties for charities. The Bill gives effect to recommendations of the Law Commission in its Recommendations Paper, Social Investment by Charities (September 2014).
- 23 The social investment provisions in the Bill were prepared by the Law Commission, as were the notes on clauses on the relevant provisions below.
- 24 In relation to social investment, the Bill:
 - a. introduces a power for charities to make social investments;
 - b. sets out the duties that must be complied with by charity trustees when making social investments, whether pursuant to the statutory power or otherwise; and
 - c. makes consequential amendments to the Trustee Act 2000.

Legal background

- 25 The Charities Act 2011 contains the current provisions relating to removal and disqualification of charity trustees, and powers of the Charity Commission to act for the protection of charity. The current provisions are:
 - a. sections 76 to 87 of the Charities Act 2011 ("Powers of Commission to act for the protection of charities etc"). Most of these powers can only be exercised after the Commission has opened an inquiry under section 46 of the Charities Act 2011.
 - b. sections 178 to 184 of the Charities Act 2011 ("Disqualification of charity trustees and trustees etc.")
- 26 The Charities Act 2011 will continue to be the main Act of Parliament dealing with charity law, and this Bill inserts new provisions into the 2011 Act and makes changes to it. The social investment provisions of the Bill also make consequential changes to the Trustee Act 2000.

Territorial extent and application

- 27 The Bill extends to England and Wales only. Charity law and regulation is devolved in Scotland and Northern Ireland.

Scotland

- 28 The Bill does not contain any provisions falling within the terms of the Sewel Convention. Because the Sewel Convention provides that Westminster will not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament, if there are amendments relating to such matters which trigger the Convention, the consent of the Scottish Parliament will be sought for them.

Wales

- 29 The Bill does not contain any provisions relating to devolved matters. If there are amendments which relate to such matters, the consent of the National Assembly for Wales will be sought for them.

Northern Ireland

- 30 The Bill does not contain any provisions relating to devolved matters. If there are amendments which relate to such matters, the consent of the Northern Ireland Assembly will be sought for them.

Commentary on provisions of Bill

- 31 The Charities Act 2011 and the Bill refer to the terms “charity trustees” and “trustees of a charity”. “Trustees of a charity” are people who hold property for a charity established as a trust. These people are usually, but not necessarily always, the charity trustees, and are treated in the same way by the legislation whether or not they are. In these notes we use the term “charity trustees” to refer to both for simplicity.

Clause 1: Official warnings by the Commission

- 32 Clause 1 inserts into the Charities Act 2011 new section 75A, which provides the Commission with a power to issue an official warning to a charity or charity trustee. Subsection (1) specifies when the Commission may issue a warning. A warning may be issued where there is a breach of trust or duty by a charity or trustee, or other misconduct or mismanagement in the charity. A breach of duty would include non-compliance with a Commission order or direction. Subsection (2) enables the Commission to publish a warning. The Commission is required to give notice of a warning (subsection 3), and the means by which it may do so (subsection 4). Subsection (5) requires the warning notice to specify certain matters, including the grounds for the warning, and any remedial action that could address the warning. Subsection (6) requires the Commission to take account of any representations on the content of the warning made to it within the period set out in the notice.
- 33 There is no right of appeal to the Charity Tribunal against an official warning, as is currently the case with non-statutory warnings issued by the Commission. However in addition to the representations process described above, an official warning could be challenged through judicial review.
- 34 The official warning will be similar to powers already available to many other regulators. It is intended to be a more reasonable and proportionate way of dealing with breaches of statutory provisions of the Charities Act 2011, breaches of fiduciary duty or other mismanagement where the risks and impact on charitable assets and services are relatively low. Sometimes this may be as a more proportionate alternative to use of remedial powers such as suspensions, or removal of trustees or restitution action against trustees. In such cases the Commission will make clear that continuing or repeating the breach will lead to tougher action being taken straight away next time. In other cases, a warning might be used alongside or with reference to other powers to increase the incentive to comply.
- 35 The Commission would be able, but not required, to publish official warnings. If it does publish it can do so in any form. The Commission will publish its policy for when and how this will be done and expects to apply a similar process to the way it currently deals with its discretion to publish the results of inquiries under the Charities Act 2011.
- 36 The Commission has provided the following examples of when the warning power could be used:

Example (1): unauthorised payments

A charity makes unauthorised payments to a connected company or that benefit a trustee. The size of the sums involved mean it is disproportionate to take stronger action but the Commission could issue an official warning on future conduct.

Example (2): governance problems

Breaches of a charity's governing document that lead to governance problems. For example, not running internal elections properly or repeated failure to call Annual General Meetings. This can lead to complaints and disputes within the charity but often the impact is not great enough to justify the use of current powers. A published Warning could promote compliance and increase transparency and wider public trust and confidence.

Example (3): where a statutory inquiry would be disproportionate

The Commission is unable to make directions outside of an inquiry (the consultation proposed changing this but it was rejected by Government in the light of responses). Where the Commission considers it disproportionate and unnecessary to open an inquiry purely for the purpose of making a direction, issuing an official warning could be an alternative way of making it clear to a charity that they should take action.

Clause 2: Investigations and power to suspend

- 37 Clause 2 amends section 76 of the Charities Act 2011, which deals with the exercise of the Commission's temporary protective powers. It puts beyond doubt that failure to comply with an order of the Commission, or failure to remedy a breach specified in an official warning constitutes misconduct or mismanagement (clause 2(2)).
- 38 It also enables the Commission to extend a suspension pending removal by up to one year, subject to a two year overall limit. The Commission asked for this change because in some cases it must await the outcome of a criminal prosecution before it can proceed with its regulatory action.

Clause 3: Range of conduct to be considered when exercising powers

- 39 Clause 3 inserts into the Charities Act 2011 new section 76A. Where the Commission has opened an inquiry into charity A, provided there has been misconduct/mismanagement in charity A and the Commission can link it to a person, this provision enables the Commission to take into account any other evidence of that person's conduct for example in charity B or outside of charity but which may damage public trust and confidence in charity, for the purpose of deciding what protective power(s) it would be proportionate/appropriate to exercise in relation to charity A. In effect, once misconduct or mismanagement has been established this provision enables the Commission to consider whether there is other evidence of misconduct or mismanagement in other charities, or conduct outside of charities which could undermine public trust and confidence in charities before determining how to act.

Clause 4: Power to remove trustees etc following an inquiry

- 40 Clause 4 inserts into the Charities Act 2011 a substitute section 79 which deals with removal of charity trustees following an inquiry, and makes several consequential amendments. The revised section 79 makes it clear that the Commission can make a scheme in relation to a charity when there is an inquiry open and the Commission is satisfied that there is either misconduct or mismanagement or there is risk to charity property. The test for the

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Commission to exercise its power to remove a charity trustee, or other office holder, remains that there must be both misconduct or mismanagement and risk to charity property.

- 41 The difference between the two tests is because it is considered that there must always be misconduct or mismanagement in order to remove a person from their position in the charity. However there are cases where the Commission considers it may need to make a scheme where only one limb of the test is met.
- 42 Substitute section 79(5) and (6) enable the Commission to continue the removal process (and consequent automatic disqualification) where a person ceases to hold office. This is to enable the Commission to deal with cases where the person they have been seeking to remove resigns their position in order to avoid removal and consequent disqualification.

Clause 5: Power to remove disqualified trustee

13. Clause 5 inserts into the Charities Act 2011 a new section 79A which enables the Commission to remove a disqualified charity trustee if they continue to remain in their position once disqualified. The Commission is required to give notice to each of the charity's trustees, but is not required to give public notice of the order, and is not required to provide a particular period of notice or a mechanism for representations as this is not considered necessary where an already disqualified trustee is being removed. The power does not extend to removing disqualified persons from senior management positions, as this would be for the charity's trustees to enforce (their failure to do so could result in the Commission taking action against the charity's trustees).

Clause 6: Power to direct specified action not to be taken

- 43 The Commission already has the power (in section 84 of the Charities Act 2011) to direct that a charity (or trustees) take certain actions in the context of a statutory inquiry. Clause 6 gives the Commission a new power to direct a charity not to take certain actions in the context of a statutory inquiry.
- 44 Clause 6 inserts into the Charities Act 2011 a new section 84A which enables the Commission, once a statutory inquiry has been opened into a charity, and the Commission considers that any action if taken or continued by the charity or its trustees would constitute misconduct or mismanagement, may direct the charity or its trustees not to take it or continue it. In addition to specifying the action that must not be taken or continued, the order must set out the Commission's reasons for making it.
- 45 In addition to requiring its use only under a statutory inquiry, a further safeguard to the use of this power is that the Commission must formally review such orders at least every six months.

Clause 7: Power to direct winding up

- 46 Clause 7 inserts into the Charities Act 2011 a new section 84B which enables the Commission to direct a charity to wind up in certain circumstances.
- 47 The Commission's usual practice is to attempt to restore a charity to health following a statutory inquiry. However there are rare cases where it would be more appropriate for any remaining assets to be transferred to another charity with the same or similar purposes (something the Commission can already do under existing powers) and the shell of the charity to then be wound up (which this new power would enable). The Commission itself cannot wind up the charity, as to do so would be acting in the charity's administration, so this new power enables the Commission to direct the trustees (or if necessary other persons in the charity such as any remaining employees or members) to take the necessary steps to wind it up (new section 84A(2)).

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3)

- 48 The power would only be available in the context of a statutory inquiry, the Commission must be satisfied that the charity does not operate or that its purposes could be more effectively promoted if it were to cease to operate, and that the exercise of this power is expedient in the public interest (new section 84B(1)).
- 49 New section 84B(3) enables an order to give the recipient(s) of the order powers that they may not have, in particular powers that normally only the members of the charity would be able to exercise in the context of winding up the charity. New section 84B(3) also prevents the order from requiring action to be taken that is prohibited by statute. Similar provision already exists in sections 84(3) (Power to direct specified action to be taken) and 85(3) (Power to direct application of charity property) of the Charities Act 2011. The Commission is required to give public notice of its intention to make a winding up order (new section 84B(4) and must consider any representations made (new section 84B(5)) before making the order. The Commission must give at least 60 days public notice of intention to make a winding up order unless there is a particular need for less notice to be given (new section 84B(6)). Action taken under such an order is treated as properly done (new section 84B(7)) but existing contractual rights are protected (new section 84A(8)).
- 50 Clause 7(5) provides for a right of appeal to the Tribunal, both for the recipient(s) of a winding-up order and where the order displaces members' rights or powers, the members of the charity.

Clause 8: Power to direct property to be applied to another charity

- 51 Clause 8 amends section 85 of the Charities Act 2011 so that compliance with a Commission order to apply charity property properly does not result in a breach of contractual obligations to the charity (e.g. banks who act on client instruction). This is intended to address circumstances where the person holding the charity property is "unable" to transfer the charity property because it owes a contractual duty to the charity or charity trustees. The Commission asked for this provision following several cases where financial institutions holding charity property were contractually unable to transfer it to secure its proper charitable application but would have been willing to do so.

Clause 9: Automatic disqualification from being a trustee

- 52 Clause 8 amends section 178 of the Charities Act 2011 and inserts new section 178A into the Act to extend the criteria that automatically disqualify a person from being a charity trustee.
- 53 The existing criteria for automatic disqualification remain unchanged. So, for example, a person with an unspent conviction for an offence involving deception or dishonesty is automatically disqualified until the conviction is spent or a waiver is granted by the Commission.
- 54 Cases "H" to "J" are new criteria for automatic disqualification which are not criminal offences.
- a. Case "H" is where a person has been found guilty of contempt of court in civil proceedings where a false statement or disclosure is made.
 - b. Case "I" is where a person has been found guilty in the High Court of disobedience to a Commission order or direction.
 - c. Case "J" is designation under terrorist asset-freezing legislation. Designation under terrorist asset-freezing legislation can be made only on the basis of reasonable belief of involvement in terrorism, and only if it is necessary for purposes connected with protecting the public from terrorism. There is a right of appeal against such a designation. Under Case J the disqualification would last until the designation is

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removed.

- 55 Subsection (6) inserts new subsections (3) and (4) into section 178. These provide that where a person is disqualified under section 178 from charity trusteeship they are also to be disqualified from positions with senior management functions. A senior management function is defined in new subsection (4). In effect it is the most senior executive position in a charity, and where control of the charity's finances has been delegated, the person (other than the most senior executive) who controls the finances.
- 56 New section 178A (inserted by subsection (7)) introduces convictions for several criminal offences as new criteria which would automatically disqualify a person from acting as a charity trustee until the conviction is spent or a waiver granted by the Commission. There is the potential for an overlap with the current "offences involving dishonesty or deception" criteria, which is dealt with by clause 9(3).
- 57 Offences that have been superseded by those listed are also caught by new section 178A(2), and ancillary or inchoate offences are caught by new section 178A(3).
- 58 New section 178A(4) provides a power for the Minister for the Cabinet Office to make regulations to amend the list of criteria (the Minister is required to consult if the regulations add a new offence). Such regulations would be subject to Parliamentary debate and approval before they could be made.
- 59 The existing regime of waiver under section 181 Charities Act 2011 would also apply to persons disqualified under these new criteria, enabling such persons to apply for their disqualification to be waived in relation to a particular charity, class of charities, or any charity.
- 60 The civil and criminal consequences of acting whilst disqualified (sections 183 and 184 Charities Act 2011) are extended to disqualified persons holding an office or employment from which they are disqualified under new subsections (3) and (4) of section 178 Charities Act 2011.

Clause 10: Power to disqualify from being a trustee

- 61 Clause 10 inserts four new sections (181A, 181B, 181C and 181D) into the Charities Act 2011, and makes some other consequential changes.
- 62 New section 181A provides the Commission with a power to disqualify a person from being a charity trustee or in a senior management position in a charity. It sets out the criteria that must be met for the Commission to make a disqualification order. To make a disqualification order the Commission must be satisfied that one or more of the listed conditions A to F is met, that the person is unfit to be a charity trustee (either in relation to charities generally or a particular class of charity to be specified in the disqualification order), and that making the order is desirable in the public interest to protect public trust and confidence in charities.
- 63 The Minister for the Cabinet Office may vary the list of conditions by regulations (new section 181A(8)) which would be subject to Parliamentary debate and approval before they could be made (clause 10(5) to (8)). The Minister is required to consult if the regulations add a new condition.
- 64 New section 181B inserted by clause 10 provides that a disqualification order must specify the period of disqualification, which can be up to 15 years, but must be proportionate having regard to certain matters. It also provides that a disqualification order can only take effect after the period for lodging an appeal to the Charity Tribunal has expired without an appeal being lodged, or where an appeal is lodged when it is either withdrawn or finally determined by the Tribunal. The right of appeal against the decision to make a disqualification order is provided in clause 9(9).

These Explanatory Notes relate to the Charities (Protection and Social Investment) Bill [HL] as introduced in the House of Lords on 28 May 2015 (HLBill 3)

