CAZENOVE
CAPITAL MANAGEMENT

CHARITIES AND INVESTMENT MATTERS: A GUIDE FOR TRUSTEES (CC14)

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In the autumn of 2011, the Charity Commission published new guidance on Charities and Investment Matters which replaced the previous CC14 Investment of Charitable Funds: Basic Principles published in 2004 and Charities and Social Investment (2003). The new document describes the legal duties and principles that apply to charity investments and the associated risks within the decision making framework.

The updated guidance confirms that charities can invest in a number of ways but emphasises that Trustees must be clear about their motive in making any investment and must be able to justify that they are using their charity's resources in its best interests.

The guidance gives support to Trustees on how to make decisions with confidence and that comply with their duties. Below is only a summary, selecting some of the key issues.

Charities invest to further their charitable aims.

Types of investment:

1. **Financial Investment:** where the aim is to invest to achieve the best financial return with an appropriate level of risk.
2. **Programme Related Investment (PRI):** the primary aim is to invest to further the charity's aims. As a consequence it may also potentially produce a financial return.

   Trustees must be able to justify that the PRI wholly furthers the charity's aims.
3. **Mixed Motive investment:** this is where the Trustees decide that it is in the charity's best interests to both further the charity's aims and it does not fit into the other two types.

If Trustees have considered the relevant issues, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised for adopting a particular investment policy.

However, Trustees do have **general duties of care and responsibilities**:

- They must exercise care and skill when making investment decisions
- They must know and act within the charity's powers to invest
- Consider how suitable any investment is for their charity (the guidance goes into some detail on the main risks associated with investment which should be considered when assessing suitability)
- Consider the need to diversify

- Take advice from someone experienced in investment matters, unless they have a good reason for not doing so
- Review investments (and their investment manager) from time to time
- Explain their investment policy (Trustees who give discretionary powers to an investment manager are legally required to have a written investment policy) in the Trustees' annual report

KEY POINTERS FOR FINANCIAL INVESTING

Most unincorporated charities and charitable companies will have the "general power of investment". This means that investments can be made in any asset that is specifically intended to maintain and increase its value and/or produce a financial return. In the **Trustee Act 2000** the general power of investment for Trustees was stated to be that "*a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust*."

Trading:

Trustees must be clear about the difference between investment and trading. NB trading can only be undertaken when this is directly furthering or supporting a charity's aims. Profits made from trading are not always subject to tax relief and this distinction is particularly important when looking at derivatives, property, commodities and other opportunities which can be regarded as an investment or trading, depending on the context in which they are made.

Ethical Investing:

Trustees can consider whether to invest ethically even if the investment might not provide the best rate of return. Ethical investment means investing in a way that reflects a charity's values and ethos and does not run counter to its aims.

However, a charity's Trustees must be able to justify why it is in the charity's best interest to invest in this way. The law permits the following reasons:

1. If a particular investment conflicts with the aims of the charity (it may be restricted)
2. If the charity might lose supporters or beneficiaries if it does not invest ethically
3. There is no **significant** financial detriment

Trustees should evaluate the effect of any proposed policy on potential investment returns and balance any risk of lower returns against the risk of alienating support or damage to reputation.

Setting Investment Objectives:

Trustees should be clear about what the charity is trying to achieve and its investment aims. A policy should be set out in writing*, e.g. the investment objective may be to maximise income, preserve capital or ensure stability of income etc.

If a charity is **permanently endowed**, it will need to consider balancing capital growth and income in order for the charity to meet its aims and its beneficiaries' current and future needs.

Permanently endowed charities can adopt a total return approach to investment if they obtain the consent of the Charity Commission.

Before making any investment decision, Trustees should consider what is the appropriate level of risk that they want to, or are able to accept. Trustees must be satisfied that the overall level of risk is right for their charity and its beneficiaries.

Trustees must follow their **duty of care when delegating decision making to an investment manager** and in preparing their investment policy. Even where an investment manager has been appointed, Trustees have overall responsibility of the charity's funds. There must be a written agreement or contract, **and** a written investment policy statement.

Trustees always remain responsible for:

- Setting out and reviewing their charity's investment policy on a regular basis
- Deciding whether, to whom and on what terms, to delegate management of a charity's investments
- Reviewing the suitability and performance of investment managers at regular intervals
- If necessary, ending appointments

A Trustee is not liable for any act or default of the investment manager unless he or she has failed to comply with their duty of care.

The charity's annual report should contain a statement about the performance of a charity's investments during the year and where an ethical investment approach has been adopted, this must also be explained.

* The Charity Investors' Group and the Charity Finance Group have produced a comprehensive guide for "Writing your charity's investment policy" which can be accessed via both organisations' websites, www.cfg.uk and www.charityinvestorsgroup.org.uk

INVESTMENT – AN EVOLVING CONCEPT

The term “investment” in this new guidance is now used to include any outlay of funds in something which ***may*** lead to a financial return. This definition covers a wide range of strategies used by charities in employing their funds which are covered below:

1. **FINANCIAL INVESTMENT** – the motive: financial investment

This is the most common form of investment e.g. “property held by the trustees for the purposes of generating money, whether income or capital growth, with which to further the work of the trust”. (Bishop of Oxford)

2. **PROGRAMME RELATED INVESTMENT (PRI)** – primary motive: social return

In making a PRI, Trustees are not bound by the legal framework for financial investment because their decision is about applying assets directly in furtherance of the charity’s aims (as well as potentially achieving a financial return).

PRI uses charitable resources to finance charitable and other organisations in a way that

- Is wholly in furtherance of the charity’s stated aims
- Is for public rather than private benefit and
- Is expected to produce some financial return **but this is not the main motive for doing it**

The main difference between a financial investment and a PRI lies in the primary intention of the investment, although at face value the investments may look similar.

When making a PRI, Trustees must act in the best interests of their charity and ensure that

- Their charity’s funds are only used to further its stated aims
- Any private benefit arising is necessary, reasonable and in the interests of the charity

There is no legal obligation to take advice. Much will depend on whether the Trustees feel comfortable and competent enough to make decisions on PRIs.

Trustees must include an explanation of the charity’s policy for making a PRI and how any material PRI has performed against the objectives set for it. In the annual accounts, financial investments and PRI must be shown separately.

Examples: Loans/guarantees
Renting/renovating properties
Social impact bond

3. **MIXED MOTIVE INVESTMENT** – main motive: social and financial returns combined

It is recognised that some new and developing investment opportunities do not fall entirely within the definitions of a financial investment or a PRI but can still be justified as being in the interests of the charity. In essence they are a mix of 1) and 2) but the whole is greater than the sum of the parts.

The Charities SORP does not currently address this, as a mixed motive investment can take many different forms.