



Consultation

Charities and investment matters

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Foreword

It has always been important for trustees to know how they can invest their charity's funds. But it has become increasingly important for trustees to be clear about what they are investing for.

On one level, the answer is quite simple – they invest in order to achieve the best return so they can further their charity's aims. Historically, this has meant the best financial return. But since we last updated our investment guidance, policy and practice have moved on; many charities now invest to deliver both a financial return and direct social benefit. This could mean considering ethical issues or taking into account how an investment helps the charity further its aims directly.

Our draft guidance confirms that charities can validly consider seeking a return which brings social as well as financial benefits. It explains these different approaches to help trustees make the best use of their charity's assets, while managing any risks appropriately. We make clear that it is up to trustees to decide the best approach for their charity. For some, this will mean seeking best return, for others it will mean a combination of both furthering their charitable aims directly and achieving a financial return. The crucial point is that trustees are clear about what they are doing and can justify that they are using the charity's resources in its best interests.

Our aim is to enable trustees to use their charitable assets as effectively as possible in the best interests of the charity and its beneficiaries. The draft guidance demonstrates the opportunities for charities to adopt a range of approaches to investment.

In 2010 registered charities held nearly £78 billion in investment assets, so clearly this is an important consultation for many trustees. It is also vital that in the current climate, where charities are facing a tough funding environment, trustees have the tools to make their assets work harder.

We would like to encourage you to share your views on this draft. Please do take the time to comment – it is important that we are able to take the views of trustees, their advisors and other stakeholders into account.



Dame Suzi Leather, Chair

Sam Younger CBE, Chief Executive

What are we consulting on?

We are consulting about our new draft guidance on charity investments. *Charities and Investment matters* (CC14) will replace three separate pieces of guidance:

- *Investment of charitable funds: basic principles* (CC14)
- *Investment of charitable funds: detailed guidance*
- *Charities and social investment*

We have also published, and welcome any comments on, the shorter *Charities and investment matters: At a glance* which acts as a basic introduction to the subject area. This forms section B of the main guidance.

Alongside the main guidance, we have also set out the *Legal underpinnings: Charities and investment matters* that explain the legal framework and relevant case law.

Please note that when the final guidance is published, it will also be available in an interactive web format, in addition to a downloadable PDF.

Why are we consulting about our new investment guidance?

Before we publish the revised guidance, we want to make sure that trustees and those who act for them:

- are able to find the answers to the common questions they have about investing their charity's money;
- have enough information to help them weigh up the advantages and disadvantages of the different approaches to charity investment and understand the terminology associated with those investments.

This consultation will help us to assess whether we need to do any further work to achieve this.

What are the key features of this draft guidance?

This guidance is a complete redraft of the guidance on investments and social investment mentioned above. Key changes include:

- an updated understanding of investment;
- updates that reflect the changing environment in which charities operate, for example, information on the revised Financial Services Compensation Scheme;
- greater detail about asset classes and the fit with trustee duties;
- a balanced range of different approaches to using a charity's funds to achieve a return or a potential return. The underlying law may differ for some of the approaches, but we have clarified what applies to each approach;
- further information on the circumstances in which charities can choose to make programme related investment; and
- further details about how a charity can make social investments.

The draft guidance may raise questions as well as provide answers, but we hope that the consultation process will ultimately result in more meaningful and helpful guidance.

Who do we want to hear from?

We would like to receive comments on the draft guidance from those with an interest in charity investments, including trustees, advisers and charity employees, those who benefit from, use or support charities and those with professional expertise in charity investments.

We will also discuss the guidance with other relevant regulators and government departments, representative professionals and umbrella bodies. If you think there are other interested parties who should be consulted, please let us know.

The consultation questions

We would like to hear your views on any aspect of the draft guidance. We would in particular like to hear views on the questions set out below. Some of these are general questions about the draft guidance as a whole, whilst others are about specific aspects of the draft guidance.

General questions

1. Are the issues and approaches to investment sufficiently clear, easy to understand and to apply?
2. Is the guidance in a form that is accessible and easily navigable for trustees and those who make decisions on behalf of trustees?
3. Does the tone of the guidance strikes the right balance in facilitating charities in furthering their aims while managing risk?
4. Is the draft guidance likely to give trustees confidence in making decisions about investments?
5. Does the guidance meet the needs of all charities, large and small?
6. Are there additional examples that could be used to illustrate points made or issues covered?
7. Are there gaps or omissions where further guidance would be helpful?

Specific questions

a) Scope of the guidance

We have merged our previous guidance on *Investment of charitable funds* (CC14) and *Charities and social investment* and presented the whole range of investment approaches that a charity can consider within the law.

Historically, most charities used their investments to achieve their charitable aims by seeking the best financial return, appropriate to risk. The return was then spent directly on the charity's aims. The rules for this way of investing are set out clearly in the Trustee Act and we explained them in our guidance *Investment of charitable funds* (CC14). In recent years, more charities have considered wider approaches to investment, specifically approaches that link investment activity directly with the charity's aims or reflect its ethical stance. Collectively, these approaches, which focus on a financial return and social purpose, are referred to as social investment.

This draft guidance on investment explains the legal framework for how a charity can invest. All charity activity must be in the best interests of the charity, and this also applies to making investments.

In this draft guidance, we use the term investment in its widest sense. By investment we mean using assets to obtain a financial return in a way that best serves the interests of the charity.

For some charities, this will mean using their assets to get the best financial return to spend on their charity's aims, for others it will mean using the assets to further the charity's aims directly (with the potential of receiving a return). Sometimes, it will mean making investments that do both.

The important point is that trustees are able to demonstrate that they are acting in the best interests of the charity. This means they must be able to justify their investments at the outset as getting the best financial return (financial investment), furthering the charity's aims (programme related investment) or doing both, (part financial investment, part PRI). Different rules apply depending on what the charity is doing.

Trustee should consider how they can use any assets available for investment in the best interests of the charity and its beneficiaries. This means looking at their investment activity and charitable aims in a holistic way. Our guidance encourages trustees to start from a strategic position and then decide themselves which approach to investment is in the charity's best interests.

We are aware that the terminology used when referring to investments can be confusing. We have therefore clearly defined our understanding of these terms, as they relate to investment rules, throughout the guidance. Our intention is to provide more clarity about the range of options available to charity trustees.

8. Do you agree with the approach we have taken in the guidance?
9. Have we achieved clarity around the range of options available to charity trustees in the guidance?

b) Definition of financial investment

We previously took the view that a financial investment required an investor and an investee. This was designed to eliminate as far as possible activities which were unduly speculative or more in the nature of trading than investment. We consider it appropriate to be clear exactly what the legal obligations are and what are good practice recommendations. We have therefore refocused our guidance on the proper exercise of the trustees' power of investment, as set out in the Trustee Act 2000.

10. Is the approach we have taken here, focusing on investment powers and application of duties, more helpful for charities?
11. Is the detail on asset classes and their compatibility with trustee's duties in Annex 1 helpful and necessary?

c) Ethical investment

Ethical investment is a form of financial investment that takes into consideration a charity's values and ethos. Interest in ethical investment has grown considerably in recent years, with more charities now adopting an ethical approach to investments. The legal underpinning to ethical investment is still informed by the Bishop of Oxford¹ judgment and our guidance is based upon that.

¹ Bishop of Oxford and others v Church Commissioners for England

12. Is there anything further to add to the guidance on ethical investment?

d) Mission connected investment (MCI)

Mission connected investment is a form of financial investment where the charity is also furthering its aims. It has the potential to enable charities to further their aims directly, while also achieving the best financial return on their investment. The law has always allowed charities to pursue an MCI approach. However, it has become an area of interest and growth in recent years. We have therefore included it as an approach to investments in our guidance.

13. Do you think this recognition of MCI in our guidance is a constructive step and is there anything further we could say?

e) Mixed purpose investment

Some charities seeking both a financial and charitable return find they are unable to justify making the investment solely on the basis of it either furthering the charity's aims or as a financial investment. We consider that the law permits, where it can be justified in advance of the investment decision, a mixed purpose investment.

14. Is the framework we have set out in the guidance for mixed purpose investments helpful and likely to be of use to charities?

15. Are there examples of mixed purpose investment that you are aware of that charities have made that could be included as case studies?

f) Programme related investment (PRI)

A programme related investment is investment made by a charity specifically to further its aims for the public benefit. It involves a potential return within an established timescale. We have made a number of changes to how we define and describe PRI. We consider the changes more accurately reflect how charities are permitted by law to use their assets for furthering their charity's aims.

In the past the terms PRI and 'social investment' were used interchangeably in our guidance. However, because of how the term 'social investment' is used in a variety of formats and settings, we consider using it to describe PRI to be confusing. We therefore propose referring to this type of investment only as PRI, which is consistent with the charity's accounting and reporting arrangements (SORP).

In our earlier guidance, we described PRI as 'a method of carrying out the objects of a charity' and also explained that it is 'not investment in the conventional sense of financial investment'. This means that the rules on financial investment, for example in the Trustee Act 2000, do not apply. However, while PRI is bound by different rules, it can still be considered as a form of investment. The definition used in our earlier guidance was wide reaching and meant that grants were considered as a form of PRI. However, the types of activity charities pursue as PRI frequently resemble some types of mainstream investment activity, and therefore we feel it is better to use the term PRI to refer to investments that further a charity's aims and involve a potential return. This means that grants would not be included within this definition.

When making PRIs, charities must be clear that there is a tangible link with their stated charitable aims. They must also ensure that any private benefit is incidental or is recoverable to the charity. We have set out what trustees would need to consider when assessing whether private benefit is incidental to the furtherance of the charity's aims or recoverable to the charity.

We have also clarified in this guidance how a charity can use its permanent endowment for PRI. We will also be consulting later in December on regulations to allow charitable trusts with permanent endowments to adopt a total return investment policy by means of a resolution, using a power conferred by the Trusts (Capital and Income) Bill.

16. Is our guidance on PRI helpful to charities and our use and definition of the term appropriate?
17. Is the section on public benefit helpful in assessing whether private benefit is incidental or recoverable to the charity?
18. Is the explanation about how permanent endowment can be used helpful?
19. Do examples of PRI in the guidance reflect charity's current practice? Are there more useful examples we could add?

g) Social investment

Social investment is a term widely used when investing to achieve a social purpose and also a financial return. The term is used in a range of different contexts with different emphasis on social and financial return.

In the past we have used the term interchangeably with PRI to describe a method of carrying out the aims of a charity. However we consider that the term social investment describes a much wider range of approaches to investment which reflect different degrees of financial return and social purpose. The social purpose will usually be the charity's aims, although it may also be a wider social benefit.

In our draft guidance we have tried to show the range of ways that a charity can engage in social investments within the law. These include:

- Ethical investment
- Mission connected investment
- Programme related investment
- Mixed purpose investment

20. Do you agree that these accurately describe the ways that a charity can make social investments? Is our guidance on this helpful to charities?

Timetable for the consultation

13 December 2010	Start of 12 week consultation
28 February 2011	End of 12 week consultation on draft guidance
Spring 2011	Guidance to be published

How, where and when to send comments on this consultation

Everyone is welcome to respond to this consultation and we would be grateful for all responses in writing, which should be headed *Consultation on draft guidance on charities and investment matters* (CC14) and sent by email to:

investment@charitycommission.gsi.gov.uk

Or, by post to:

Charity Commission Direct
PO Box 1227
LIVERPOOL
L69 3UG

Please provide us with the following standard information, in the order requested, as part of the introduction to your response. This will allow us to manage the responses and use the information more effectively as well as enabling us to keep you up to date with any progress:

- Organisation/Charity name (if applicable)
- Charity number (if applicable)
- Contact name
- Position within organisation (if applicable)
- Contact number, address and email
- Contact e-mail
- Confidentiality statement (if applicable – see following sections)
- Consultation response/answers to consultation questions

The closing date for responses to this consultation is the 28 February 2011.

Where appropriate we encourage you to provide evidence in support of your response. If you are a representative group please provide a summary of the people and organisations you represent as part of your response. If you represent a charity, it would be helpful if you could state your organisation's charitable aims.

How we will treat the information provided

All information contained within the responses (including personal information) may be published or disclosed in accordance with the access to information regimes, primarily set out in the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you want information given in response to the consultation to be kept confidential it will only be possible to do so if it is consistent with our legal obligations. There is a statutory Code of Practice under the Freedom of Information Act 2000 which public authorities must comply with. This sets out how confidential information must be dealt with. We cannot give assurances that all information will be kept confidential but we will take into account any representations made by you.

If you object to any of the information (including your personal details) which you are giving in response to the consultation being published, please say so. It would be helpful for any such objections to be supported with an explanation of why you regard the information to be confidential so that a decision can be made as to whether there are grounds for not publishing such information.

What will happen at the end of the consultation period?

We will review our draft guidance, *Charities and investment matters*, taking into account the comments that we have received by the end of the consultation period. We will then publish a summary of the responses to this consultation on our website alongside the final guidance in spring 2011.

Government Code of Practice on Consultation

This consultation has been designed to comply with the seven consultation criteria in the Government *Code of Practice on Consultation*:

Criterion 1 – When to consult

Formal consultation should take place at a stage when there is scope to influence the policy outcome.

Criterion 2 – Duration of consultation exercises

Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

Criterion 3 – Clarity of scope and impact

Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

Criterion 4 – Accessibility of consultation exercises

Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

Criterion 5 – The burden of consultation

Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

Criterion 6 – Responsiveness of consultation exercises

Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

Criterion 7 – Capacity to consult

Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

Respondents are invited to comment on the extent to which the criteria have been adhered to and to suggest ways of further improving the consultation process. If respondents have comments or complaints about the consultation process they should contact the address below.

Further information

For further information on this consultation, please contact:

Email: stephanie.wong@charitycommission.gsi.gov.uk

Phone: 020 7674 2470