Investments

Why do Charities Invest?

Charities usually invest to generate a return to help them carry out their objectives. This ranges from largescale investment by charities wholly reliant on investment income, to the investment of funds that form part of a charity's reserve buffer.

Increasingly, charities are looking to invest funds not just to generate a return, but also to deliver their charitable objectives. These are known as mixed motive investments. An example is a loan to a subsidiary company where the subsidiary's activities either directly deliver or support the charitable objective.

Virtually all charities undertake some form of investment.

What are your Responsibilities when making Financial Investments?

As a trustee you have overall responsibility for the investment of the charity's funds. This responsibility cannot be delegated. When making investment decisions you should use your skills and knowledge in a way that is reasonable in the circumstance (the 'duty of care').

If you can demonstrate that you have considered the relevant issues, taken advice as appropriate and reached a reasonable decision, it is unlikely you will be criticised for your decisions.

Setting Investment Objectives

Trustees should approve an investment policy. The policy is the framework in which investment decisions are made. The policy may be very simple, for example if the charity has limited funds to invest, or more sophisticated, for example, if the charity has significant permanent endowment to invest.

When setting the policy you need to be aware of the immediate, short, medium and long term plans and financial needs of the charity.

The policy will also set out the level of risk you are willing to take. You must be satisfied that the overall risk is right for the charity and its beneficiaries.

This doesn't mean avoiding risk completely. For example, if you are investing funds that you know the charity will need in the short to medium term, the level of risk should be low. However, for funds invested for the longer term, the level of risk can be higher because short term drops in the capital value of invested funds will not impact the charity's operational capabilities.

A good investment policy will cover:

- What is the charity trying to achieve by investing?
- Attitude to risk.
- How much is to be invested and for how long?
- The types of investment the charity wishes to make.
- How investment decisions are made.
- How investment performance is measured.
- Role of investment managers.

What can you Invest in?

Investments that are very high risk or controversial are unlikely to be suitable. If you would be uncomfortable with your investment decision being reported in the media, this is an indicator it is not a suitable investment for a charity.

The most common forms of investment charities make are cash deposits, equities, government securities, unit trusts and property. You should consider diversifying your investments as a means of managing risk. You can invest ethically, but you must be able to justify why it is in the charity's best interest.

The Charity Commission's main guidance is document CC14 "Charities and investment matters: a guide for trustees". although the Charity Commission conducted a consultation in 2021, which is now closed, on draft revised guidance about adopting a responsible (or 'ethical') approach to investing. Final guidance has not yet been published but there is reassurance that investment return is not the only measure of "being in the charity's best interest".

In order to preserve tax advantages, if challenged, you would need to be able to demonstrate that the investment was made for the benefit of the charity and not for the avoidance of tax. As long as best practice is followed this should not be an issue.

How should you make Investment Decisions?

The investment policy and key decisions, including rationale, should be recorded in writing.

When making decisions, you need to consider whether external advice is required. Where the only investment is moderate cash deposits, this is unlikely. However, for complex or significant investment decisions this is likely to be necessary. You could also consider appointing a trustee with specialist investment knowledge. When obtaining advice, you must ensure the person is suitably qualified and impartial.

For equity investments, an investment manager may be used. Even if you have delegated some investment decisions to an investment manager, you must retain overall control. This can be achieved by ensuring the investment manager acts only in line with your instructions, which are determined by your investment objective and policy. There should also be a regular review of the suitability and performance of the investment manager. Investments in subsidiaries should be appraised just like any other investments.

Monitoring Performance

Investment performance must be monitored. The 'how' and 'when' should be set out in your investment policy. You should compare performance with benchmarks and objectives. If investments are under or over performing, you should determine why and consider whether it is acceptable. If it is not, you should be prepared to act.

Mixed Motive Investments

These are investments made both for financial return and to help meet the charitable objective. You must be able to demonstrate that making the investment is in the best interests of the charity, taking into account both the financial return and advancement of the charitable objective.

Mixed motive investments however, are not permitted where there is an inappropriate level of private benefit as a result of the investment. This is where charities can make mistakes, so take care. For example, investing in a project with a trustee may make financial sense, but if the trustee will also obtain significant financial reward from the investment, and therefore obtain a private benefit, this is unlikely to be an appropriate investment.

Did you know?

- Charity sector long term investments exceed £161bn
- More than 60% of charities have some form of investment (not including current accounts).
- Investment income comprises approximately 4% of total charity income.

Bank Deposits

Don't forget cash in the investment policy. Consider:

- Access: You must ensure that access to funds is compatible with the charity's cash demand.
- Which institution: Cash should only be deposited with reputable institutions. Other factors to consider will be the rates of interest, location etc.
- Protection: The Financial Services Compensation Scheme (FSCC) offers protection to account holders on the first £85,000 of funds. You should decide whether to limit deposits in each institution to £85,000. Note that the compensation is available per UK banking licence. Some banks, if part of the same group, will share a licence, meaning accounts with two seemingly different banks will have only one £85,000 available, for example, HSBC and First Direct.

How do I know if I am doing a good job?

Ask yourself:

- Do you have a written investment policy, approved by the trustees?
- Are you acting in line with the policy?
- Are significant investment decisions, including the rationale, documented?
- Do the trustees have sufficient expertise to make informed investment decisions? If not, is appropriate advice taken?
- Is investment performance regularly reviewed? And just as important, do the actions from the review accord with the results and also the overarching investment policy?
- Is the investment policy regularly reviewed to ensure it remains appropriate to the charity?

How we can help

We recommend that all charities review their investment policy to confirm it remains relevant and is being applied. If you need any help with drafting an investment policy or with any other areas, please don't hesitate to get in touch with your local member firm.

If you would like to discuss any matter arising from this article please contact MHA on info@mha-uk.com or your usual MHA contact.