
CC14 - Investment of Charitable Funds: Basic Principles

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Introduction

1. Many charities have surplus funds not needed to fund their immediate charitable activities; often the trustees invest some or all of this surplus in order to generate extra income to fund future activities. This guidance sets out to explain briefly the powers and duties of charity trustees when investing charitable funds. It is intended to be an introduction to the subject for trustees and members of the general public who have little or no experience in this area. For those with a deeper interest or more experience of investment by charities, we have published more detailed guidance on **Investment of Charitable Funds** in the Publications area on our website (www.charitycommission.gov.uk).

2. While the general guidance given here applies to most charities, there are a number of ways in which the situation differs in detail for the directors of charitable companies. For more information relating to these charities please see the detailed guidance.

3. The basic principle governing trustees' decisions about investing their charity's funds is that they must take a prudent approach.

4. When investing charitable funds (especially where those represent permanent endowment), trustees must seek to strike the right balance for their particular charity between the two objectives of:

- providing an income to help the charity carry out its purposes effectively in the short term; and
- maintaining and, if possible, enhancing the value of the invested funds, so as to enable the charity effectively to carry out its purposes in the longer term.

5. In order to discharge the duty to adopt a prudent approach to the investment of the charity's funds, trustees must:

- know their investment powers (paragraphs 11-14);
- discharge their duties properly when they take decisions about investments (paragraphs 15-19);
- have proper arrangements in place for holding investments on behalf of the charity (see paragraphs 20-25);

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- follow certain legal requirements if they are going to use someone to manage the charity's investments on their behalf (see paragraphs 26-29);
 - know what they can and cannot do if they are going to apply an ethical approach to the charity's investments (see paragraphs 32-38).

6. We also strongly recommend that, where the size of the funds to be invested justifies this, trustees should decide on a formal investment policy for the charity. This will, of course, vary in the level of detail and complexity depending on the size of the charity, and on whether the function of investment has been delegated (see paragraphs 30-31).

7. Conceptions of what constitutes "investment" vary - in this context it needs to be distinguished from other forms of income generation, such as trading and gambling. The definition of "investment" used in trust law, and more information on what does and does not constitute investment, are in the detailed guidance on our website. However, for most trustees, particularly of smaller charities, the examples of what are and are not investments in paragraphs 9-10 below should be sufficient as a guide.

Meaning of words and expressions used

8. In this guidance:

The **Charities Act** means the Charities Act 1993.

The **Trustee Act** means the Trustee Act 2000.

Charitable companies are companies formed and registered under the Companies Act 1985 or to which the provisions of that Act apply and which are established for **exclusively** charitable purposes.

Governing document means any document setting out the charity's purposes and, usually, how it is to be administered. It may be a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal Charter, or Charity Commission or Court Scheme. The expression "**trust instrument**" is used in the Trustee Act; in the vast majority of cases its meaning is the same.

Investment manager means an individual or a corporate body appointed by a charity or its trustees to make investment decisions on behalf of the charity. The investment manager will make those decisions within the framework of an investment policy which the trustees have formulated.

Land includes any buildings on the land.

Permanent endowment is property of the charity (including land, cash or investments) which the trustees may not spend as if it were income. It must be held permanently, sometimes to be used in furthering the charity's purposes, sometimes to produce an income for the charity. The trustees cannot normally spend permanent endowment without our authority.

Trustees means **charity trustees**. Charity trustees are the individuals or corporate bodies who, under the charity's governing document, are responsible for the general control and management of the administration of the charity. In the charity's governing document they may be called trustees, managing trustees, committee members, governors, council members or directors, or they may be referred to by some other title.

Must or **need to** are used to refer to actions that trustees, or their agents or employees, are required to take, by law or under the charity's governing document.

Where we use terms such as the trustees **should** or we **suggest, recommend** or **advise** we are referring to actions which the trustees, their agents or employees could take and which we consider to be good practice, but which are not legal requirements.

Examples of investments

9. The term "investment" is not defined in statute. Instead the courts have interpreted the phrase. Whilst not exhaustive, some common examples of investments include:

- shares in companies;
- land rented or leased out by the charity to tenants;
- interest-bearing loans by the charity, for example, government bonds, company loan stock, deposits at banks and building societies; and
- units in collective investment schemes, such as unit trusts, open-ended investment companies or common investment funds.

Examples of what are not investments

10. Some examples of what **do not** constitute investments are:

- Land purchased and developed with a view to sale. This will usually be regarded as trading rather than investment, and hence may attract only limited tax relief. (See our publication **Charities and Trading, CC35.**)
- Works of art or commodities such as gold or vintage wine, acquired with a view to resale in the future at a profit. This is the only prospect of a financial benefit from the transaction. The purchase and sale of such items will also usually be viewed as trading.

Trustees' powers of investment

11. Under the Trustee Act, most trustees will have a very wide power of investment. In practice this means that most trustees are able to invest in almost anything regarded under trust law as an investment (see above for examples of what the Commission considers falls within the trust law definition). There are some restrictions on investment in land.

12. The following paragraphs explain the circumstances in which trustees do not have the power of investment which the Trustee Act confers. They also explain the conditions which apply when using powers of investment.

Exceptions

13. These general powers of investment are **not** available where:

- the charity is a charitable company (except when the company is itself acting as a charity trustee);

- the charity's governing document excludes or restricts the Trustee Act power (although in certain circumstances this statutory power over-rides restrictions or exclusions in the governing document). For instance the governing document may restrict the trustees to investing in certain types of investment (eg shares traded on the London stock market) or prohibit investment in certain industries (eg armaments or tobacco). See the detailed guidance on our website for more examples of restrictions and exclusions, and paragraphs 32-38 of this guidance on ethical investment.

14. Where the Trustee Act powers are not available, trustees must rely on any powers within their governing document when making investments.

15. When managing a charity's investments, trustees must act to certain standards as defined in the Trustee Act, whether they are using the investment powers in that Act or not:

- Firstly there is the general duty of care (as described in section 1 of the Trustee Act), which is the duty to exercise such care and skill as is reasonable in the circumstances. This applies both to the use of any power of investment and to the discharge of the specific duties which the Act attaches to the use of investment powers (see below). A higher level of care and skill is expected of a trustee who is or claims to be knowledgeable about or experienced in investments, or who is paid.

Trustees' duties

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- Secondly, trustees must comply with the following specific duties:
 - Trustees must consider the **suitability** for their charity of any investment. This duty exists at two levels. The trustees must be satisfied that the type of any proposed investment (eg a common investment fund or a deposit account) is right for their charity (including whether it is consistent with an ethical investment policy if the charity has one). They also have a duty to consider whether a particular investment of that type is a suitable one for the charity to make. Trustees should, at both levels, try to consider the whole range of investment options which are open to them; how far they should go here will, of course, depend on the amount of funds available for investment.
 - Trustees must consider the need for **diversification**, ie having different types of investment, and different investments within each type. This will reduce the risk of losses resulting from concentrating on a particular investment or type of investment. Again, how far the trustees can go here will depend on the amount of funds available for investment.
 - Trustees must periodically **review** the investments of the charity. The nature and frequency of these reviews is up to the trustees to decide, but the reviews should be proportionate to the nature and size of the charity's investment portfolio. To review too infrequently may result in losses or

missed opportunities; chopping and changing investments too frequently may incur unnecessarily high levels of transaction charges. We recommend that for most charities a review should be carried out at least once a year.

- Before exercising any power of investment, and when reviewing the charity's investments, trustees must obtain and consider proper **advice** from a suitably qualified adviser (who may be one of the trustees), unless the size of the funds available for investment is so small that seeking investment advice would not be cost effective.

16. The Trustee Act requires the objective consideration of the points mentioned above, and the technical guidance **Investment of Charitable Funds** on our website provides further information. The trustees of charitable companies have similar obligations, even though the Act does not apply to them expressly. All trustees must also take into account any relevant provisions in their charity's governing document.

17. Trustees of all charities with permanent endowment have a duty to be even-handed between the interests of present and future beneficiaries of the charity. In practice this means that they must consider whether an investment provides a suitable balance between providing income for current needs and preserving or increasing the value of the investments so that the charity can operate effectively in future.

18. Some other duties of trustees with respect to investments are as follows:

- Charity trustees need to manage the risks their charity faces, balance those risks against the potential returns from particular investments, and be careful to avoid undue risk to their charity's funds (see our more general guidance on **Charities and Risk Management** on our website). Three ways in which we recommend trustees can do this are:
 - to invest in markets where financial services are closely regulated, and compensation schemes are in place;
 - to have a suitably diversified investment portfolio; and
 - to be particularly wary of making speculative forms of investment.
- A charity's annual report must include a description of the policies used by the trustees to select the charity's investments. Larger charities must, as part of their compliance with accounting requirements, also report on the performance of their investments. For more details see our guidance **Reporting the Activities and Achievements of Charities in Trustees' Annual Reports (CC59)**.

19. Trustees are not liable to make good the charity's loss simply because an investment made by them is unsuccessful. However, trustees may be liable if, in making or retaining the unsuccessful investment, they have acted outside the scope of their powers, or have failed to discharge the duties referred to above.

Holding investments for a charity

20. Charities which are corporate bodies (of which the most common are charitable companies) have a legal identity and **can** hold investments in their own name.

21. Unincorporated charities, such as trusts and associations, do not, however, have their own legal identity, and therefore the charity trustees will have to hold the investments in their own names. It will usually be more convenient for them to appoint one or more individuals or a corporate body to hold the investments on behalf of the charity. A person who does this is a "**nominee**". In practice this term tends to be used where the nominee is a corporate body. Nominees are often called **holding trustees** where they are one or more individuals, who are often selected from among the charity trustees.

22. A **custodian** is someone who, on behalf of the trustees as a whole, looks after the documents or other evidence of the title to the charity's property - for example share and land certificates. Often the two roles of nominee and custodian are combined. A custodian may also provide other investment-related services, such as handling claims for repayments of tax due in respect of investment income.

23. A **custodian trustee** combines the functions of a nominee and custodian, but someone who is both nominee and custodian is not necessarily a custodian trustee. The identity, and powers and duties, of a custodian trustee are prescribed by statute; for further information about custodian trustees please refer to **Operational Guidance OG39**, written primarily for our staff, on our website under Guidance for Charities.

Delegation of investment management

24. The Trustee Act enables charity trustees to appoint, in writing, certain types of person to act as their nominee and the same or a different person to act as their custodian. It is up to the trustees to decide whether to make these appointments, and whether they relate to some or all of the charity's assets, including investments. This statutory power is in addition to any other powers to appoint a nominee or custodian or custodian trustee which the trustees have, either from statute or the charity's governing document.

25. Detailed information about the scope of powers to appoint nominees, custodians and custodian trustees, and the duties associated with the use of those powers, is given in our guidance **Appointing Nominees and Custodians: Guidance under s.19(4) of the Trustee Act 2000 (CC42)**. This is available in hard copy or on the Publications section of our website.

26. Many charity trustees will consider it best to place the management of the charity's investments in the hands of a specialist. There are two main ways of doing this:

- investing in one or more collective investment schemes, such as unit trusts, open-ended investment companies or common investment funds for charities; or
- delegating their investment decisions by appointing an investment manager.

27. For smaller charities the first option may well be a cost-effective way of achieving a professionally managed and balanced portfolio. But trustees must still fulfill the investment duties described in paragraphs 15-19 above and satisfy themselves of the suitability of any collective scheme as an investment vehicle for their charity.

28. Larger charities with significant funds may consider appointing an investment manager, which is unlikely to be cost-effective for smaller charities. This involves the trustees in a number of extra duties in appointing an investment manager, providing them with direction as to the charity's investment policies, and reviewing their performance. Detailed information on delegation to an investment manager is given in **Investment of Charitable Funds** on our website, and we strongly recommend that trustees thinking of entering into such an agreement read that guidance before doing so.

29. The advantage of using an investment manager is, of course, that the manager can pursue an investment strategy which is tailor-made to the needs of the particular charity. But this advantage comes at a cost, both in terms of fees charged for the service, and in terms of the trustees having to discharge the extra responsibilities referred to above in their relationship with the investment manager.

Investment policy

30. We strongly recommend that charity trustees decide on an investment policy for their charity, record it clearly in writing, and keep it under regular review - if they have delegated their investment function to an investment manager these are legal requirements. Without an investment policy, trustees are likely to find it difficult to demonstrate that they are making good use of the charity's funds.

Ethical investment

31. Any investment policy should, for example, address the following considerations:

- the need for enough resources for the charity to carry out its present and future activities effectively;
- the level of acceptable risk and how to manage it (see paragraph 18); and
- the charity's stance on ethical investment, if any (see below).

32. The question of basing an investment policy on ethical considerations can be an important one for charities. The legal basis on which charities may pursue an ethical investment policy is set out in the detailed guidance **Investment of Charitable Funds** on our website, but the essentials are dealt with briefly here.

33. If trustees are to adopt an ethical investment policy, or follow one laid down in the charity's governing document, they need to keep in mind their duty to invest in a way that furthers the purpose of the charity. This will normally be achieved by seeking the maximum return from a set of investments which have been selected prudently. An ethical investment policy can be entirely consistent with this duty, but there can also be a risk that the exclusion from consideration, or preference, of certain investment classes or particular investments, may detract from the objective of obtaining the best direct financial returns from investment.

34. Trustees may well consider that the adoption of a particular ethical investment policy does not detract from the objective of obtaining the best direct financial return from investment. They must, of course, then be able to justify

their position, through being able to show that they have, in following the policy, fully discharged the investment duties referred to above. Some trustees may, however, wish to adopt an ethical investment policy, even though it does or may detract from the objective of obtaining the best direct financial return. The circumstances in which they may do this are outlined in the following paragraph.

35. Trustees are able to adopt an ethical investment policy which will involve:

- Avoiding investments in a particular business that would for practical reasons conflict with the aims of the charity; for example, a charity with objects for the protection of the environment and wildlife may decide not to invest in businesses which pollute what the charity is trying to protect.
- Avoiding investments that might hamper a charity's work, either by making potential beneficiaries unwilling to be helped because of the source of the charity's money, or by alienating supporters. This requires trustees to strike a balance between the likely cost of lost support, if the charity were to hold the investments, and any risk of financial under-performance if those investments are excluded from its portfolio.

36. There may be some cases where the two previous statements do not apply, but the trustees wish to make investment decisions on moral grounds (this may include using positive or negative criteria, or a combination of both). In these cases, however, the trustees must be particularly clear that their decisions will not place the charity at risk of significant financial

detriment due to under performance by the preferred investments or by the exclusion from consideration of forms of investment to which the trustees are opposed.

37. Trustees are unlikely to be criticised for adopting a particular policy if they have considered the correct issues, taken appropriate advice and reached a rational result.

38. Note that ethical investment is not the same as "social investment". Also known as "programme-related investment" ("PRI"), this is an entirely separate concept, and is not investment in the financial sense, as its primary aim is to carry out the objects of a charity. For more details please see the separate guidance on **Charities and Social Investment** on our website.

Tax implications

39. Most investments are treated as "qualifying investments" by the Inland Revenue. However, the making of certain types of investment (mostly in categories which we would consider unsuitable for the majority of charities) may be treated as "non-qualifying investments". This can lead to a restriction of the charity's tax reliefs. Trustees making such investments will need to be able to satisfy the Inland Revenue that the investments are made for the financial benefit of the charity and not for the avoidance of tax, whether by the charity or by any other person.

40. Guidance on the tax implications of investment by charities can be found on the Inland Revenue website (http://www.inlandrevenue.gov.uk/charities/annex_iii.htm).