What to include in an investment policy statement

This document provides charities in England and Wales with some guidelines on what to include in an investment policy statement. It draws heavily, but not exclusively, on the Charity Commission's investment policy framework. This publication is also known as *Charities and investment matters: a guide for trustees (CC14)*, and is similar to OSCR's framework for Scottish charities.

An investment policy statement sets out a charity's investment objectives and how it intends to achieve them, which in turn enables the trustees to demonstrate they have complied with their duties. It also provides investment managers with a framework to make informed investment decisions within the charity's parameters.

The investment policy statement must be owned by the trustees rather than an investment manager. However, many trustees find it useful to prepare the statement in consultation with their investment manager, which can help to ensure it is both realistic and workable.

The level of detail that is relevant for your investment policy statement depends on a variety of factors. Some charities only hold cash on deposit, which means a simple and short document is usually sufficient. Those with more complex investment requirements need to include more comprehensive information.

A good place to start is by writing the heading, which would typically include your charity's name, registration number and the date of the policy. Most statements then comprise the following sections.

1. Introduction

Introduce your charity and set out the background to the investment policy to provide context for the rest of the document. This section should include information like:

- the overall value of your organisation's assets (including any property) and the amount available for investment
- the role the investments play within your charity's business model
- the governance arrangements – for example, do you have an investment committee?

2. Investment objectives

When defining your charity's investment objectives, consider your overall financial position and your short- and long-term financial commitments. Include other policies as part of this exercise, particularly those relating to financial risk and reserves. You may wish to include details about:

- overall return expectations
- preference between capital growth and income
- future spending commitments the portfolio will fund
- any 'restricted' funds where a donor has imposed restrictions on when you can use them.

3. Time horizon

The time horizon will influence the amount of risk your investment strategy can take in order to meet its objectives. Typically, a longer-term approach provides the flexibility to take more risk because it allows time for a portfolio to recover from any short-term periods of weak investment performance. Time horizon can be framed as short term, medium term or long term. You may even decide to split your assets into a number of 'pots' to reflect different periods of time.

When stating short, medium or long term it might help to include the number of years as a guide.

For example:

Short term	Medium term	Long term
Up to 1 year	1 to 5 years	More than 5 years

4. Attitude to risk and capacity for capital loss

Setting your charity's attitude to risk can be challenging because there are many types of risk to take into account. We have listed five of the key risks below along with questions trustees should consider:

Capital risk. Your portfolio could fall in value. This risk is greatest for a portfolio with a short time horizon because if it suffers a substantial fall in value, there may not be enough time to recoup the losses. It is less of an issue for charities that have a longer time horizon, which should be able to tolerate a higher level of volatility in the expectation of achieving a higher return.

- Is there a limit to the fall in value of your portfolio that your charity is willing to tolerate?
- Are spending expectations tied to the portfolio within the discretion of your charity or an absolute commitment? If the former, then you may be able to accept more capital risk and have a greater capacity for loss, meaning the portfolio could be invested in assets that have the potential to deliver a higher level of growth.

Inflation risk. Your portfolio might not grow at a pace that keeps up with inflation (which erodes the spending power of money). Inflation is a big risk for a portfolio that is invested for the long term.

- Is inflation a risk for your charity's portfolio?

Liquidity risk. You may not be able to sell an investment when you want to. For example, it is quick and easy to sell most shares and government bonds. However, some other types of investments, such as some corporate bonds and alternative funds, could be difficult to sell under certain market conditions.

- Do you want to set restrictions on the amount of less liquid assets that your portfolio can hold?

Currency risk. An asset denominated in a foreign currency could fall in value against the pound.

- What is the base currency of your portfolio? The answer is likely to be the same as the currency in which most of your charity's commitments lie.

Regulatory and governance risk. Some investments are unregulated or based in countries that are subject to looser regulations than in the UK.

- How does your charity feel about a lack of regulatory control and protection in relation to any investments it might make?

Your answers to these questions will help determine your charity's risk appetite and guide your investment manager to an appropriate investment strategy.

5. Liquidity requirements

Your policy should include information about any:

- ongoing spending requirements and whether you want to fund them from investment income and/or capital if necessary
- significant capital requirements and likely timings
- restrictions on the proportion of the portfolio that may be held in less liquid assets (to cater for the above and for unexpected events).

6. Ethical policy

An ethical investment policy can help align your charity's investments with your objectives. Trustees should put their own personal views about what may be ethical to one side when they consider this subject.

Ethical investing could be negative screening, which involves avoiding certain companies and sectors, such as tobacco. Alternatively it could be positive screening, such as investing in companies that demonstrate high standards of governance and contribute to creating a more socially and environmentally sustainable world. Or it could involve stakeholder engagement, where the charity exercises its voting rights that come with the company shares it owns. A charity's ethical policy may include one or more of these approaches.

Charity trustees have a duty to seek "the maximum financial return consistent with commercial prudence". However, the 1992 Bishop of Oxford case highlighted three situations where trustees may allow their investment strategy to be governed by considerations other than the level of investment return.

First, if a particular investment would conflict with the aims of the charity. For example, an organisation involved in protecting the environment may decide not to invest in companies that have poor environmental records.

Second, if the charity might lose supporters or beneficiaries if it did not invest ethically. An organisation can avoid investments that might hamper its work, either because potential beneficiaries would be unwilling to be helped due to the source of the charity's money or (more likely in practice) by alienating potential donors. For example, donors to a cancer research charity might be less willing to give if the charity invests in companies that manufacture cigarettes. The trustees must balance the likely cost of lost support (for example, the loss of potential donations) against the risk of financial underperformance if its investment policy excludes tobacco companies from its portfolio.

Third, if there would be no risk of significant financial detriment. Trustees may be able to conclude, after taking advice if necessary, that a particular ethical policy is likely to perform just as well as an unrestricted policy. If a charity's ethical policy is to invest in a positive manner in companies that demonstrate high standards of corporate social responsibility and governance, then this may be relatively easily satisfied. This is because there is an increasingly held view that such companies are likely to deliver the best long-term balance between risk and return.

This section of the investment policy statement should include:

- your charity's ethical approach (negative screening, positive screening, stakeholder engagement or a combination)
- whether the policy relates to both direct and indirect (via a pooled fund) investments
- tolerances around ethical investments. For example, your charity will not invest in companies that generate more than 10% of revenues from alcohol or tobacco.

7. Eligible asset classes

This section should state which asset class you can invest in and might also include any maximum and minimum ranges for each asset class.

8. Performance benchmarks

Trustees should set a performance benchmark that will help them assess their investment manager. There are various measures, and the one that is appropriate for your charity will depend on your investment strategy. Some of the most commonly used benchmarks include:

— **Cash/inflation plus**. For example, the Retail Price Index +3% a year.

— **Composite market index**. The expected long-term average asset allocation of the portfolio is taken as the neutral position. Appropriate market indices are then applied to each asset class held in the portfolio according to their neutral percentage allocations. This might include the FTSE All Share for UK equities, FTSE World Equity (ex UK) for overseas equities and FT Government All Stocks for UK bonds. Adding these numbers together gives a composite market index against which the performance of the whole portfolio may be measured.

— **Peer group**. There are a number of charity peer group benchmarks, such as those provided by ARC and Teknometry. The trustees should select the one that is most closely aligned to their charity's objectives.

It's important to ensure any benchmarks you select are appropriate for your investment strategy, and that they are not very easy or difficult to beat.

9. Restrictions

Specify any constraints you wish to impose, such as:

— excluding investments in non-investment grade bonds

— cash balances only being deposited with institutions that have a minimum credit rating of A

— limiting the proportion of the portfolio that can be invested in non-sterling assets

— excluding investments in derivatives other than for hedging purposes

— limiting a single direct equity investment to no more than 5% of the portfolio

— excluding investments that cannot be sold within three months.

10. Management, reporting and monitoring

Set out how you would like your investment manager(s) to communicate with you. Typically, this section covers:

— frequency of reports (quarterly is standard)

— the information you require in the reports

— frequency of face-to-face meetings with your investment manager (usually once or twice a year)

— details of the authorised signatories and who can make decisions

— whether your charity has an investment committee.

11. Approving and reviewing

To end the document, it is a good idea to include:

— the date your charity approved the investment policy

— when you will review it (once a year is typical unless there is a material change in your charity).

For more information, please visit **rathbones.com/charities** or email **charities@rathbones.com**