

CHARITY COMMISSION
DECISION OF THE CHARITY COMMISSIONERS TO REGISTER
THE CHARITY BANK LIMITED
AS A CHARITY

The Decision

The Commissioners have accepted The Charity Bank Limited (Charity Bank) for registration as a charity. Charity Bank was registered with the Commission on the 17 April 2002 under number 1091648.

Background

Charity Bank is an innovation of the Charities Aid Foundation (CAF). Charity Bank is established to make beneficial loans and guarantees to charities and for charitable projects by obtaining loans and taking deposits on beneficial terms from the public and others. It requires a licence from the Financial Services Authority (FSA) to take deposits from the public. It is an essential feature of the arrangements that the taking of deposits on beneficial terms should be accepted as an integral part of the charitable purposes of the organisation. The organisation has a novel structure for a charitable organisation.

In 1995 CAF established the Investors in Society operation as a response to a need it had identified for the provision of social investment and to act as a “pathfinder” towards a possible future charity bank. A track record on raising of funds and lending was required before the FSA would approve the granting of a licence to take deposits from the public. Investors in Society was established initially as a special trust fund operating within CAF with financial support from CAF and its clients, although, subsequently funds have been raised by way of donations and grants as well as accepting interest free loans. It had no authority to take deposits from the public at beneficial rates.

The purposes and activities of Charity Bank

Objects

Charity Bank is registered with the following objects:

To promote any charitable purpose for the benefit to the public by:-

- (i) the provision of loans and guarantees on beneficial terms to charities or for charitable purposes by receiving donations and by obtaining loans and taking deposits on beneficial terms from the public and others in order to provide such loans or guarantees;*

- (ii) *promoting the efficient and effective application of charitable resources by those charities and for charitable purposes by the provision of financial advice, support and related assistance to charities and for charitable projects in relation to such loans and guarantees;*
- (iii) *advancing any other purpose which may be charitable according to the law of England and Wales.*

“Beneficial” to mean on terms of or subject to arrangements which are advantageous to charity as compared with commercial terms or arrangements.

To promote its objects, Charity Bank has specific powers, which include:

To carry on the business of deposit taking and otherwise to borrow and raise money on such terms as to security as may be thought suitable.

To lend or advance money with or without security and to act as guarantor.

To undertake or promote research into charity and charitable resources and disseminate the useful results.

To promote the education and training in the effective management of financial and other resources for charitable purposes.

Activities

Charity Bank is established to provide loans, guarantees and related financial assistance on beneficial terms to charities and for charitable projects by way of “social investment” in circumstances where loans are either not available in the commercial market or only available on normal commercial terms which are beyond the ability of charities prudently to finance without prejudicing charitable initiatives. The funding for this activity is to derive in part from raising deposits from the public, again on beneficial terms – ie a rate of interest below that which would normally be offered commercially. The raising of deposits in this way is an integral part of the process of providing the beneficial finance to charities (or for charitable purposes) which otherwise would have to be at a commercial rate. In other respects Charity Bank would raise funds by seeking loans, grants and outright gifts from individuals, corporations, central and local government, government agencies and charities, the latter being by way of charitable application.

CAF has transferred its Investors in Society business to Charity Bank . Investors in Society consists of a loan-book in excess of two million pounds, the loans being provided on beneficial terms to charities and for charitable projects. The funding for Investors in Society comes through donations and loans to CAF (including donations and loans from charities) but does not involve any deposit taking from the public at beneficial rates of interest or premium.

In addition to its primary objects Charity Bank proposes to support charities and charitable projects generally by the provision of specific financial advice, support and related assistance where charities and charitable projects are being financed by loans and guarantees from Charity Bank.

Charity Bank will also promote education and training in the effective management of financial and other resources for charitable purposes and will carry out research into such issues.

Licensing and regulation by the Financial Services Authority

As Charity Bank will be seeking to raise deposits from the general public on beneficial terms, it will be required to conform with the relevant legislation¹. This legislation requires Charity Bank to obtain a licence from the FSA and thereafter requires its activities as a licensed deposit taker to be monitored and regulated by the FSA. The purposes of the banking regulation is to strengthen the protection of depositors by ensuring that prudential standards are met in the conduct of any organisation acting as a bank.

Under the relevant legislation, there are minimum criteria for authorisation. These are that:

- the directors and managers of the institution concerned must be fit and proper persons to hold their positions in the institution,
- the institution will conduct its deposit taking business in a prudent manner
- the business will be conducted with integrity and professional skill appropriate to the nature and scale of the activities and
- the institution must have not less than a specified minimum amount of net assets in paid up capital and reserves.

The institution would have to meet and maintain (as a minimum) capital in the form of permanent share capital or reserves amounting to not less than €5,000,000. Any bank must also maintain adequate capital having regard to the nature and size of its business from time to time.

The FSA has statutory powers to act and intervene in the administration of any banking institution for the protection of depositors. These include a power to restrict or revoke authorisation to raise deposits, and to restrict the activities of a banking institution and in extreme cases to require the removal of any director or manager.

¹ Formerly the Banking Act 1987 and regulations. Now regulated by the Financial Services and Markets Act 2000 and regulations.

Structure of Charity Bank

The structure of Charity Bank must ensure the capital requirements imposed on Charity Bank by the relevant legislation and banking regulation are fully met. In order to address this issue Charity Bank is incorporated as a company limited by shares (not guarantee) which is extremely unusual for a charity. The payment of dividends to charity shareholders is permitted but subject to constraints designed to ensure that the primary purposes of Charity Bank cannot be prejudiced.

The share capital of Charity Bank at the date of incorporation was 75,000,011 shares divided into:

25,000,000 ordinary shares at £1 each;

50,000,000 non-cumulative preference shares at £1 each:- and

11 A shares at £1 each

Under the Memorandum and Articles of Association the ordinary and preference shares can only be issued to or acquired by way of transfer by qualifying charities.²

A shares can only be issued to a category of persons described in the Memorandum and Articles of Association as “non connected trustees”³ of Charity Bank (the trustees of Charity Bank also being Companies Act directors) . Holders of A shares are not entitled to receive any dividend or share of surpluses in a winding-up or to any other participation in profits or assets of Charity Bank. The role of A shareholders is crucial to protect the independence of Charity Bank from conflicts of interest which might arise from having charity shareholders.

Dividends

The Memorandum and Articles of Association provide that Charity Bank may by ordinary resolution declare dividends in accordance with the rights of the ordinary and preference shareholders, (but not in respect of A shares). However:

- No dividend can be declared unless it is authorised by the trustees.
- No dividend can be paid unless a majority of the non-connected trustees confirm that the income of Charity Bank from which the dividend is to be paid is surplus to the operating requirements of Charity Bank.
- No dividend can exceed the amount recommended by the non-connected trustees.
- No dividend is to be paid at a rate which exceeds the then prevailing level of interest on loans of comparable size or 5% whichever is the greater.

² Qualifying charities are charities established within the UK who have objects compatible with those of Charity Bank.

³ Non connected trustees are persons who within the preceding 12 months have not been a trustee of an ordinary or preference shareholder or connected in specified ways with ordinary or preference shareholders.

Initially Charity Bank will be capitalised by CAF acquiring 1 million ordinary shares and 1.5 million non-cumulative preference shares paid for from its general funds on the basis that this represents an application by CAF for its own charitable purposes under its own constitution. In addition CAF is making a grant of £1.8 million to Charity Bank and, together with the value of the Investors to Society business to be transferred by CAF to Charity Bank, this satisfies the minimum capital requirements under the relevant legislation, as the FSA has confirmed.

Issues for the Commissioners

The Commissioners considered the following issues:-

- 1. Whether the purposes and activities of Charity Bank are charitable in law.*
- 2. Whether the effect of the banking regulation arising under the relevant legislation and administered by the FSA ousts the charitable jurisdiction of the court and the Commissioners in relation to Charity Bank.*
- 3. Whether the proposed shareholding structure for Charity Bank is inconsistent with charitable status.*
- 4. Whether Charity Bank would be sufficiently independent from CAF to protect it against conflicts of interest.*

These issues are addressed in turn below.

- 1. Whether the purposes and activities of Charity Bank are charitable in law?*

The Courts have long accepted that the provision of beneficial loans as a means of providing charitable relief to individuals is a charitable purpose and activity in law.⁴ Confirmation of this view is also to be found in the case of **Hadaway v Hadaway**⁵, where the Privy Council indicated that the trust in that case to provide loans at low rates of interest to assist planters and agriculturists would not be regarded as charitable unless at least there was a condition that the loans should be employed for a purpose which could in itself be regarded as charitable.

This approach has been adopted by the Commission on many occasions – an example of this is the registration of the **Garfield Property Trust**.⁶

Charity Bank will lend to charities, or in the case of non-charitable organisations, in support of charitable projects undertaken by these organisations. The Courts have accepted that the making of grants by one charity to another, can be a proper charitable application of the first charity's fund, even in circumstances where the funds granted would simply be added to the general reserves of the second charity.⁷

⁴ Re Monk [1927]2 Ch 197

⁵ [1955] 1 WLR16

⁶ Registered Charity No 1003336

⁷ IRC v Slater (Helen) Charitable Trust Ltd [1981] 3AllER98

In the case of Charity Bank it will make loans on the basis that the charity could not raise commercial finance elsewhere on affordable or otherwise acceptable terms. The Commissioners concluded that there is no reason in principle which prevents the making of soft loans from one charity to another for specific charitable purpose or purposes being a proper charitable activity or which prevents the funding of charitable projects administered by non charitable bodies from being a proper charitable activity.

The raising of funds by obtaining loans and other deposits from the general public on beneficial terms is an integral part of the purposes of Charity Bank. As a consequence, to the extent that this activity is to be regarded as a trading activity, it would be considered to be part of Charity Bank's primary charitable purposes and not an activity of a trading nature which was merely directed towards the raising of funds. By contrast, the Commissioners have not recognised fund-raising as such, whether carried out generally or through a trading activity, as a charitable purpose in its own right. This remains their view.

The Commissioners considered whether the purposes could be accepted as a novel charitable activity under the fourth head of charity law. They took into account their stated policy on the recognition and acceptance of novel charitable purposes as most recently set out in the Commission publication *Recognising New Charitable Purposes*.⁸ The Commission takes a constructive approach in applying the law which takes into account changing social circumstances and needs and which is open to novel ideas through which those needs can be addressed. Acting within the current legal framework the Commission looks to see if there is a sufficiently close analogy with cases previously decided by the courts or accepted by the Commission or with the broad principles derived from the scope of the 1601 preamble⁹. The Commission is concerned to act constructively and imaginatively particularly where public benefit arising through a proposed new charitable purpose is clear.

The Commissioners considered that the Charity Bank's aim is to contribute to the building of a more robust charitable sector better resourced to meet modern needs and to the strengthening of charities to help them better serve their beneficiaries. Charity Bank will not simply be raising funds which it will then pass on to charity nor will it be promoting a particular form of fund-raising. Rather it aims to operate in such a way as to provide a pool of funds available to charity on a lasting basis. It will do this by operating as a bank, taking deposits cheaply so as to raise a capital base on which resources are made available to charity by way of soft loans and can continue to be made available to charity on an ongoing basis as loans are repaid and funds recycled.

By way of analogy, the Commissioners considered the Pay Roll Giving Association¹⁰ which they had accepted as charitable in 1990. The Association was established to promote any charitable purpose for the benefit of the public by promoting pay roll giving as a means of procuring resources for charities and so enabling them to better fulfil their charitable purposes.¹¹

⁸ RR1A, Paragraph 23

⁹ The Preamble to the Charitable Uses Act 1601

¹⁰ Since removed as ceasing to operate

¹¹ The Commissioners considered that the promotion of payroll giving was the way in which the organisation would carry out its charitable purpose and that this was therefore an integral part of its objects and not simply a means to a charitable end.

The Commissioners were satisfied that there was a sufficient analogy in relation to Charity Bank not only from the Association case but also to the established charitable purposes of promoting efficiency and effectiveness of charities and the efficient and effective use of charitable resources¹² which would enable them to accept the purposes of Charity Bank as charitable (subject to satisfying the public benefit test and the other issues discussed below).

In relation to public benefit, the Commissioners were satisfied that tangible benefits would arise from Charity Bank's activities and in particular through the provision of finance of charitable purposes in circumstances where nothing comparable currently existed, and through the provision of targeted financial advice .

Charity Bank may also confer intangible benefits,¹³ (amongst others) through the promotion of the concept of charitable giving in the community, bringing relief and benefit to the objects of charity, encouraging altruism in society, fostering closer association between donors and charities and charitable beneficiaries and identifying and supporting the charity sector where it seeks, on its own or in partnership with Government, to relieve the disadvantaged in society.

The Commissioners were satisfied that the objects of Charity Bank did constitute a novel charitable purpose for the benefit of the public and that Charity Bank was acceptable for registration as a charity, subject to the following issues.

2. *Whether the effect of the banking regulation arising under the relevant legislation and administered by the FSA ousts the charitable jurisdiction of the court and the Commissioners in relation to Charity Bank ?*

A charity for the purposes of the Charities Act 1993 is a body which is subject to the control of the High Court and the exercise of the court's jurisdiction with respect to charities.¹⁴ The issue for consideration was whether the effect of banking law and regulation could oust the charity jurisdiction of the Court to any material extent.

The Commissioners noted that some charities are subject to elements of dual regulation, for example in the case of charitable companies the regulation of companies in accordance with the various Companies Acts, and in somewhat different ways in the case of housing associations or residential homes licensed by local authorities. In none of these cases does the involvement of further regulation under the responsibility of a regulator other than the Charity Commission fetter the charity jurisdiction of the Court. It was however not the fact of dual regulation which was the issue but the nature and the extent of that regulation which would determine whether or not the court's charity jurisdiction is ousted to any substantial degree.¹⁵

¹² Re White's Will Trusts [1951] 1 AllER528

¹³ Public benefit under the fourth head of charity law may be demonstrated by tangible benefits and also by intangible benefits where there is common acceptance that these are for the public good. National Anti-Vivisection Society v IRC [1948]AC31

¹⁴ Section 96(1) Charities Act 1993

¹⁵ CITB v AG[1973] Ch 173 – the test is whether the court's charity jurisdiction is substantially ousted.

Having considered the FSA's role in licensing and then regulating Charity Bank as a bank, the Commissioners concluded that, while regulation is important, the FSA's jurisdiction and banking regulations would not oust the charity jurisdiction of the courts or of the Commissioners to any material extent.

Charity Bank will be subject to a dual regulatory regime which would not detract from its charitable status. The banking regulation would add to public protection and confidence.

The scope of the FSA to intervene in the administration of Charity Bank in the case of concerns about the protection of depositors' interests would not be inconsistent with the Court's or the Commission's functions and powers.

In consequence the Commissioners concluded that the extent of the FSA's regulatory powers did not oust the charity jurisdiction of the courts, but was complementary to it and supported the Commission's aim of promoting public confidence in charity.

3. *Whether the proposed shareholding structure for Charity Bank is inconsistent with charitable status ?*

The proposed structure for Charity Bank - as a charitable company with a share capital, which permitted in certain circumstances a distribution by way of dividend and by way of capital on a winding up to charitable shareholders - was considered by the Commissioners. This structure is necessary to provide Charity Bank with the appropriate capital in order to satisfy the minimum requirements of the FSA for licensing as a deposit taker. The key provisions in the Memorandum and Articles of Association which restricted the distribution of other income or capital of Charity Bank to charities are entrenched so that no amendment can be made to them without the consent of the Commission under section 64 of the Charities Act 1993. The Commissioners noted that any acquisition of shares by charities would have to be consistent with the objects of contributing charities and seen as a charitable application of the funds to the extent that it could not be viewed as an investment.

In order to ensure that Charity Bank has the ability to raise further capital in the future for its future lending, Charity Bank will have power to increase its share capital and it will not be prevented from issuing shares to non-charities. However the Memorandum and Articles of Association provides that, should this occur, any such shares issued to non-charities cannot participate in any dividend or in the distribution of any surplus assets on a winding up. Any shares issued to non-charity shareholders could have voting rights if this was considered appropriate at the time of issue but if this were to happen votes on these shares could not be exercised in a way which detracted from the entrenched constitutional provisions in the Memorandum and Articles of Association restricting distributions to charities.

The Commissioners considered whether arrangements, which allowed for distribution of Charity Bank's assets in certain circumstances by way of dividend and return of capital on a winding up, would prevent Charity Bank from being accepted as a charity. The Commissioners considered that no issue in principle arose as the income and the property of Charity Bank can only be applied for exclusively charitable purposes. Income and capital distributions could only be made to charities who hold ordinary and preference shares. The entrenched constitutional arrangements underpinned this. This is written into the Memorandum and Articles of Association

and could not be amended to allow for any distribution to non-charity shareholders without Commission consent.

In relation to capital, the position is comparable to that under a typical charitable company limited by guarantee as all distributions of surpluses would be in favour of other charities. The only distinguishing feature from the normal situation would be that shareholders would have the right to return of the nominal value of their capital. Subject to that, surpluses would be applied for the benefit of charities in the normal way as decided by Charity Bank in general meeting.

Any dividend paid out to charity shareholders would be available for their specific charitable purposes rather than those of Charity Bank. Whilst this could create the potential for conflict (without the safeguards) as between charity shareholders and Charity Bank, it is noted that there can be no potential for “leakage” of income or capital surpluses away from charity. Safeguards relating to the payment of dividends deal with the two key issues – conflicts of interest and whether such payment could be said to be surplus to the needs of Charity Bank. The Commissioners were satisfied that these safeguards were appropriate and sufficient.

On this basis the Commissioners concluded that the charitable status of Charity Bank would not be compromised by being structured in this way.

4. Whether Charity Bank would be sufficiently independent from CAF?

A close relationship will exist, at least at the outset, between CAF and Charity Bank. It was noted that the initial transfer of assets to Charity Bank (a grant, the Investors in Society loan book business and the initial capitalisation) would all come from CAF.

CAF would have power to appoint trustees of Charity Bank and would retain representation on the trustee body. CAF would be the principal shareholder from the outset.

The Commissioners recognised the reality that initially there would be a close association between the two organisations. They also noted that all staff working on Investors in Society activity within CAF would become employed by Charity Bank.

The following safeguards were included in the Memorandum and Articles of Association of Charity Bank to address potential conflicts of interest which might arise between Charity Bank and its charity shareholders and between CAF and other shareholders.

- There will be a maximum of fifteen and a minimum of three trustees of Charity Bank but the majority of trustees of Charity Bank shall consist of non-connected trustees (see footnote 3) and not more than three trustees of Charity Bank shall also be trustees of CAF.
- Non-connected trustees of Charity Bank would each be required to hold an A share which would constitutionally entrench the rights and duties of the non-connected trustees.
- CAF would have no power to remove a non-connected trustee of Charity Bank except with the consent of the majority of other non connected trustees.

- Any resolution of the trustee body of Charity Bank would require a majority of all trustees' votes cast and a majority of votes cast by non-connected trustees.
- Any delegation to committees of Charity Bank would require the majority of members of such committees to be non-connected trustees and the chair of any committee would be a non-connected trustee who would have the right to veto any resolution passed.
- The chair of Charity Bank would be a non-connected trustee (except with the consent of the Commission).
- Provisions managing conflict of interest on authorising payments of dividends to capital shareholders were in place as described above.

Having considered these safeguards the Commissioners concluded that the independence of Charity Bank was properly protected.

Conclusion

The Commissioners consider that the proposals to establish Charity Bank represent a worthwhile imaginative and forward looking initiative and welcome this development which will support the growing interest and need within society for social investment. Having considered the objects, activities, structure and constitutional safeguards for the operation of Charity Bank and on receiving confirmation from the FSA that a licence to take deposits from the public would be granted, they concluded that Charity Bank was charitable and should be registered with the Commission.