Understanding investing: CC14 and how to develop an investment policy

A guide for charities

Rathbones
Look forward

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance.

Understanding investing: CC14 and how to develop an investment policy

A guide for charities

Contents

A brief overview of financial investments, a charity trustee's investment management duties and the investment policy statement.

Although many charities choose to outsource the task of investing to a professional investment manager, the relationship between a charity and its investment manager tends to work best when the trustees have a good understanding of what's involved.

To help trustees better understand the intricacies of investing, the Charity Commission offers guidance in the form of *Charities and investment matters: a guide for trustees*, commonly known as CC14.

In this guide we consider some of the key aspects of CC14, including trustees' duties in relation to financial investments and how to develop an investment policy and statement.

Defining financial investments

The purpose of a financial investment is to achieve ‘the best financial return within the level of risk considered by the charity to be appropriate’.

The law permits trustees to make financial investments in any assets specifically intended to produce a financial return and CC14 lists the following assets as examples:

- cash deposits
- corporate or government-issued bonds
- shares in companies
- hedge funds
- commodities, such as gold and silver
- derivatives, such as futures and options
- common investment funds or other types of collective investment schemes, such as pooled funds, unit trusts, Open Ended Investment Companies (OEICs) and investment trusts.

Certain other assets – including coins, stamps, timber, art, wine, vintage cars, books and antiques – are not listed in CC14 as these are typically not regulated by the Financial Conduct Authority (FCA) and can therefore potentially expose trustees and charities to additional risk. While charities may still choose to invest in these assets, it is particularly important to seek advice from an appropriate professional.

Understanding a trustee's duties relating to financial investments

Trustees have to comply with certain legal requirements and duties when investing their charity's assets for a financial return.

As outlined in CC14, trustees are required to:

Know, and act within, their charity's powers to invest:
All charities can make financial investments, but a charity's governing document may restrict certain types of investment.

Exercise care and skill when making investment decisions:
Trustees should use their skills and knowledge in a way that is reasonable under the circumstances. Although trustees aren't expected to have specialist investment knowledge, charities often find it helpful to have at least one trustee who does have this expertise.

Take advice from someone experienced in investment matters unless there is good reason not to:
Most charities delegate to an appropriately authorised and regulated investment manager.

Consider the suitability of any investment, as well as the need to diversify the many different types of risk that exist:
Trustees should aim to invest in a range of asset classes and investments to help reduce the risks of investing.

Decide on an appropriate investment policy:
Charities should have a written investment policy statement that is 'owned' by the trustees.

Follow certain legal requirements when using an investment manager:
If a charity's trustees choose to appoint an investment manager, they must satisfy themselves that the manager has the necessary expertise to meet the charity's investment objectives.

Review investments (and the investment manager) regularly:
Trustees should review the performance of their charity's investment portfolio every 3, 6 or 12 months. It's also important to review other investment managers every five years or so to ensure that the charity's investment manager remains suitable. In addition, it may be necessary to conduct a full review if a charity's circumstances change materially or if its investment objectives change.

It's important to note that even if trustees delegate the charity's day-to-day investment management responsibilities to an investment manager, they remain responsible for:

- deciding on their charity's investment policy statement and reviewing it on a regular basis
- deciding to whom and on what terms to delegate the management of their charity's investments
- reviewing the suitability of their investment manager.

Some charities may choose to establish an investment committee to which investment matters are delegated. If they do, they are required to document the committee's precise remit.

CC14 makes it clear that if trustees have considered the relevant issues relating to their investment duties, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised. Trustees should always record their key investment decisions and rationale in writing for evidential purposes.

Setting a charity's investment objectives

Once trustees understand what constitutes a financial investment and what their duties are in relation to these investments, they can start thinking about putting the theory into practice – firstly by setting the charity's investment objectives.

Trustees should be clear about what the charity is trying to achieve by investing its funds. This will be unique for each charity and will depend on the charity's aims, operating model, timescales and resources.

For example, trustees should consider what the charity's resources are and how they may change both in terms of income and expenditure, and whether any of the charity's investments are 'restricted funds' that can only be used for a specific purpose.

The trustees need to be satisfied that the charity has sufficient cash available to meet any needs that could arise, whilst also looking to maximise the returns on the 'pots' that will ultimately fund those future needs.

This review will help the charity's trustees to identify 'pots' of funds that:

- need to be available on an 'instant access' basis (i.e. for use within the next 12 months)
- are available for medium-term investment (i.e. one to five years)
- can be tied up for longer periods of time (i.e. five years or more).

Of course, these types of planning scenarios can lead to a number of valid solutions for any given situation. What matters is that trustees consider the issues pertinent to the charity and come up with a financial plan that may be shown to be reasonable given the circumstances.

Developing an investment policy statement

Once a charity has agreed its investment objectives, they need to be documented in a way that allows those within a charity (and its investment managers) to have a shared understanding of the charity's financial situation and aims. The objectives are most often documented in a written investment policy statement.

Investment policy statements do not need to be long or complex and they should only contain the information that is relevant to the charity's situation. The level of detail included in the statement will vary from charity to charity: for example, some charities will only hold cash on deposit for which a simple and short policy will normally suffice, while others will have more complex investment requirements that demand a more detailed statement.

Although the investment policy statement can be prepared in consultation with an investment manager, which can help ensure it is realistic and workable, the law stipulates that charities can't delegate this responsibility. The statement needs to be written, maintained and 'owned' by the trustees, ensuring it is in line with the charity's aims.

Most investment policy statements include the following sections and content.

Introduction

This section is used to introduce the charity and set out the background to the investment policy. It usually covers factors such as the value of the charity's assets, the amount available for investment, the role that the investments play within the charity's business model, the powers the charity has to make investments and the governance arrangements relating to the investments.

Investment objectives and time horizon for each 'pot'

This should include an indication of the total return the trustees expect and the time frame over which this anticipated return should be achieved, along with any ongoing withdrawal requirements. The time horizon will influence the amount of risk that a charity can afford to take to meet its objectives, with a longer time horizon usually affording more risk (and vice versa).

Attitude to risk and capacity for capital loss for each 'pot'

This section should cover the charity's and its trustees' attitude to and appetite for risk, as well as the charity's capacity for loss, considering how the charity would be impacted by a decrease in the value of its investments.

Eligible asset classes

Trustees should list the asset classes they are prepared to invest in. This could include any maximum and minimum asset allocation ranges for each asset class, which will most likely be agreed in partnership with the charity's investment manager.

Investment restrictions
There may be certain assets a charity and its trustees do not wish to invest in, or they may want to impose certain investment limits or constraints, which would be incorporated in this section.

Ethical policy
An ethical investment policy can help align a charity's investments with its aims and objectives. For example, a charity may want to avoid investments in certain sectors or companies (known as negative screening), or only invest in companies that demonstrate good governance or that are contributing to a more socially and environmentally sustainable world (known as positive screening).

Trustees should put their personal views to one side and think about ethical investing from the charity's perspective.

While trustees have a basic duty to seek 'the best financial return' for the charity, the Bishop of Oxford case (1992) set out three situations in which trustees can allow the investment strategy to be influenced by ethical considerations:

- if a particular investment would conflict with the aims of the charity
- if the charity might lose beneficiaries or donors if it did not invest ethically
- if there would be little risk of significant financial detriment.

Performance benchmark(s)

Trustees should set a comparator (or comparators) in the investment policy that will help them ascertain whether the charity's investment manager is managing the portfolio well. There are different types of benchmark available, and trustees must take care to ensure that any benchmark chosen makes sense in view of the investment strategy being pursued.

The most commonly used benchmarks for charities include a cash/inflation-plus comparator, a composite market index and peer group benchmarks.

Management, reporting and monitoring

The management, reporting and monitoring section of the statement should cover how the investments are managed (i.e. execution-only, advisory or discretionary), how the investments are reported on by the investment manager and monitored by the trustees and a list of authorised signatories who can give instructions to the investment manager.

Approval and review

This should cover when the investment policy statement was approved and when it will next be reviewed. Reviews of the policy should be reasonably regular – at least once a year, or more often if there is a material change in circumstances.

The fundamentals of investing

This guide accompanies one of our charity investment training webinar series: CC14 and how to develop an investment policy. You can watch the full webinar by following this link.

Our training webinar series is designed to provide trustees and senior finance staff with an understanding of the fundamentals of charity investment.

Please visit:
rathbones.com/charities to find out more about the training series or to read our other guides.

To find out more about Rathbones' approach to developing an investment policy and statement, please contact:

Natalie Yapp
natalie.yapp@rathbones.com

Important information

This document is published by Rathbone Investment Management Limited and does not constitute a solicitation, nor a personal recommendation for the purchase or sale of any investment; investments or investment services referred to may not be suitable for all investors.

No consideration has been given to the particular investment objectives, financial situations or particular needs of any recipient and you should take appropriate professional advice before acting.

Rathbone Investment Management Limited will not, by virtue of distribution of this document, be responsible to any other person for providing the protections afforded to customers or for advising on any investment.

Unless otherwise stated, the information in this document was valid as at March 2021.

Rathbones is the trading name of Rathbone Investment Management Limited, which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919.

The company named above is a wholly owned subsidiary of Rathbone Brothers Plc. Head office: 8 Finsbury Circus, London EC2M 7AZ. Registered in England No. 01000403. Tel +44 (0)20 7399 0000.

T3-ChGuide1-02-21

Rathbones
Look forward

rathbones.com
@Rathbones1742
Rathbone Brothers Plc