



CHARITY COMMISSION  
FOR ENGLAND AND WALES

GUIDANCE

# Charities and investment matters: a guide for trustees (CC14)

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# 1. Introduction

## 1.1 What is this guidance about?

This guidance is about how to make decisions about investing charity funds.

All charities are able to invest, and investments can be a major source of funding for them. However, investing also exposes charities to risks which, if not properly managed, can affect not just the charity itself but the public's trust and confidence in the sector more generally. Because of this, it's important that charities manage these risks and operate within the law.

As the regulator of charities in England and Wales, the Charity Commission has produced this guidance to support charities and their trustees in confidently making decisions about investments that comply with their duties.

## 1.2 Why do charities invest?

On one level, the answer is quite simple - they invest in order to achieve a return so they can further their charity's aims. Usually, this means the best financial return within the level of risk considered to be acceptable - in this guidance the commission refers to this as 'financial investment'.

However, charities are increasingly interested in how they can invest to directly further their aims as well as achieve a financial return - in this guidance the commission refers to this as 'programme related investment'.

Where the investment does not fit wholly within either of these categories, charities can make 'mixed motive investments' if their trustees decide that this is in the charity's best interests.

These are all valid investment approaches for charities, although different considerations and legal duties apply.

## 1.3 What does this guidance cover?

This guidance sets out the legal and good practice framework for the investment of charity funds. It covers:

- financial investment - investing to produce the best financial return within the level of risk considered by the charity to be acceptable
- the key steps in making financial investments
- programme related investment - using assets to directly further the charity's aims while potentially also generating a financial return
- the key steps in making a programme related investment
- mixed motive investments - investing to both further a charity's aims and generate a financial return

## 1.4 Who is this guidance for?

Trustees and those who make decisions on behalf of trustees about a charity's investments and assets should use this guidance as a tool to help them make confident, informed decisions and publicly to report on those decisions.

The duties set out in this guidance are based on the law relating to Trust Law, but directors of charitable companies (who are charity trustees) are likely to have similar duties when investing their charity's assets.

Section 2 'Executive summary' provides a brief overview of the investment of charitable funds and the legal requirements and good practice recommendations that apply.

Charities that only invest cash, perhaps those that receive all their income through grants, are likely to find section 2 and section 9 'Cash deposits' to be of help. The other sections in this guidance provide detail for charities that are interested in a wider range of investments.

## 1.5 'Must' and 'should' what the commission means

The word 'must' is used where there is a specific legal or regulatory requirement that you must comply with. 'Should' is used for minimum good practice guidance you should follow unless there's a good reason not to.

The commission also offers less formal advice and recommendations that trustees may find helpful.

## 1.6 What is the status of this guidance?

Trustees are responsible for making decisions about their charity's investments. The commission has written this guidance to support trustees in making these decisions so that they can comply with their duties. While it cannot provide specific investment or legal advice, trustees who follow this guidance should be able to support the decisions they have taken.

The guidance is complemented by **Legal underpinning: charities and investment matters**, which explains in more detail the law and case law on investment matters for charities.

## 1.7 How has the guidance changed?

This guidance replaces the commission's previous publications Investment of Charitable Funds: basic principles (CC14) (February 2004), Investment of Charitable Funds: Detailed guidance (February 2003) and Charities and Social Investment (2003). It is a complete rewrite in a new format.

## 2. Executive summary

Charities invest so that they can further their charitable aims.

They can invest in a number of ways to achieve their aims, and there are specific legal duties and decision making processes attached to each.

If trustees have considered the relevant issues, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised for their decisions or adopting a particular investment policy.

In this guidance the commission has concentrated on financial investment and programme related investment. It has also included some guidance on mixed motive investment (section 11). This is another approach to investing and is an emerging area of interest for some charities.

### Financial investment

The purpose of financial investment is to yield the best financial return within the level of risk considered to be acceptable - this return can then be spent on the charity's aims.

In order to act within the law, trustees must:

- know, and act within, their charity's powers to invest (legal requirement)
- exercise care and skill when making investment decisions (legal requirement)
- select investments that are right for their charity; this means taking account of:
  - how suitable any investment is for the charity
  - the need to diversify investments (legal requirement)
- take advice from someone experienced in investment matters unless they have good reason for not doing so (legal requirement)
- follow certain legal requirements if they are going to use someone to manage investments on their behalf (legal requirement)
- review investments from time to time (legal requirement)
- explain their investment policy (if they have one) in the trustees' annual report (legal requirement)

The commission also recommends that trustees should:

- decide on the overall investment policy and objectives for the charity
- agree the balance between risk and return that is right for their charity; this may include a wide range of factors that will impact on return including environmental, social and governance factors
- have regard to other factors that will influence the level of return, such as the environmental and social impact of the companies invested in and the quality of their governance
- be aware that some investments may have tax implications for the charity
- invest any permanently endowed funds in a way that helps them to meet their short and long-term aims
- decide whether to adopt an ethical, socially responsible or mission related approach to investment and ensure that it can be justified

## An example of financial investments

A medium sized local arts charity receives its income mainly from grants and ticket sales. Surplus funds not needed in the short or medium term are invested in a common investment fund designed for longer term investment, while grants received in advance are invested on the money market. The charity also owns a block of garages which it rents out at the market rate. Some or all of the return on these investments is spent each year on the charity's beneficiaries.

## Programme related investment (PRI)

**The Charities (Protection and Social Investment) Act 2016 has introduced a statutory power for charities to make social investments. This is the commission's interim guidance on the considerations for trustees when making social investment decisions. It will be reviewed in 2017.**

**Other than the addition of this annex and the removal of the definition of social investment from Annex 1, the substance of this guidance has not been changed. The existence of the power and its practical application for charities will be one of the issues the commission will consider as part of a future review of its investment guidance.**

The aim of a PRI is to use a charity's assets directly to further its aims in a way that may also produce some financial return for the charity. PRI is different from financial investment in that the justification for making a PRI is to further the charity's aims: this means that charities are not bound by the principles or law for investment (see section 10).

In order to fulfil their duties and act within the law, trustees:

- must be able to show that the PRI is wholly in furtherance of the charity's aims (legal requirement)
- should make sure that any benefit to private individuals is necessary, reasonable and in the interests of the charity
- should consider reasonable and practical ways to exit from a PRI if it is no longer furthering the charity's aims

## An example of PRI

A charity that works to help and advise the unemployed usually makes grants to charities and other organisations that help unemployed people back into work. However, it has decided in certain cases to make loans instead of grants. It expects that loans will be repaid, potentially with some interest, enabling the charity to spread the work it does among more beneficiaries.

## Mixed motive investment

**The Charities (Protection and Social Investment) Act 2016 has introduced a statutory power for charities to make social investments. This is the commission's interim guidance on the considerations for trustees when making social investment decisions. It will be reviewed in 2017.**

**Other than the addition of this annex and the removal of the definition of social investment from Annex 1, the substance of this guidance has not been changed. The existence of the power and its practical application for charities will be one of the issues the commission will consider as part of a future review of its investment guidance.**

Where an investment cannot be wholly justified as either a financial investment or a PRI, it may be possible to justify it as a mixed motive investment. Considerations for trustees should include:

- the justification for making the mixed motive investment that will need to be established before making the investment
- the suitability of a mixed motive investment for the charity
- whether there is a need to take professional advice before making the investment
- whether any private benefit arising from the investment will be acceptable

## 3. The legal framework for financial investment

Trustees have to comply with certain legal requirements and duties when investing their charity's assets for a financial return. This section explains what they are and how charities can work within them, and also sets out some matters of good practice.

### 3.1 Can all charities make financial investments?

#### The short answer (legal requirement)

Yes. All charities can make financial investments. A charity's specific powers of investment may depend on its constitutional form (for example, whether a charity is unincorporated or a company). In addition, a charity's governing document may place some conditions or limitations on the use of any power of investment.

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#### In more detail

Most unincorporated charities have a 'general power of investment'. This allows trustees to invest the charity's funds in any asset that is specifically intended to maintain and increase its value and/or produce a financial return. When using this power, trustees must comply with the duties described in section 3.2.

The governing document may set out additional provisions, restrictions or exclusions on the types of investments a charity can make; these may take priority over, or affect, the general power of investment.

For more information about investment powers, restrictions and exclusions, see **Legal underpinning: charities and investment matters (part 1)**.

The investment powers available to trustees of 'charitable companies' are normally set out in its articles of association and are usually similar to the general power of investment referred to above. Where a charitable company acts as a trustee of an unincorporated charity, the 'general power of investment' applies.

### 3.2 What is the trustees' role when making financial investment decisions?

#### The short answer (legal requirement)

Trustees have overall responsibility for the investment of a charity's funds. This means that they have a crucial role to play in making strategic decisions about how to use a charity's assets to achieve its aims. However, trustees may choose to delegate day to day decisions about investments to a third party.

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#### In more detail

Trustees must:

- use their skills and knowledge in a way that is reasonable in the circumstances ('the duty of care'); for example, a trustee with investment experience should draw on his or her skills and knowledge of investments when making decisions
- consider how suitable any investment is for their charity; trustees must be satisfied that:
  - an investment type or class is appropriate for the charity (for example, shares)
  - the investment within that type or class is appropriate for the charity (for example, shares in a specific bank)

- consider the need to diversify investments (for example, owning shares in a number of different companies)
- take advice from someone experienced in investment matters where they consider they need it
- review investments (and their investment manager) from time to time, changing them if necessary

If trustees can demonstrate that they have considered the relevant issues, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised for their decisions, or for adopting a particular policy.

These legal requirements do not apply to trustees of ‘charitable companies’. However, they should adopt these principles as good practice when making investment decisions.

For more information about trustee’s duties, see **Legal underpinning: charities and investment matters (part 1, section 3)**.

### 3.3 Can a charity decide to make ethical investments?

#### The short answer

Yes. Trustees of any charity can decide to invest ethically, even if the investment might provide a lower rate of return than an alternative investment. Ethical investment means investing in a way that reflects a charity’s values and ethos and does not run counter to its aims. However, a charity’s trustees must be able to justify why it is in the charity’s best interests to invest in this way. The law permits the following reasons:

- a particular investment conflicts with the aims of the charity
- the charity might lose supporters or beneficiaries if it does not invest ethically
- there is no significant financial detriment

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#### In more detail

Trustees must ensure that any decision that they take about adopting an ethical investment approach can be justified within the criteria above. They must be clear about the reasons why certain companies or sectors are excluded or included. Trustees should also evaluate the effect of any proposed policy on potential investment returns and balance any risk of lower returns against the risk of alienating support or damage to reputation. This cannot be an exact calculation but trustees will have to assess the risk to their charity.

An ethical investment approach may involve one or a combination of the following approaches:

- negative screening: this means avoiding investment in companies or sectors or companies undertaking a particular activity or operating in a way which may be harmful to the charity’s interests
- positive screening: this means investing all or part of an investment portfolio in companies or sectors which reflect a charity’s values in areas like environmental protection, health, employment or human rights, or in a wider range of companies that demonstrate good corporate social responsibility and governance; for example, positive screening might involve only investing in companies that have targets/proven records for reducing their carbon footprint
- stakeholder activism: this is where a charity, as a shareholder, exercises its voting rights in order to influence a company’s policies in a way that reflects its values and ethos; this could mean that a charity might invest in companies whose environmental policies it does not approve of in order to encourage more responsible business practices within those companies - it is also possible to engage in stakeholder activism as a programme related or mixed motive investment (see section 8)

## Examples of ethical investment strategies

(1) An environmental charity with aims to protect wildlife and the environment decides to adopt an ethical investment policy. It decides to avoid investing in companies that have a poor environmental record (for example, recent cautions or convictions for pollution offences).

(This approach would be referred to as negative screening)

(2) A charity established with the aim of educating the public in the causes and prevention of heart disease decides to adopt an ethical approach to the investment of its funds by choosing to invest in companies that promote healthy living through their products and services. This might include running gyms, production of sports equipment or the production of healthy food products.

(This approach would be referred to as positive screening)

For more information on ethical investment, see **Legal Underpinning: charities and investment matters (part 1, section 4)**.

## 4. Setting a charity's investment objectives

Trustees should be clear about exactly what the charity is trying to achieve by investing its funds. This will be different for each charity and will depend on its aims, operating model, timescales and resources. For example, the investment objective may be to maximise income, preserve capital or ensure stability of income.

### 4.1 How should a charity set its investment objectives?

#### The short answer

In simple terms, a charity needs to be clear about what it wants to do, how it intends to do it and what the timescale for delivery will be. These considerations will govern how it decides what its investment objective will be. If a charity is permanently endowed, it will need to consider balancing capital growth and income return in order for the charity to meet its aims and its beneficiaries' current and future needs.

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#### In more detail

The trustees may find it helpful to review the charity's overall financial position and how they are using the charity's assets to achieve its aims when setting the investment objectives. This will mean considering short and long term financial commitments, as well as the charity's anticipated income.

For example, they may want to consider:

- immediate financial needs - for example, cash required for use in the near future that needs to be sufficient and easily accessible
- future spending commitments - they should be satisfied that there is sufficient cash available to meet these needs
- whether the charity has restricted funds - this means that there are limitations on how the funds can be used
- longer term organisational objectives - for example, projects, initiatives, changes in strategy or other spending that the charity is planning and how they will be resourced
- past patterns of expenditure and anticipated demand for the charity's support as an indication of future trends
- unplanned changes in activity or events that may impact on the charity. This includes the wider economic and financial outlook - for example, the likelihood of inflation or deflation, or changes in interest rates

The trustees should then be able to identify funds that:

- need to be available on instant access
- can be used for short term investment
- they can afford to tie up for longer periods of time
- will be used to react to unplanned events

## 4.2 What risks should a charity consider when making investments?

### The short answer

Risk is part of the investment process and there are a number of risks that trustees should take into account. Before making any investment decisions, trustees should consider what is the appropriate level of risk that they want to, or are able to accept. As part of their duty of care, the trustees must be satisfied that the overall level of risk they are taking is right for their charity and its beneficiaries.

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### In more detail

Setting investment objectives is not about avoiding risk, but about recognising and managing it. If a risk materialises and results in a loss to the charity, the trustees will be better protected if they have properly discharged their duties and identified and considered the management of the risk. A loss might mean a low return on an investment or the loss of some, or all, of the amount invested, but it can also be about loss of reputation, perhaps through investing in an unpopular or discredited company. As with any loss or setback, the trustees should review the circumstances of the loss, their risk appetite and how they identify and manage risk generally. They should also take the opportunity to learn from their experiences in order to benefit the charity in the future.

Funds invested for the short and medium term should be relatively risk free as charities will want to avoid sudden drops in capital values which could reduce their available funding. A drop in capital value for funds invested for the longer term is less critical because such investments can be held until their value has recovered.

Although it might be difficult for trustees to justify an investment policy that involves the charity taking on a high level of overall risk, it may be appropriate to include certain high risk investments within the overall portfolio.

Some of the main risks associated with investment and ways that they can be managed are outlined in the next section. Charities should consider these when deciding what investments are suitable for their charity.

### Capital risk

There are 2 main risks to capital:

- loss of capital: the main risk for charities arising directly from investments is that they could lose capital and/or income as the value of those investments change; all investments involve some degree of risk because their value can go down as well as up - generally speaking risk and return go together - the more risky the investment, the higher the possible return, but also the greater the possibility of losing money
- volatility risk: this is the existence of variability in the price of an asset like a share; some asset types are more volatile than others, which needs to be taken into account when selecting an investment and considering its place in the overall investment portfolio

## Managing capital risks

Capital risk can be mitigated by having a diversified portfolio of assets - if the investment return from one asset class falls, the losses may be offset by better investment returns in a different asset class. A diverse portfolio can help:

- reduce the risk that the loss from a single investment, or type of investment, could significantly harm the charity's viability
- protect the charity's investments from sudden variations in the market by balancing the levels of risk and return in the portfolio
- ensure that the charity's needs for both income and capital growth are met, particularly where permanent endowment is involved

## Liquidity risk

This is about whether a charity will be able to raise the cash to meet its obligations when they fall due or at short notice. Certain types of investment are inherently less liquid than others: for example, land cannot usually be converted into cash as quickly as listed shares. Other types may demonstrate different levels of liquidity at different times; this is particularly so where the market conditions are unpredictable.

## Managing liquidity risk

Some asset classes are more suitable as short-term investments and others are better for the medium or long term. Charities should consider their time frame for investing and the characteristics of different types of investments.

## Market risk

There are different kinds of market risk and these include:

- inflation risk: if the investment does not at least keep pace with inflation, it will fall in value in real terms
- interest rate risk: investments that pay a fixed rate of interest regularly may become unattractive if held for a long period if interest rates available elsewhere rise above that fixed rate
- exchange rate risk: assets based in other countries will generally be valued in different currencies; if the currency falls in value relative to sterling, the investment may be worth less, even if its home currency value has increased
- regulatory and governance risks: some investments are unregulated or based in countries where the regulation is less rigorous - some regulated investments also invest in unregulated funds or assets; these non mainstream funds carry a governance risk - there is a risk of the investment going wrong or falling in value, sometimes significantly, as a result of poor management and lack of regulatory controls

## Managing market risk

Trustees should:

- be aware of likely changes in inflation rates, interest rates and exchange rates
- consider investing only, or investing substantially, in markets where financial services are closely regulated and compensation schemes are in place

For more information on UK compensation schemes, see [Financial Services Compensation Scheme](#)

## Valuation risk

Some investments such as property are not valued independently on a daily basis. The actual value of these investments will depend on the price that can be realised at the time of sale. There is a risk that the estimated valuation until this time may prove inaccurate. If there is a need to realise capital urgently, it may be that a lower price must be accepted to find a buyer quickly.

### Managing valuation risk

Trustees should:

- be aware of valuation risk and of how this risk can be accentuated by other risks
- consider valuation risk together with the overall financial position of the charity; this might mean consideration of, for example, its risk appetite, its liquidity needs and the diversification of its investment portfolio
- understand the valuation risk that can be inherent in certain investments and discuss this with investment managers

## Counterparty risk

This is the risk that a firm with which the charity does investment business (for example, a bank, stockbroker or investment manager) will default on its contractual obligations.

### Managing counterparty risk

Trustees should:

- look at whether the business is regulated
- look at whether there is any compensation scheme to cover all or part of any loss the charity might incur
- ensure as far as possible that investments are held with a reputable firm
- agree performance measures so that all parties know what is expected of them
- establish monitoring and review arrangements to make sure the charity continues to be satisfied with performance
- review contractual agreements periodically to make sure that they continue to be appropriate for the charity's needs

## Tax risks

- Although tax legislation places no restrictions on what a charity can invest in, some investments may be treated as non-qualifying expenditure, with tax consequences. The charity may lose exemption from tax on an amount of income or gains equal to the amount invested.
- If making foreign investments, where there are not equivalent tax reliefs for UK charities in the countries concerned, the investment return may be reduced by foreign taxes.

### Managing tax risk

Trustees should:

- refer to HMRC's guidance. **HMRC Charities: detailed guidance notes. Annex III: Approved charitable investments and loans**
- consider the impact of incurring any tax liability on its investments and take advice where appropriate; it may not always be the case that incurring a tax liability on an investment should mean it is excluded from a portfolio

## Environmental, social and governance (ESG) risk

When considering which companies and organisations to invest in, charities are increasingly taking into account such factors as impact on climate, employment practices, sustainability, human rights, community impact, executive compensation and board accountability. These are all examples of ESG risk areas which can have long term impacts and can affect the value of a company's shares positively or negatively depending on how the risk areas are managed.

## Managing environmental, social and corporate governance risk

Trustees can:

- decide on the importance and extent of ESG criteria in their investment policy
- look at the reputational risk to the charity that might arise from their ESG policy (or lack of one)
- make sure that any investment manager they use is aware of and willing to act in accordance with their ESG policy
- recognise that the extent to which a company manages ESG risk may have an effect on the returns that it can offer and its long term viability
- look at whether a company discloses its ESG risk management processes and how it verifies that disclosure

## 4.3 What should an investment policy cover?

### The short answer

A charity's investment policy should set out in writing what its investment objectives are and how it intends to achieve them.

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### In more detail

A charity's investment policy will usually include the following information:

- the scope of its investment powers (see 3.1)
- the charity's investment objectives (see 4.1)
- the charity's attitude to risk (see 4.2)
- how much is available for investment, timing of returns and the charity's liquidity needs
- the types of investment it wants to make, this might include ethical considerations (see 3.3)
- who can take investment decisions (for example, trustees, an executive, an investment adviser or manager)
- how investments will be managed and benchmarks and targets set by which performance will be judged
- reporting requirements for investment managers

## 5. Deciding what to invest in

This section sets out some of the basic types of financial investment that are available to charities. Once the trustees have established their charity's investment policy, they (or their investment managers), can decide on the type and range of assets that will achieve their investment objectives.

### 5.1 What can a charity invest in?

#### The short answer (legal requirement)

Trustees can make financial investments in any asset that is specifically intended to maintain and increase its value and/or produce a financial return.

Trustees must also be clear about the difference between investment and trading (see 5.2 and **Legal underpinning: charities and investment matters (part 1)**).

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#### In more detail

Trustees can invest in any type of investment while following the principles set out in this guidance. Possible types of investment include:

- interest bearing cash deposits in bank or building society accounts (see section 9)
- shares in a listed company (listed equities)
- interest bearing loans to a company or the government (bonds or gilts)
- buildings or land
- common investment funds and other collective investment schemes (see 5.3)
- non traded equity in private companies
- hedge funds
- commodities
- derivatives

In all cases trustees must consider:

- how suitable any investment is for their charity - this will be influenced by the charity's attitude to risk across its investment portfolio
- the need to have a mix of assets in their portfolios - this can protect the charity's investments from sudden variations in the market and reduce the risk of the loss

Some types of asset, for example derivatives and commodities, are likely to be suitable only as part of a well-diversified investment portfolio because of the higher risk they can represent. Trustees should take professional advice where appropriate in selecting and reviewing these types of investment.

## 5.2 What is the difference between trading and investment?

If trustees purchase an asset with the intention of selling it for a profit after a short amount of time, it is likely to be considered as trading. Being clear about the difference is important because:

- a charity itself can only undertake trading activity when this is directly furthering or supporting its aims
- profits made from trading are not always subject to tax relief

This distinction is particularly important when looking at derivatives, property, commodities and other opportunities which can be regarded either as an investment or as trading, depending on the context in which they are made. Trustees should be able to demonstrate their intention through their decision making.

For more information on:

- trading see **Trustees, trading and tax (CC35)**
- what charities can invest in, see **Legal underpinning: charities and investment matters (part 1)**
- investments primarily intended to further the charity's aims, see section 10

## 5.3 Collective investment schemes (pooled funds) - what are the benefits for charity investors?

### The short answer

This form of investment can help charities diversify their investments and thus reduce their investment risk in a more cost effective way than investing directly in individually selected investments. Such schemes can form part, or all, of their investment portfolio, depending on the charity's investment policy.

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### In more detail

Collective investment schemes are investment vehicles where the assets of individual investors are pooled together with those of other investors to achieve appropriate levels of diversification. They allow charities to reduce investment risk by spreading their investments more widely than would normally be possible if they were to directly invest in the individual assets held by the scheme. Investing directly in particular assets can usually mean higher costs, both in terms of money and administration, to a charity. This means that this type of investment will be particularly attractive to charities with smaller sums to invest.

### An example of a collective investment scheme

A collective investment scheme that many charities use is called a common investment fund (CIF). CIFs are regulated charities in their own right and only charities established in the United Kingdom can invest in them. They give charities of all sizes the ability to invest in a tax efficient way in a range of investments to achieve a professionally managed, diversified and balanced portfolio.

However, diversification through pooled funds does not eliminate all investment risks. Certain funds will be riskier than others, often depending on the extent to which they are diversified amongst different asset classes, different sectors and different countries or regions.

Trustees have to consider the suitability and diversification of the underlying investments in any pooled fund, as well as the suitability of the fund manager. Particular funds will be designed to take into account different investment strategies, for example ethical, short term income or long term growth. This gives charities the opportunity to select one or more to fit with their investment policy.

Each pooled fund will produce documentation which should include such details as:

- its overall aims
- its ethical stance (if any)
- performance reporting details
- the asset mix
- the diversification of assets
- all the costs involved in the administration of the fund

Before investing, trustees should review these documents and regularly review them after investment, to ensure that each selected pooled fund continues to meet the charity's needs.

For more information, see **Common investment funds: a basic guide to their regulation**

## 6. Who can manage and make decisions about investments?

The previous sections focus on what needs to be considered when making decisions about investments. This section is about who can make the decisions and, where it is not the trustees, what the trustees should do to maintain oversight and control.

### 6.1 What arrangements should a charity put in place to make decisions about investments?

#### The short answer

The arrangements for making these decisions will be different for each charity depending on:

- its internal resources and expertise
- the relative importance of its investments in terms of its ability to achieve its aims

Whatever arrangements are put in place, the trustees should be able to demonstrate that they have retained overall control of decision making and have complied with their duties.

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#### In more detail

A charity's trustees have overall responsibility for investment decisions. They might find it helpful to consider the following points:

- although trustees do not need to have specialist investment knowledge themselves, charities that have invested, or want to invest, significant funds will find it helpful to have a trustee with specialist knowledge of investments on its board
- some charities may find it helpful to establish internal investment committees or a sub-committee of trustees and/or officers to advise the trustee board on the more detailed aspects of its investment policy (for example, asset allocation); the trustees should be clear about the remit of any sub-committees, what they can make decisions about, what financial and other limits there are on their decision making and how and how often these decisions are reported to the trustees
- trustees should ensure that details of their investment approach and key decisions are recorded in writing; this will enable them to demonstrate that they have considered the relevant issues, taken advice if appropriate and reached a reasonable decision
- trustees should agree how frequently and at what level they will review their charity's investments

## 6.2 What advice must trustees take?

### The short answer (legal requirement)

Trustees must take and consider advice from someone experienced in investment matters before making investments and when reviewing them, unless they have good reasons for not doing so. They may decide not to take advice if they conclude that it is unnecessary, or inappropriate in the circumstances. They may decide not to take external advice if they have sufficient experience within the charity.

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### In more detail

The law says that an investment adviser must be someone who is reasonably believed by the trustees to be qualified to give it by his or her ability in and practical experience of financial and other matters relating to the proposed investment.

The most usual options for trustees are:

- an investment manager
- an investment adviser (who may be independent or tied)
- a fellow trustee, if one of the trustees has suitable financial experience and ability
- some other individual who meets the criteria set out above

Independent financial advisers (IFAs) must be authorised by the Financial Services Authority to give advice. They are able to sell the products of many different companies. Tied advisers, such as those working for banks and building societies, are only able to offer the products of their own company.

Trustees need to be careful to ensure that they receive impartial advice. If any trustee has a connection that might benefit directly or indirectly from any financial advice provided to the charity, this should be identified and managed as a conflict of interest.

Trustees who give investment advice are responsible for the quality of the advice which they offer. Like any other adviser, they may be liable to the charity if it makes a loss as a result of their poor or negligent advice. The other trustees must also consider any advice from a fellow trustee objectively and act in the best interests of the charity.

## 6.3 Should a charity manage investments itself or use the services of an investment adviser or manager?

### The short answer

The charity's trustees should decide whether it would be more efficient to manage their investments by:

- managing their investments themselves where they (or the charity's staff) have the necessary expertise
  - using an investment manager or a stockbroker to advise them in managing their investments (advisory investment managers)
  - giving investment managers some powers to make decisions about their investments on their behalf (discretionary investment managers)
- 

### In more detail

When deciding the most appropriate approach for their charity, trustees may wish to consider:

- whether they (or the charity's staff, if any) have the specific skills needed to manage investments
- the amount they are able to commit for long or shorter term investment
- the cost of appointing an investment adviser or manager - this includes costs relating to the initial appointment and all ongoing costs

They will also need to consider whether they are using the services of an investment manager in:

- an advisory capacity - the investment manager will have to contact trustees for confirmation before any transactions are undertaken
- a discretionary capacity - they are giving the investment managers powers to make decisions about their investments on their behalf

## 6.4 What should a charity think about before choosing an investment manager?

### The short answer

If a charity decides to use an investment manager, its trustees should:

- satisfy themselves that an investment manager can perform effectively in line with their investment objectives and policy
  - consider how the services offered by a number of different managers meet those needs, and compare them in terms of cost, investment approach and level of service
- 

### In more detail

Most charities that decide to use an investment manager usually go through a formal tendering process and meet with a number of shortlisted firms. This process gives the trustees an opportunity to learn more about the potential investment manager and how they will implement the charity's investment policy

Charities should consider:

- whether the response to the tender meets their needs
- the firm's reputation and track record including short and long term performance, the type and number of portfolios held and the value of assets it manages; trustees should also bear in mind that a good performance history does not necessarily guarantee a good performance in the future
- what experience the investment manager has in charity investments including:
  - knowledge about investing for the charitable sector
  - knowledge of regulations that apply specifically to charities
  - whether the firm has existing charity clients
- the nature of the investment and risk review process such as how the investments will be selected and managed and what the decision making structure is
- a realistic breakdown of all the fees and charges that may apply to a portfolio in the short and long term
- the reporting arrangements - what will be the frequency and content of written and face to face reports? the charity might request and review sample reports in order to assess past performance in this area
- flexibility - the investment manager's ability and willingness to modify their approach to suit the charity
- the investment manager's capacity to handle any ethical requirements; does the investment manager understand the charity's ethical policy and can they respond to the charity's requirements? what other experience do they have in investment approaches such as ethical investment or mission connected strategies for charities?

## 6.5 Can a charity appoint more than one manager?

Yes. Charities can appoint more than one investment manager, for example to manage a diversified portfolio or an individual asset class, or to give access to a niche market. This is often the case when large portfolios are involved as it can help to spread some of the risk associated with the manager and the portfolio performance.

## 6.6 What are the trustees' and the investment manager's responsibilities?

### The short answer (legal requirement)

The trustees have overall responsibility for the investment of a charity's funds.

Where an investment manager manages the charity's investments, there must be:

- a written agreement or contract with any investment manager appointed
- an investment policy for the charity which clarifies the responsibilities and remit of the investment manager; the investment manager must select investments in line with these instructions, unless there is a good reason not to do so

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### In more detail

#### Written agreement

There must be a formal written contract between the charity and the investment manager. It should be reviewed from time to time by the charity (taking advice where appropriate).

The investment management agreement will be different depending on whether the management of the funds will be discretionary or advisory. It may also be a simple application form. The investment management agreement must require the manager to follow an investment policy in line with the charity's investment policy, which may be included in the agreement.

If giving the investment manager discretionary powers, trustees must not enter into an agreement that:

- allows the investment manager to appoint a substitute or select their own successor
- reduces the investment manager's normal duty of care, or places a cap on his liability for breach of contract
- allows the investment manager to act in situations that might give rise to a conflict of interest

unless it is reasonably necessary for them to do so.

#### Investment policy

Trustees who give discretionary powers to an investment manager are legally required to have a written investment policy (Section 4.3) that covers:

- the remit and responsibilities of any investment manager
- the principles that any investment manager must follow when taking any investment decisions on behalf of the charity

It should be clear from the investment policy that the functions delegated to any investment manager will be carried out in the charity's best interests. If investing in pooled funds, the trustees and the investment manager should ensure that they only invest in funds that are within the remit of the charity's investment policy.

Preparing the policy statement cannot be delegated to the investment manager, but trustees can take independent expert advice on its content. Trustees might find it helpful to prepare it in consultation with the proposed investment manager to ensure its terms are workable and achievable.

## Trustees' duty of care

Trustees must follow the duty of care when delegating decision making to an investment manager and preparing their investment policy.

Trustees always remain responsible for:

- setting out and reviewing their charity's investment policy on a regular basis
- deciding whether, to whom, and on what terms to delegate management of a charity's investments
- reviewing the suitability and performance of investment managers regularly
- if necessary, ending appointments

## 6.7 Can trustees be liable for the acts of the investment manager

Legal requirement: a trustee is not liable for any act or default of the investment manager unless he or she has failed to comply with their duty of care when:

- selecting the individual or company
- determining the terms of the charity's agreement with the investment manager
- preparing the policy statement under which the investment manager acts
- carrying out the duties of review

## 6.8 What should a charity consider when looking at an investment manager's charges?

### The short answer (legal requirement)

A charity should:

- be clear about what payments or benefits the manager or other parties receive under the agreement
- be satisfied that these payments or benefits represent good value for money for the charity

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### In more detail

Trustees should request an outline of all the fees that may apply to a portfolio and ensure there are no unexpected fees (for example, fees the investment manager may pay to a third party for research). The most usual types of fees include:

- a management fee
- commission on transactions
- charges relating to pooled funds which are for investment management, and other related fees
- administrative charges
- performance fees (a proportion of the returns on a fund)
- bank interest deductions
- operating fees
- custody fees
- third party fees including those for further research or other outsourced services

Trustees should also consider any tax implications. For example, fees charged by investment managers may be liable for VAT.

If the charity appoints an investment manager by a tendering exercise, the trustees may be able to use this to satisfy themselves that the fees represent good value for money and are in the interests of the charity.

Trustees may, alternatively, want to consider taking independent professional advice about whether the charity is getting the best value for money from the arrangements with its investment manager. This could involve a one-off arrangement at the time of a strategic review or an ongoing relationship with a consultant.

## 6.9 Who can legally hold financial investments for a charity?

Legal requirement: charitable companies have a legal identity and can hold investments in their own name. This simplifies the administration involved in buying and selling investments.

Unincorporated charities do not have a separate legal identity and this means that trustees have to hold investments in their own names on behalf of the charity. This can mean extra administrative costs when buying and selling investments. For this reason, it is often more convenient to appoint a nominee/custodian to hold investments on behalf of the trustee body.

It is up to the trustees to decide whether to appoint a nominee/custodian and whether they will hold some or all of the charity's assets and investments.

For more information, see the guidance on **Appointing nominees and custodians: guidance under s.19 of the Trustee Act 2000**

## 7. Monitoring investments and performance

### 7.1 What must the trustees do to assess the performance of their charity's investments?

#### The short answer (legal requirement)

Trustees must keep their investment portfolio under regular review. Reviews must cover:

- how investments are performing
- the service provided by the investment manager, if used

They should also monitor and review their internal arrangements for managing the charity's investments.

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#### In more detail

The key areas for trustees to consider when monitoring and reviewing the performance of their charity's investment portfolio can be summarised as:

- measuring investment performance
- deciding who should conduct the review
- reviewing the service offered by an investment manager
- the frequency of reviews
- criteria for intervening

#### Measuring investment performance

Trustees should decide on a system of target returns (for example benchmarks) against which they can measure the performance of the charity's financial portfolio over a specified time period. The precise nature of the benchmarks and targets will vary for each charity. Trustees may wish to take expert advice from an independent organisation.

If appointing an investment manager, trustees should agree appropriate benchmarks and targets against which performance can be judged over the time period. This will allow an effective and fair assessment of both the investment manager's overall performance, and also their performance against a particular benchmark. The trustees may also wish to consider and compare the performance of their funds against those belonging to other charities with similar investment objectives.

If funds are underperforming, trustees should seek to understand whether it is for an acceptable reason. Similarly, if funds are performing significantly above average, trustees should ensure that it is not because the charity is exposed to greater risks than it is prepared to accept.

#### Who should conduct the review?

The review of the charity's investment performance can be carried out in conjunction with the investment manager.

On the other hand, the review of the service provided by the investment manager should be carried out independently of the investment manager. If trustees are unable to make a proper assessment without some expert assistance, they can employ someone who is independent of their investment manager to provide that assistance.

## Reviewing the service provided by the investment manager

Trustees must consider:

- whether the terms under which the investment manager is acting are suitable
- how well the manager is performing
- whether the manager continues to be a suitable person to carry out the function
- whether the terms of the appointment remain appropriate
- whether the manager is complying with the policy statement

## The frequency of reviews

Trustees may decide to hold reviews on a regular basis or they may hold one in response to other events, for example:

- if there is evidence of inadequate performance
- if there is a change in the economic outlook
- if the charity's financial circumstances change materially

## Intervening

Trustees should consider whether they need to intervene, for example by giving directions to the investment manager, or revising or terminating their agreement with the investment manager. They should be prepared to intervene if necessary.

## 8. Other questions on financial investments

### 8.1 What must be included in the trustees' annual report?

Legal requirement: where charities are required to present a trustees' annual report and are subject to a statutory audit, they should include within those reports an outline of any policies their trustees have adopted when choosing financial investments.

The report should also contain a statement about the performance of a charity's investments during the year. Where an ethical investment approach has been adopted, this must also be explained.

Charities that are not subject to a statutory audit must still prepare an annual report but do not have to provide such detailed financial information. For example, it is possible that a small charity will not have an investment policy, especially if it relies solely on grant funding for its operations.

For more information, see the guidance **Charity accounting and reporting**

### 8.2 What are the tax implications of financial investments?

#### The short answer (legal requirement)

Charities can benefit from tax exemptions on their investment income/gains when these are used to further their aims.

However, if certain investments are not deemed by HMRC to be 'approved charitable investments', it may lead to a restriction on the charity's tax reliefs.

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#### In more detail

Certain specified investments automatically qualify as 'approved charitable investments'. Those that do not meet the criteria set out in tax law may be treated as 'non-charitable expenditure'.

Further guidance on this can be found on the HMRC website **HMRC charities: detailed guidance notes. Annex III: Approved charitable investments and loans**

Charities considering investments which may be treated as non-charitable expenditure should bear in mind that they will need to be able to satisfy HMRC:

- that the investments are made for the benefit of the charity
- are not for the avoidance of tax, whether by the charity or by any other person

If an investment is treated as non-charitable expenditure the charity may lose exemption from tax on income equal to the amount invested. This may mean that the overall investment return is lower than where the returns are relieved from tax, although this may not always be the case. Trustees should consider what is in the best interests of the charity.

If making foreign investments, charities should be aware that there may not be equivalent tax reliefs for UK charities in the countries concerned, and that the investment return may be reduced by foreign taxes. However, charities should take advice if appropriate, about whether there may be alternative foreign tax reliefs.

## 8.3 What should charities with permanent endowment consider when making financial investments?

Legal requirement: charities that have a permanent endowment must keep the capital fund invested. Only the income earned from the investment of the capital fund can be spent on the charity's aims. Charities with permanent endowment should be aware that some assets may be more likely to provide capital growth over a long time period while others might provide better income returns. This means that it is important when they are putting together a portfolio of investments to balance:

- the need for enough income to meet the charity's current needs
- the need to increase the value of the investment ('capital growth') to produce a sufficient level of income for future beneficiaries

In this way, trustees can aim to ensure that their investment portfolio will enable them to further the charity's aims both now and in the future.

## 8.4 Can a permanently endowed charity adopt a total return approach to investment?

### The short answer (legal requirement)

Yes. The Charities Act 2011 gives trustees the power to adopt this approach by resolution and **The charities (total return) regulations 2013** and the **guidance** set out how trustees can exercise and use the power.

Charities that do not have permanent endowment can adopt a total return approach without the commission's consent.

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### In more detail

Total return describes an investment approach that charities can adopt to manage their investments. Under this approach, the form in which investment return is received (for example, income, dividend or capital growth) does not matter. Instead, investments are managed to make the most of the total investment return they generate.

A total return approach can give charities greater flexibility in achieving their investment objectives. This is because the focus is on investments that are expected to give the best performance in terms of their overall return, rather than on investments which will give the 'right' balance between capital growth and income (see 8.3).

The trustees can allocate whatever portion of the total return they consider appropriate as income - this can be spent in furthering the aims of the charity. The balance remaining is carried forward as unapplied total return and invested as capital.

The Charities Act 2011 allows trustees of permanently endowed charities to adopt a total approach to investment by their resolution, and the commission has made regulations and issued guidance setting out how this power can be exercised and operated. The regulations also allow trustees some additional flexibilities in the way they use a total return approach which must be exercised in the interests of their charity.

For more information on this subject, see **Total return investment for permanently endowed charities**.

## 8.5 Can a charity make a financial investment in a subsidiary trading company?

### The short answer (legal requirement)

Yes, but the trustees must be able to justify financial support for the subsidiary trading company as a suitable way of investing the charity's resources.

Charities sometimes set up a subsidiary trading company to carry out their aims, rather than to generate income. This is not dealt with in this guidance - for further information see **Trustees, trading and tax (CC35)**.

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### In more detail

Trustees must use the usual criteria (see 3.2) to assess whether an investment in a subsidiary trading company would be appropriate for the charity. They must:

- consider whether it is in the charity's interests to make an investment in a subsidiary trading company after making a fair comparison of this form of investment with other forms of investment available; this should involve an objective assessment of the company's business prospects (the suitability of the investment type or class)
- be satisfied that the particular company is financially viable based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information (the suitability of the investment within that asset type or class)
- take appropriate advice on the investment and the financial viability of the subsidiary trading company; what is 'appropriate' will depend on the circumstances - the cost of taking the advice is a relevant factor, and should be proportionate to the size of the proposed investment (considering and taking advice if appropriate)
- decide the nature of the investment in the subsidiary trading company, taking professional advice as needed (the trustees' duty of care)
- consider from time to time whether the investment in the subsidiary trading company should be retained (the review and diversification of investments)

Trustees should also:

- take account of the length of time over which funds may be tied up in an investment in a subsidiary trading company, since funds invested in this way may not be easily realised if they are needed in the short to medium term
- consider, and take suitable advice on, the possibility of obtaining funding from another source as an alternative to funding by the charity

Investing in a company which is not economically viable, and has no real prospect of becoming so, would not satisfy the criteria listed above. This would be the case where the investment is to be used to pay the debts of an insolvent company before it goes into liquidation, solely to prevent it having to be treated as an insolvent company.

Sometimes a subsidiary trading company can be set up to further both the charity's aims and to generate a financial return. It is important that trustees are able to justify the investment either on the basis of the financial return or the extent to which it furthers its aims. Where the company is doing both, it is a mixed motive investment and the criteria set out in section 11 apply.

## Tax treatment

Trustees should be aware that there may be tax implications for investments in, and loans to subsidiary trading companies which are made by a charity where the subsidiary trading company is connected to the charity. Charities are unlikely to encounter difficulties where investment in the subsidiary is undertaken to generate funds that are then used by the charity to deliver its charitable aims. Investments and loans that are made to prop up an ailing connected trading company may not be considered to be made for the benefit of the charity and may impact on the charity's tax exemptions.

HMRC are likely to look critically at a charity's investments in trading companies where the charity appears to be little more than an adjunct tacked onto a business as opposed to the company being there to raise funds for the charity.

It is important to ensure that any investment by a charity in a subsidiary trading company is not treated as non-charitable expenditure. If it is so treated, there may be tax liabilities.

For more information:

- on investment in trading subsidiaries, see **Trustees, trading and tax (CC35)**
- on tax issues, see **HMRC charities webpage**

## 8.6 Can a charity make a financial investment in companies in which the charity trustees, or people connected with them, have private interests?

### The short answer (legal requirement)

Yes, but trustees must be able to justify the investment as appropriate for the charity and that the charity has the necessary power to make it.

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### In more detail

Trustees must be careful not to become committed to supporting a company in which trustees, or people connected with them, have a private interest without giving full consideration to whether:

- the investment is appropriate for the charity and in line with its investment policy
- any conflict of interest issues have been identified and managed
- any private benefit is acceptable - in this guidance, private benefit means any benefits that a person or organisation receives from a charity other than as a beneficiary

Trustees must use the usual criteria (see 3.2) to assess whether an investment in a company in which trustees, or people connected with them, have a private interest would be appropriate for the charity. They must:

- consider whether it is in the charity's interests to make the investment after making a fair comparison of this form of investment with other forms of investment available; this should involve an objective assessment of the company's business prospects (the suitability of the investment type or class)
- be satisfied that the company is financially viable based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information (the suitability of the investment within that type or class)
- consider taking appropriate advice on the investment and the financial viability of the company; what is appropriate will depend on the circumstances - the cost of taking the advice is a relevant factor, and that should be proportionate to the size of the proposed investment (considering and taking advice if appropriate)

- consider from time to time whether or not an existing investment should be retained (the review and diversification of investments)

For more information on managing conflicts of interest, see **Manage a conflict of interest in your charity**.

### **Tax treatment**

Trustees should be aware that there may be tax implications for investments made by a charity in a company connected with its trustees, or in which they or their associates have a significant personal interest. HMRC will have to consider whether the investments are made for the benefit of the charity and not for the avoidance of tax. Investing in a company connected with significant donors, including trustees, may also be subject to the substantial donors rules and may impact on the charity's tax exemptions. Investments may be subject to the tainted charity donations rules introduced in 2011. While these rules primarily affect the donor, they can impose a tax charge on charities as well in some circumstances. Making the investments for other purposes may have tax consequences.

For more information, see **HMRC charities webpage**

## **8.7 Can a charity make a financial investment in outcomes-based finance?**

### **The short answer**

Yes, it's possible that this type of investment could be viewed as a financial investment if the likely financial return justifies it. Charities will need to take advice where appropriate on this.

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### **In more detail**

Investors in outcomes-based finance structures receive a financial return that is fully or partially linked to the social and/or environmental outcomes generated by the services delivered using the investment. A social impact bond is an example and describes a contract which is typically between a public sector body and investors where the former commits to pay for an improved social outcome. Investor funds are used to pay for a range of interventions to improve the social outcome.

Alternatively, charities might approach this as a programme related investment - see section 10 - or as a mixed motive investment (section 11).

## 8.8 Can a charity keep gifts of financial investments?

### The short answer (legal requirement)

Yes, providing the trustees consider it is in line with their investment duties. For example, they must consider:

- how suitable the investment is
- the need to diversify investments

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### In more detail

Tax legislation offers incentives to donors who give investments, including land, to charity. It is up to trustees to decide whether to sell or keep the investment. In doing so, they must ask:

- Are the investments donated suitable for the charity?
- Is there a need for further diversification within the charity's overall investment portfolio?
- Is there a need for further diversification within the donated investments?

There are also other questions that trustees may want to ask such as:

- Would selling part, or all, of the gift discourage donors from making further gifts to the charity?
- How practical would it be to change the donated investments?
- Would the true value of the investments be realised on a disposal, or would this only be achieved by holding onto the investments for a longer period?

If the charity has accepted the gift of an investment with the condition attached that the donor must consent to any change in that investment, donors should not withhold their consent because it suits their own personal interests to do so, but should act in the interests of the charity.

### Tax considerations

Trustees should be aware that there have been some cases where the reliefs for giving investments have been subject to misuse as part of tax avoidance schemes. In these schemes, the investments given typically conveyed little benefit to the charity or the charity received a very small return for allowing itself to be used as a conduit through which valuable investments were passed. Charities should avoid becoming involved in such arrangements. In certain circumstances, the tainted charity donations rules might impose a tax charge where the donation in question is made under Gift Aid.

Complicity in tax avoidance could amount to a breach of trust or a non-charitable activity. If trustees of a charity are concerned that an investment or investments have been given to them as part of tax avoidance arrangements they should consider informing HMRC.

For more information, see [HMRC charities website](#)

## 8.9 Can a charity engage in stakeholder activism?

### The short answer

Yes. A charity as a stakeholder can engage with an organisation that it has an interest in or whose activities might affect its work on a number of levels. It can ask it for information or express views, or it can exercise any voting rights in order to influence an organisation's policies in a way that better reflects its own values and ethos.

Stakeholder activism can also be used for the purpose of engaging with the corporate governance of the companies in which the charity invests. This is in order to safeguard its investment and to ensure that the companies it invests in are being managed for the long term benefit of shareholders. It can also be used for the purposes of programme related investment (section 10) or mixed motive investment (section 11).

Charities may ask their investment manager to vote on their behalf.

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### In more detail

A charity as a stakeholder in a particular business may wish to exercise its voting rights in order to influence a company's policies in a way that reflect its own particular values and ethos.

Where a charity chooses to engage directly in shareholder activism, there are some important points for it to consider:

- shareholder activism needs to be related to its aims, and the charity needs to consider and manage any risk of significant financial detriment
- when exercising a vote as a shareholder, all points of view should be considered - specifically, the potential effect on the value of the charity's investment
- stakeholder activism is more effective if it is carried out with other stakeholders
- any time and resources spent on stakeholder activism should be proportionate to the benefit to the charity

In some circumstances, a charity may wish to acquire investments that are related to its values and ethos primarily to engage in stakeholder activism.

Where a charity has delegated voting responsibilities to its (discretionary) investment manager, the charity should ensure that it is aware of the philosophy and processes behind its investment manager's voting policy. The charity is likely to want regular reports on how its shares have been voted.

Investment managers should vote and engage with the company management as a matter of course. However, they will generally be voting with long term financial outcomes in mind, in other words seeking the best long term financial return for the charity. They should provide the charity with their corporate governance statement and regular reporting of their engagement activity. Some investment managers have stakeholder activism policies that can be followed on behalf of many clients, achieving a greater effect with economy of effort.

## 9. Cash deposits

### 9.1 What should trustees consider when investing in savings and cash deposits?

#### The short answer (legal requirement)

Savings and cash deposits are forms of investment and the legal requirements set out in section 3.2 apply. Cash deposited in a bank or building society normally earns interest which can be used by the charity to generate income until it is either needed to spend on the charity's aims or placed in longer term investments.

There are a number of other ways of investing cash, particularly for larger charities, and charities should take advice where appropriate. They should identify and plan for the management of any risks attached to the investment of cash.

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#### In more detail

Cash needed for the day to day running of the charity is usually held in an instant access current or deposit account. Charities wishing to lock away cash for longer periods of time, for example to fund a project at a defined point in the future, can deposit cash in a fixed term or notice account, which can offer higher rates of interest, but will usually have restrictions on access to funds.

In complying with their duties (set out in section 3.2), trustees should:

- **Have a short written policy:**

This should cover where and how long cash may be deposited and the maximum amount to be placed in one institution. If necessary, the statement should cover the policy for short, medium and long term deposits.

- **Consider thoroughly which institution to invest with:**

Cash should only be deposited with reputable institutions, such as those authorised by the FSA in the UK or by the relevant financial regulator in any other country.

- **Investigate the benefits offered by a particular deposit account:**

Cash deposits should be in an interest bearing account, unless trustees plan to use the money on deposit in the short term or invest it elsewhere for the longer term. Trustees should consider:

- the rates of interest on offer; interest rates vary across institutions and on particular accounts over time - charities should regularly review accounts to ensure they are getting competitive rates, rather than constantly seeking the highest rate, trustees may prefer to deposit cash in an institution that has consistently good interest rates
- the timing of interest payments, for example, whether they are monthly or annual
- the conditions of access to funds, including any charges or penalties arising from access at short notice or early termination
- whether interest is paid gross or net of tax
- the charity's ethical stance

Non financial considerations, such as the location of the institution, are important but only secondary to those listed above.

- **Investigate what protection there is for deposits:**

Charities should seek assurance that institutions are protected wherever possible and trustees should be fully comfortable with the protection arrangements before depositing money with that institution, whether in the UK or abroad. For further information, see:

- the **FSCS** website

- **Limit the amount deposited in any one institution:**

Trustees should balance the benefit of getting a higher rate of interest for depositing a single large sum against the risks involved with depositing with a single institution. Charities depositing large amounts should consider establishing a policy for the maximum amount to be placed with any one institution in order to reduce the risk of lost deposits. By splitting large deposits between banking institutions, trustees reduce the risk of large losses due to institutional failure.

- **Get professional advice where appropriate:**

Charities must take advice from someone experienced in investment matters where they consider they need it.

- **Ensure all deposits are properly authorised:**

The opening or closing of bank accounts should be authorised by the whole trustee body, but can be delegated where appropriate subject to reasonable limits. The commission recommends that all subsequent deposits of funds should be authorised by at least 2 authorised individuals. For most charities, these individuals should be trustees. Subject to restrictions imposed by the charity's governing document, trustees are recommended to appoint more than 2 signatories, so that 2 can always be available if necessary. All trustees share responsibility for ensuring that proper and appropriate steps are taken to protect the investment before arranging for deposit of the charity's money.

- **Recovery of tax:**

There are many deposit accounts available, and some designed specifically for charities, which pay interest gross of tax. If, however, the account preferred by trustees pays interest on the charity's deposit net of tax, then trustees should ensure they are able to reclaim the tax.

- **Consider whether Common Deposit Funds would be appropriate:**

Common Deposit Funds (CDFs) are deposit taking schemes that are tax efficient, administratively simple and cost efficient. They do not fall within the Financial Services Compensation Scheme. They enjoy the same tax status as other charities. CDFs accept deposits from depositing charities and place the money they have accepted on deposit in the money market. By pooling funds (usually for relatively short duration) on deposit, CDFs can secure a higher rate of interest for the depositing charities than each charity would otherwise get, if undertaken separately.

For more information, see **Common Deposit Funds - a basic guide to their regulation**

- **Review arrangements regularly:**

Trustees should regularly review their cash management arrangements and the costs and benefits of their charity's cash accounts to ensure their deposits are protected and that charges and rates of interest are competitive.

## 10. Programme related investment (PRI)

### 10.1 What is PRI?

The Charities (Protection and Social Investment) Act 2016 has introduced a statutory power for charities to make social investments. This is the commission's interim guidance on the considerations for trustees when making social investment decisions. It will be reviewed in 2017.

Other than the addition of this annex and the removal of the definition of social investment from Annex 1, the substance of this guidance has not been changed. The existence of the power and its practical application for charities will be one of the issues the commission will consider as part of a future review of its investment guidance.

The short answer

PRI allows a charity to directly further its aims and, at the same time, potentially achieve a financial return. In making a PRI, trustees are not bound by the legal framework for financial investment (see 3.2), because their decision is about applying assets directly in furtherance of the charity's aims.

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#### In more detail

PRI uses charitable resources to finance charitable and other organisations in a way that:

- is wholly in furtherance of the charity's stated aims
- is for public rather than private benefit
- is expected to produce some financial return for the charity (but this is not the main reason for doing it)

#### Example

A charity that works to relieve poverty may give a loan to another charity that helps unemployed people back into work.

This will:

- relieve poverty (wholly in furtherance of the charity's aims)
- be for the public benefit
- be expected to achieve repayment of the loan and a financial return from interest payments on the loan

Successful PRI can enable charities to:

- increase the help they can provide; if the investment is recouped and/or yields a return for the charity, then the resources can be reused to support a greater number of projects
- employ a wider range of funding methods; for example, sometimes loans and equity are better suited to particular projects than grants
- make a long term, flexible investment that directly furthers the charity's aims ie at low interest rates, interest free or involving repayment (partly) through in-kind services
- improve the terms on which charities are offered finance, enabling finance to be accessed at a lower cost

## The difference between financial investments, PRI and grants

A PRI is different from a financial investment or a grant although it may look similar in form.

The difference between a financial investment and a PRI lies in the primary intention of the investment. The main reason for making a PRI is to further the charity's aims, not to generate a financial return. The main reason for making a financial investment is to generate a return which can then be used to further the aims of the charity. Usually the charity will be seeking the best financial return on their investments within the level of risk they consider appropriate for the charity. The intention is important because it allows trustees to show how they are acting in the interests of the charity.

PRI also differs from grant making because a grant is made to further the charity's aims with no expectation of a financial return. However, some charities might choose to make a grant alongside a PRI, for example to help build an organisation's management capacity thus helping to ensure loan repayment.

Financial investment targeting the best rate of financial return given the level of risk considered appropriate

PRI furthering a charity's aims, with the expectation of some financial return

Grants directly furthering a charity's aims

## 10.2 What form can a PRI take?

### The short answer

PRIs can take a wide range of forms and can be made to both charities and other types of organisation. They can range from:

- relatively small sums of money provided as loans to another organisation or individual, for example a housing deposit, buying new equipment or renovating a property to
- large sums invested in complex high profile projects, for example regeneration projects

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### In more detail

PRIs often take the form of loans, equity investments or pooled funds more commonly associated with financial investment. PRIs may also be made through intermediaries.

Common examples include:

#### Loans

The key characteristic of a loan is that the borrower should repay the amount of the loan with or without interest.

If making a loan, a charity should ensure that the terms of the loan set out:

- how it will be used to further the charity's aims
- a rate of interest; trustees should consider the impact on their charitable aims and the rate that the borrower might be able and willing to pay
- the timescale and terms of repayment; trustees can be flexible in considering these arrangements

A charity can also guarantee loans on behalf of organisations or individuals that will further the charity's aims. With loan guarantees, trustees are promising a third party that they are responsible for the obligations of the recipient should it not be able to meet those obligations. The trustees should ensure that they have, or can access, sufficient resources to meet any call under the guarantee. In the meantime they retain use of their organisation's funds.

### **Equity investments**

Exceptionally, PRI can take the form of an equity investment where a charity buys shares in a company and provides it with start up capital. Ownership usually gives a right to a dividend if paid and a right to vote at the annual general meeting. However trustees should be aware that there are particular risks involved. They will need to consider what processes can be put in place to ensure the funding will continue to be used to further the aims of the charity. For example this could take the form of shareholder agreements, buy back positions and convertible loan stock.

For more information on equity investments in non charitable companies, see 10.9.

Charities can also engage in the following:

### **Revenue participation or quasi-equity**

This means that the charity as an investor gets a financial return based on the share of revenue/profits made by an organisation in return for providing capital for the development of a particular initiative. The initiative must be in furtherance of the charity's aims in order for this to be a PRI. The return the investor receives is linked to the financial success of the venture. Investments of this kind do not involve the issue of shares and do not generally confer ownership on the investor.

### **Outcomes-based finance**

Investors in outcomes-based finance structures receive a financial return that is fully or partially linked to the social and/or environmental outcomes generated by the services delivered using the investment. A social impact bond is an example, and describes a contract which is typically between a public sector body and investors where the former commits to pay for an improved social outcome. Investor funds are used to pay for a range of interventions to improve the social outcome. The social and/or environmental outcomes must be in furtherance of the charity's aims in order for this to be a PRI.

It's possible that this type of investment could be viewed as a financial investment if the likely financial return justifies it. It could also be made as a mixed motive investment. Charities will need to take advice where appropriate on this.

## 10.3 What is the trustees' role when making a PRI?

### The short answer

When making a PRI, trustees must act in the best interests of their charity and ensure that:

- their charity's funds are only used to further its stated aims
- any private benefit arising from the investment is necessary, reasonable and in the interests of the charity (see 10.8)

Before making a PRI, they should:

- be clear that it contributes to the charity's strategic aims
- compare PRIs with other ways of advancing the charity's aims in terms of effectiveness and risk
- consider whether they need to take advice, given the level of risk to the charity, and any knowledge or expertise that they have in the charity

Trustees are unlikely to be criticised for their decisions if they have considered the relevant issues, taken advice where appropriate and reached a reasonable decision. The PRI checklist at annex 2 is intended to guide trustees through the decision making process.

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### In more detail

The trustees have overall responsibility for PRI decisions. They should put in place the appropriate governance arrangements for managing their PRIs. The governance structure and level of delegation will be different for each charity depending on its internal resources and expertise and they should consider the following points:

- trustees do not need to have specialist project and financial knowledge themselves; however charities with significant funds invested may find it helpful to have a trustee with specialist financial and project knowledge on its board, or co-opted to its board
- charities with substantial sums invested in PRIs or that have invested in complex or high profile PRIs may find it helpful to establish an internal PRI committee or a sub committee of trustees or staff to advise the board on the more detailed aspects of PRIs
- trustees may delegate decisions about individual PRIs to a third party or to staff within the charity if they have the power to do so in their governing document, however, they will need to:
  - ensure that they provide a clear direction, in writing, about the nature and type of PRIs they consider will further the charity's aims
  - ensure they have procedures in place for monitoring and reviewing PRI performance

## 10.4 What risks should trustees consider in connection with PRI?

Trustees should consider the following risks and make decisions for their management appropriate to the size and activities of their charity and proportionate to the scale of the PRI in relation to the activities of the charity:

- Will the PRI be used to fund aims other than those intended, for example if the recipient made a significant change to its activities or if the objectives of the PRI are achieved earlier than expected?
- Will there be an unacceptable level of private benefit to the recipient or other investors (see 10.8)?
- Are there risks to the charity's reputation, for example arising from private benefit?
- What will happen if the project is not successful?
- What will happen if the charity is dependent on a financial return that is then not recouped?
- What if real return levels are lower than expected because of changes in inflation or exchange rates?

## 10.5 Should trustees take advice when making PRIs?

### The short answer

There is no legal obligation to take advice. Much will depend on whether the trustees feel comfortable and competent enough to make decisions on PRIs.

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### In more detail

The issues that might influence the need for advice are:

- the size and scale of the PRI and level of risk involved
- the complexity of the legal and financial issues
- whether a particular professional evaluation is called for

and whether the charity has in house expertise in:

- assessing projects
- undertaking due diligence checks
- determining appropriate levels of return
- assessing viability prospects

## 10.6 Can a charity make a PRI in a project that falls outside its charitable aims?

### The short answer (legal requirement)

No, a charity can only make a PRI that supports its charitable aims. However, trustees can explore new and innovative ways of using PRIs to further their aims bearing in mind the principles set out in this guidance.

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### In more detail

It is important that trustees understand the full scope of their charity's aims and can demonstrate how the intended outcomes of the PRI will further these.

Some large charities, often trusts and foundations or charitable intermediaries providing financial support to other charities, have been set up with general charitable aims and will therefore be able to make a wide range of PRIs from their income and expendable endowment that support any charitable purpose they select.

## 10.7 What if the PRI ceases to further the charity's aims?

### The short answer

Charities should consider at the outset how they would manage situations where the PRI funded activities cease to further its aims. The terms of the PRI agreement should reflect what is possible and practical to end the PRI and, if feasible, the return of funding which can no longer be used to further the charity's aims.

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### In more detail

#### Loans

Where the PRI takes the form of a loan directly from the charity to the organisation it is funding, the agreement may include a condition requiring repayment of the loan or the conversion of the loan to commercial terms in the event that the investment is no longer being used to further the charity's aims.

#### Equity investments

The position is more complicated where the PRI takes the form of equity investments because of the requirements of company law concerning the reduction of the capital of companies. However, it is possible to put other arrangements in place. For example, a company might agree conditionally to purchase its own shares, or to issue shares which are redeemable in such circumstances.

#### Intermediaries

Where the PRI is made through an intermediary, the furtherance of the charity's aims may be complicated by the intermediary's relationship with the ultimate recipient. While the principle that the PRI needs to wholly further the charity's aims remains, the trustees should take into account that practical considerations may limit the intermediary's ability to agree how to end an arrangement with its charitable investors.

#### Risk management

The charity will need to consider, when the investment is first proposed, the risk that the charity might find itself locked into a PRI which has lost any connection with its aims. Trustees may decide that, where the risk is small, the benefit to be obtained by making the investment justifies taking that risk. However, where the amount invested represents a significant part of the charity's resources, the risk becomes greater and will be more difficult for the trustees to justify taking.

## 10.8 When is some private benefit acceptable?

### The short answer

Some private benefit flowing to other investors is acceptable if the trustees are satisfied that the private benefit is:

- necessary in the circumstances
- reasonable in amount
- in the interests of the charity

Trustees must have regard to the guidance on private benefit in **Charities and public benefit** when making PRIs.

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### In more detail

A charity's aims must be for the public benefit. However, sometimes, the best way for a charity to help its beneficiaries may result in individuals or businesses making a private benefit. Where there is an unacceptable level of private benefit it can affect charitable status.

Trustees will need to use their judgment to determine whether the private benefit is acceptable. They must always act in the best interests of the charity. They can include the charity's enhanced ability to further its aims (as a repaid loan can be lent to others) in their assessment of the project's public benefit. In some cases the assessment required will be relatively simple, in others it will be complex, based on multiple factors, and the decision will be finely balanced. Trustees should make decisions based on what is reasonably known at the time of making the PRI and ensure they have a record of their decisions.

Where trustees consider that individuals or businesses are making a private return in PRI which is beyond what they consider as necessary, reasonable and in the interests of the charity, they should ensure that the private benefit is recoverable by the charity by some other means. For instance, the person receiving the private benefit may choose to pay it to the charity. If there is continuing unacceptable private benefit, the charity should consider its options for exiting the PRI.

## 10.9 What are the duties of trustees if investing in the equity capital of a non-charitable company in order to further the charity's aims?

Legal requirement: in general, investing in the equity of a private company will mean a financial return for the shareholders or will further some other non charitable purposes of the company. This will usually mean that the charity's investment is not supporting wholly charitable aims and, therefore, a charity can only make a PRI in such a company in exceptional circumstances. These circumstances are only likely to arise where there is a clear correlation between the social purposes that the company will achieve and the aims of the charity.

Therefore, the trustees must satisfy themselves that:

- there is correlation between the charity's aims and the social mission of the non-charitable organisation in which the trustees wish to invest
- any private benefit derived from the PRI is necessary, reasonable and in the interests of the charity
- any private benefit will not be excessive and the investment is clearly for the public benefit

Where there is potential for considerable economic gain by the company, the trustees should take all reasonable steps to ensure that the charity benefits from this gain. Otherwise, they could not demonstrate that any private benefit is necessary, reasonable and in the interests of the charity. There should be adequate safeguards in place to ensure that any unacceptable private benefit does not arise. For further information see **Legal underpinning: charities and investment matters (section 5)**.

### Example

#### Equity investment in a commercial organisation

A charity set up to help people with disabilities find employment might be interested in buying newly issued shares in a commercial organisation run by and employing disabled people. The success of the company will deliver benefits to shareholders. The more successful the company, the more disabled people it is able to employ and train.

#### Points to consider

- The key question here is the match between the charity's aims and the general activities of the non-charitable organisation. Trustees must ensure that when providing general loans or buying shares in a commercial organisation, the general activities of the commercial organisation should directly further the charity's aims.
- Trustees should also carefully consider at the outset how they would manage a situation where the commercial organisation changes its activity or employment policy. In particular, they should ensure they would be able to exit from the PRI in such circumstances.
- Trustees would need to be satisfied that the private benefits (including to shareholders) are acceptable.

## Example

### A loan to a commercial organisation for a specific aim.

A commercial organisation providing vocational training requests a loan to enable it to provide training facilities for the unemployed in a disadvantaged area. These new facilities will enable the company to train fifty local unemployed people each year under a local authority contract.

A local charity set up to relieve unemployment considers making the loan on the basis that it furthers its charitable aims. The contract offered by the local authority enables the commercial organisation to cover costs and make a small profit margin. However, this margin is not sufficient to support a loan at market rates.

The commercial organisation needs this loan to develop and equip training premises. It could not operate in the disadvantaged area without the charity's loan which is offered at below market rates. The loan provided by the charity may make an indirect contribution to the company's profitability because it may, for example, win more contracts of this kind with larger margins.

### Points to consider

- This sort of evidence of market failure to deliver employment, goods or services to disadvantaged people is sometimes the basis for justifying PRI in non-charitable organisations.
- Trustees have a duty to use their charitable assets to further the charity's aims. The loan should be made on the basis that it will be used by the commercial organisation only to carry out activity that will directly further the charity's aims. The loan could not be used to fund any other activity. Trustees would need to be satisfied that the private benefit is necessary, reasonable and in the interests of the charity.
- The terms agreed should allow for the loan to be repaid in full should the commercial organisation cease to carry out those specific activities.

## 10.10 Can a charity invest in and through intermediaries?

### The short answer

Yes. If investing in and through intermediaries, trustees need to be assured that:

- the charity's funds are only used to further the charity's stated aims
- any private benefit arising from the investment is acceptable

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### In more detail

Some charities and non-charitable organisations specialise in PRI and act as intermediaries. They finance, or facilitate the financing of, other charities and non-charitable businesses. This approach can:

- reduce the transaction costs associated with loans or the purchase of equity
- sometimes provide expertise in assessing and managing the financial risks associated with the projects they support
- provide knowledge about the communities and markets in which they are investing and mitigate risk
- allow charities to pool risk across a large number of investments thus reducing their exposure
- make it easier for charities to recover their investments

## Examples

### (1) Buying shares in a loan fund

A charity which aims to protect the environment by supporting the development of renewable energy sources might invest in a loan fund set up to finance new green technologies. Given that the fund can continually make loans, the investment by the charity will have a considerable impact on the number of new green technologies supported.

#### Points to consider

- The PRI can only be made on the basis that it will be used to carry out activity that will directly further the charity's aims.
- The private benefit to those who receive start up funding must be considered to be necessary, reasonable and in the interests of the charity in the circumstances.

### (2) Investing in a social impact bond

A social impact bond typically describes a contract between a public sector body and investors where the former commits to pay for an improved social outcome. Investor funds are used to pay for a range of interventions to improve the social outcome.

A charity that works to help the unemployed back to work might invest in a social impact bond that funds a project or multiple projects that aim to improve an individual's chances of finding work. This could be a direct investment in the project or be managed through an intermediary. Upon completion of the project, if the targets set out are met, then the charity will recoup its investment and receive a return. (Some charities may choose to make this type of investment as a financial investment).

#### Points to consider

- The PRI can only be made on the basis that it will be used only to carry out activities that aim to help the unemployed back to work.
- Any private benefit must be deemed to be necessary, reasonable and in the interests of the charity in the circumstances.

## 10.11 Can charities use their permanent endowment to make PRIs?

### The short answer (legal requirement)

In general, permanent endowment involves funds held on trust to be invested to provide a financial income which can be spent on furthering the charity's aims. This will not usually permit permanently endowed funds to be used for PRI.

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### In more detail

A charity might be able to use its permanent endowment for a PRI by:

#### Using the income

A charity can use part or all of the income from the permanent endowment to make a PRI.

#### Justifying it as a financial investment

A PRI is one where the financial return is not the primary reason for making the investment. Trustees can use permanent endowment held on trust for financial investment if the risk profile and financial return sought enable it to be justified as an investment.

Trustees can take account of ethical investment considerations or make mission connected investment when investing permanent endowment.

There may be some occasions when an investment generating less than a market return might be justified because of the extent to which the investment furthers the charity's aims. In this case, the justification has to show that the extent to which the charity's aims are furthered is roughly equivalent to the reduction of income. This is one type of mixed motive investment (see section 11).

### **Adopting a total return approach**

Trustees managing permanent endowment can consider adopting a total return approach. This means that part of the capital growth on the endowment can be allocated to their income fund and spent on the charity's aims. This can be spent on the PRI. A permanently endowed charity that want is to adopt a total return approach to investment may use the power in the Charities Act 2011 and the **Charities (total return) regulations 2013** to adopt a power to adopt the approach.

### **Removing restrictions on permanent endowment**

Trustees may be able to remove the restrictions from some or all of any permanent endowment their charity holds. They can do this if they decide that it will allow them to carry out the charity's aims more effectively.

The trustees will need to pass a formal resolution that the restrictions on the permanent endowment should be removed from all or part of the fund concerned. If the market value of the permanent endowment is over £10,000, they may also need the commission's approval. This would enable trustees to use the capital in any PRI scheme that furthered the aims of the charity concerned.

Further information on permanent endowment is set out in **Permanent endowment: what is it and when can it be spent?**

## **10.12 How should PRI be reported in the trustees' annual report and a charity's annual accounts?**

Legal requirement: where the trustees must prepare an annual report and are subject to statutory audit, the report must include an explanation of the charity's policy for making a PRI and how any material PRI has performed against the objectives set for it.

In the annual accounts, the balance sheet must show investments held primarily to provide a financial return for the charity (financial investments) and PRI separately. PRI should generally be included at the amount invested less any impairment and, in the case of loans, any amounts repaid. Impairments should be charged as an expense of charitable activities in the Statement of Financial Activities. Where a gain is made on the disposal of a PRI then it should either be set off against any previous impairment loss or included as a gain on disposal of fixed assets for the charity's own use and recorded under 'other operating resources' in the SoFA.

For more information, see **Accounting and reporting by charities, SORP 2005**

### 10.13 How can a charity account for a PRI that no longer fulfills the charity's aims?

If a PRI no longer furthers a charity's aims or the trustees' motive for holding the investment changes so that it is held primarily for a financial return, then it will be necessary re-classify the investment as a financial investment in the charity's balance sheet.

One of the key characteristics of a PRI is the expectation of repayment and/or a financial return for the charity, although the primary aim of a PRI is to further the aims of the charity. Therefore a PRI is an asset but one which, like any other asset, can reduce in value. If the PRI is no longer worth what it is valued at in the balance sheet, it should be included at its recoverable amount. Alternatively, provided the aims of the charity are still furthered by the investment, the charity may choose to convert the PRI into a grant.

### 10.14 How should trustees monitor and review a PRI?

Trustees will need to review their charity's PRIs regularly. The approach to, and frequency of, this review will depend on the nature and size of the charity's PRIs and on its need for resources which may change over time. Trustees will need to consider:

- the use which the recipient makes of the resources the charity has provided to ensure that they are being used to further the aims of the charity
- emerging methods of impact reporting or 'social return on investment' to measure, manage and communicate how the PRI furthers the charity's aims
- the likelihood of repayment and/or return on the PRI; this will vary depending on the form of the PRI - for example, for loans and equity investments this may involve ongoing reports on the progress of the project with regular assessment of the prospects of loan recovery and financial returns, the relevant terms should be built into any funding agreement

### 10.15 What are the tax implications of PRI?

Legal requirement: there may be tax implications for PRI which depend on the structuring of the investment and the tax treatment of any return - charities should be aware of this and take advice where appropriate. As long as charities apply the income and gains arising from a PRI charitably they will normally be exempt from UK tax.

Charities risk losing their tax exemptions if they incur non-charitable expenditure. This can include making investments or loans that are not 'approved charitable' investments or loans. Some categories of loans and investments are automatically treated as 'approved charitable' loans and investments. HMRC will consider claims for other loans and investments to be treated as 'approved charitable' as long as they are made for the benefit of the charity and not for the avoidance of tax. HMRC will normally accept claims for PRIs to be treated as 'approved charitable investments'.

For more information see the [HMRC charities website](#)

## 11. Mixed motive investments

**The Charities (Protection and Social Investment) Act 2016 has introduced a new statutory power for charities to make social investments. This is the commission's interim guidance on the considerations for trustees when making social investment decisions. It will be reviewed in 2017.**

**Other than the addition of this annex and the removal of the definition of social investment from Annex 1, the substance of this guidance has not been changed. The existence of the power and its practical application for charities will be one of the issues the commission will consider as part of a future review of its investment guidance.**

The previous sections have concentrated on 2 different forms of investment - financial and programme related. However, some new and developing investment opportunities do not fall entirely within just one or the other of these categories, but can still be justified as being in the interests of the charity. The commission refers to these as mixed motive investments.

The commission recognises that this new approach to investment could be an appropriate way for some charities to respond to the changing environment in which they work. The commission intends this basic legal and good practice framework to help charities consider whether mixed motive investments might be an option for them and to describe the decisions involved.

### 11.1 What is a mixed motive investment?

#### The short answer (legal requirement)

A mixed motive investment is one which trustees make on the basis that it has elements of both financial investment and programme related investment. The investment cannot be wholly justified as either one or the other.

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#### In more detail

Generally, trustees must be able to show that investments they make are in the best interests of the charity. They do this by justifying them as either:

- financial investment - seeking the best financial return given the level of risk considered to be appropriate or
- programme related investment (PRI) - furthering the charity's aims directly in a way that might generate a financial return

Separate legal requirements apply to both.

However, sometimes trustees will want to invest in a way that they consider to be in the best interests of their charity but not entirely justified on just one of these grounds alone. In this situation, they may be able to justify the investment as a mixed motive investment if they are satisfied that:

- the investment can be justified by the dual nature of the return - part financial and part justified by the investment's contribution to the charity's aims
- there is no other reason for making the investment, including:
  - creating unauthorised private benefit to some or all of the trustees or people connected with them
  - creating unacceptable private benefit to other individuals

As mixed motive investments are a developing area, professional advice may be required on specific proposals.

## 11.2 Why might a charity want to make a mixed motive investment?

Where an investment cannot be wholly justified either as a financial or a PRI, but the trustees still consider that it is likely to be in the best interests of the charity, it may be possible to justify it as a mixed motive investment. However, trustees should bear in mind that:

- they should be satisfied 'before' proceeding that the mixed motive investment can be justified by the combination of the anticipated financial return and the contribution the activities funded will make to the charity's aims
- any private benefit arising from the investment must be appropriate

Sometimes a subsidiary trading company can be set up both to further a charity's aims and to generate a financial return. It is important that trustees are able to justify an investment either on the basis of the financial return or the extent to which it furthers its aims. Where the subsidiary trading company is doing both, it is a mixed motive investment and the criteria set out in this section will also apply.

For permanently endowed charities, there may be some occasions when an investment generating less than a market return might be justified because of the extent to which the investment furthers the charity's aims. In this case, the justification has to show that the extent to which the charity's aims are furthered is roughly equivalent to the reduction of income.

## 11.3 What should the trustees consider when thinking about making a mixed motive investment?

### The short answer

They should carefully think through the justification for a mixed motive investment before it is made and be satisfied that it is in the best interests of the charity. It should also keep a record of the decision and the reason for it.

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### In more detail

A charity should ask the following questions when considering making a mixed motive investment:

- Will we be considering the extent that the mixed motive investment supports our charitable aims or the financial investment aspect first? Both could be appropriate ways to approach a mixed motive investment (see Legal underpinning: charities and investment matters (section 6)).
- Do we know how much of our investment can be justified by the PRI's contribution to our aims and how much can be justified by the financial return? This may not be easy to quantify, but to try to do so could be a useful analytical exercise in justifying the total mixed motive investment before it is made.
- How are we proposing to monitor the mixed motive investment?
- Are we satisfied that, taken as a whole, the mixed motive investment can be justified as being in the interests of the charity?
- Will this investment be suitable for our charity looking at its activities and financial position as a whole? This should include consideration of the size of the mixed motive investment in relation to our charity's overall investment portfolio, and our charity's attitude to risk.
- Have we applied the decision making criteria to both financial investment and the PRI?

- Have we considered whether any private benefit arising from the mixed motive investment is acceptable taking into account the contribution the activities funded make to the aims of the charity (see section 10.8)?
- Have we considered the risk of the charity's resources being used for purposes that are inconsistent with charitable status and the law on investing charitable funds?
- Do we need to take professional advice on the proposed investment? We might need advice on:
  - the fit with the charity's overall business plan
  - whether the investment contributes to the charity's aims
  - the legal issues attached to the proposed investment as a whole
  - any tax implications for the charity

## 11.4 When is a mixed motive investment not justified?

A mixed motive investment is not justified where:

- it is made for purposes other than furthering the charity's aims and securing a financial return
- one or more of the trustees (or persons connected with them) will derive an unauthorised private benefit
- the level of private benefit to other individuals is not appropriate
- the risks involved do not justify the level of resources to be invested

## 11.5 How should a charity monitor a mixed motive investment?

A mixed motive investment should be monitored both as a financial investment and as furthering the charity's aims and different criteria apply to each. In addition, the charity needs to bear in mind that the balance between the 2 elements may change.

Trustees should monitor and review:

- the extent to which their charity's resources are being used to further its aims; trustees may find it helpful to look into and apply emerging methods of reporting on impact or the social return on investment to measure, manage and communicate how the investment furthers the charity's aims
- the expected financial return on the investment and whether it continues to be a suitable one for their charity

## 11.6 What happens if a mixed motive investment is unsuccessful?

If an investment falls in value or becomes irrecoverable then there will be a financial loss. However, provided that the trustees have taken and recorded their decisions properly, then they are likely to be able to address questions or challenges about their actions.

## 11.7 How should mixed motive investments be dealt with in a charity's annual accounts and the trustees' annual report?

### The short answer (legal requirement)

The Charities SORP does not currently directly address accounting for recent developments in mixed motive investments which can take many different forms.

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### In more detail

Where mixed motive investments are material, the trustees should consider their separate disclosure within the balance sheet or within the investment notes to the accounts. The trustees should explain their investment policy in relation to such assets within their annual report and assess their performance.

In so far as the investment seeks a financial return, trustees should consider whether fair value or transaction cost approaches are appropriate to their year end accounting for such assets. As this is an emerging area, the commission anticipates further consideration will be given to accounting issues as practice develops.

For more information about accounting for investments, see **Accounting and reporting by charities, SORP 2005**.

## Annex 1: Technical terms used in this guidance

The following terms are used throughout this guidance and should be interpreted as having the specific meanings given.

‘Aims’ and ‘charitable aims’ mean the aims which the charity is set up to achieve. The aims are usually expressed in a charity’s governing document.

‘Asset class’ is the term used to describe a type or category of investments that share similar characteristics, such as equities, cash deposits or bonds.

‘Asset allocation’ is the term used to describe the process of spreading investments among different asset classes, in accordance with the needs of the charity.

‘Charitable company’ means a charity which is a company formed and registered under the Companies Acts.

The ‘Charities Act’ means the Charities Act 2011.

‘Charitable return’ means a return that directly furthers the purposes of the charity.

A ‘collective investment scheme’ is an arrangement that enables a number of investors to ‘pool’ their assets and have them professionally managed by an independent manager. The wider range of investments in a collective investment scheme can help reduce the risk of any negative effect that one investment can have on the overall performance of the portfolio. ‘Unit trusts’ and ‘common investment funds’ are examples of collective investment schemes.

A ‘custodian’ is someone who, on behalf of the charity, looks after any documents or other evidence of legal title to investments - for example share certificates and title deeds to land. A custodian may also provide other investment related services, such as handling claims for repayments of tax due in respect of investment income. The term ‘custodian’ is sometimes used to refer to a person who is both a nominee and a custodian. Custodians have no power to make management decisions and must act on the lawful instructions of the trustees.

A ‘custodian trustee’ is a corporation appointed to have the custody of trust property - it acts as both nominee and custodian. A custodian trustee has no role in the charity’s management and must act on the instructions of the charity trustees, unless they are asked to do something that is not allowed by the governing document or by charity law.

‘Endowment funds’ are the property of a charity (including land, buildings, cash or investments) which the trustees are legally required to invest or to keep and use for the charity’s aims. Endowment may be expendable or permanent.

- ‘Expendable endowment’ is that property which may be invested to produce income. Depending on the conditions attached to it and the nature of the endowment, the trustees will have the power to convert all or part of it into an income fund which can then be spent.
- ‘Permanent endowment’ is the property of the charity that the trustees cannot spend as income. It must be held permanently, sometimes to be used in furthering the charity’s aims, sometimes to produce an income for the charity. Trustees cannot normally spend permanent endowment without the commission’s authority. The terms of the endowment may permit assets within the fund to be sold and reinvested, or may provide that some or all of the assets are retained indefinitely (for example, in the form of a particular building).

‘Ethical investment’ describes a way of making financial investments which takes into account the charity’s values and ethos. Trustees must exercise their investment power in the best interests of the charity.

‘FSMA’ means the Financial Services and Markets Act 2000.

‘FSCS’ means the Financial Services Compensation Scheme.

The ‘general power of investment’ means the power of investment which is given to trustees by section 3 of the Trustee Act 2000, taken together with the power to invest in land which is given to trustees by section 8 of that Act. These provisions do not apply to charitable companies.

‘Gift Aid’ is a tax relief for single outright cash gifts made to charity by individuals (including those carrying on a trade) and companies in the UK.

‘Governing document’ means any legal document setting out the charity’s aims and usually, how it is to be administered. It may be a trust deed, constitution, memorandum and articles of association, will, conveyance, Royal charter, commission or court scheme, or any other document which describes the trusts of the charity.

‘Holding trustees’ are individuals who are appointed by the trustees to hold the legal title to a charity’s property. The way they are appointed and any other details relating to their duties and responsibilities will usually be set out in the charity’s governing document - they are not appointed using the powers in the Trustee Act. Holding trustees are often used by unincorporated charities and can be members of the trustee body. They have no management functions and must act on the lawful instruction of the charity trustees.

‘Intermediaries’ finance, or facilitate the financing of other charities and non-charitable businesses.

‘Investment’: In this guidance the commission uses the term investment in its widest sense. By investment the commission means using assets in the best possible way in the interests of the charity in a way which may attract a return.

‘Investment manager’ means an individual or a corporate body appointed by a charity’s trustees to advise and make investment decisions on their behalf. The investment manager will make those decisions in line with the investment policy which the trustees have developed.

‘Liquidity’ refers to the **ability** of an **asset** to be converted into **cash** quickly and with minimum loss of value.

‘Mission’ connected investment describes a way of making financial investments that also help the charity to achieve its aims directly. Trustees must exercise their investment power in the best interests of the charity.

A ‘mixed motive investment’ is one which trustees can justify making on the basis that it combines a financial return as well as a contribution to furthering their charity’s aims.

A ‘nominee’ is one or more individuals or a corporate body appointed by trustees to hold the legal title to the property of a charity on behalf of the charity or its trustees. The nominee’s name will be entered on the share register of any company whose shares are owned by the charity. In the case of land, the nominee’s name is entered in the proprietorship register. Nominees have no power to make management decisions and must act on the lawful instructions of the trustees.

‘Pooling schemes’ are arrangements to facilitate investment management by a charity trustee, or body of charity trustees, with a number of different charities to administer. They are a type of common investment fund.

‘Programme related investment (PRI)’ sometimes referred to as social investment, is an investment made by a charity wholly to further its aims with the potential of receiving a financial return. Different rules apply for PRI and financial investments.

‘Public benefit’ is the legal requirement that every organisation set up for one or more charitable aims must be able to demonstrate that its aims are for the public benefit if it is to be recognised and registered as a charity in England and Wales.

‘Private benefit(s)’: In this guidance private benefit means any benefits that a person or organisation receives other than as a beneficiary of a charity. It does not, therefore, include the sorts of personal benefits people might receive as a beneficiary, such as receiving an education, or medical treatment, or a charitable grant for example.

‘Reserves’ are the resources that a charity has, or can make available, to spend for any or all of the charity’s aims once it has met its commitments and made provision for its other planned expenditure.

‘Restricted funds’ are funds subject to specific trusts that fall within the wider purposes of the charity. Restricted funds may be restricted income funds, which are spent at the discretion of the trustees in furtherance of some particular aspect of the purposes of the charity, or they may be endowment funds where the assets are required to be invested or retained for actual use (for example, a building) rather than spent.

‘Risk’ is used in this guidance to describe the uncertainty surrounding the performance of investments. It also refers to the risk that a firm with which the charity does investment business may default on its contractual obligations. Risk may either enhance or inhibit any area of a charity’s operations.

‘Social enterprise’ is a broad term used to mean a business operating for a social purpose, which reinvests its profits for that social purpose rather than redistributing them. Some social enterprises are also registered charities, but not all.

‘Social investment’ is a term widely used when investing to achieve a social purpose and also a financial return. There is no precise definition of social investment and it is used in different ways. There are a number of ways that a charity can invest for a social, charitable and financial return set out in this guidance.

‘SoFA’ means Statement of Financial Accounting.

‘Taxes Act’ refers collectively to the tax legislation concerned with Income Tax, Corporation Tax & Capital Gains Tax.

‘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.

The ‘Trustee Act’ means the Trustee Act 2000.

‘Unincorporated charity’ means a charity that is not:

- formed and registered as a company under the Companies Acts
- formed and registered as an Industrial and Provident society
- established by a Royal Charter or Letters Patent
- incorporated by statute

‘Unrestricted funds’ (including designated funds) are income or funds which can be spent at the discretion of the trustees in furtherance of any of the charity’s aims. If part of an unrestricted income fund is earmarked for a particular project it may be designated as a separate fund, but the designation has an administrative purpose only, and does not legally restrict the trustees’ discretion to spend the fund.

## Annex 2: PRI checklist

When considering whether to invest in a PRI, trustees should be satisfied that it is in the best interests of the charity and that the level of risk they are taking is appropriate.

This checklist sets out the sort of questions that trustees should ask themselves when thinking about making a PRI:

- **‘Does the PRI further the aims of our charity?’**
  - Which of our charitable aims are we funding? A PRI must be made wholly in furtherance of one or all of them.
  - Is this the best way we can serve the needs of our beneficiaries in the context of the charity’s operations as a whole?
  - How does the organisation we are investing in share or further the charity’s aims?
- **‘What private benefit might there be?’**
  - Have we considered what private benefit there might be to others as a result of the proposed PRI?
  - If there is any private benefit to a person or an organisation, is it necessary, reasonable and in the interests of the charity?
- **‘What advice do we need to take?’**
  - Do we need to take advice about a PRI? For example, about the viability of a project, the terms of a loan, or whether we need to carry out due diligence checks?
- **‘Have we considered the terms of the agreement?’**
  - Are the terms on which the PRI is made reasonable as far as we are aware?
  - How easily can the PRI be ended if circumstances change? For example, what will happen if the organisation we are investing in makes a significant change to the nature of its activities, there is poor performance or the objectives of the PRI are achieved earlier than expected.
- **‘What are the risks for our charity?’**
  - How reliant is our charity on getting a financial return? The viability of a charity may be threatened if it is reliant on a predicted level of financial return that does not materialise.
  - What is the financial health of the recipient of the PRI?
- **What other factors may impact on the success of the project or the financial return (for example, the rate of inflation or exchange rates)?**
  - What is the risk that a recipient will default on their contractual obligations and how will we manage this?
  - Under what conditions can the PRI be converted into a grant or written off?
  - Are there any potential reputation risks to the charity - for example, through private benefit to non-beneficiaries if the PRI is made to a commercial organisation?
  - What are the tax implications of the PRI? Some investments may be treated as non-charitable expenditure, with tax implications for our charity.

- **'Have we considered what governance arrangements should be in place?'**

- How are our trustees going to manage the relationship with intermediaries or the recipient of the PRI?
- What monitoring and review arrangements are in place to assess the impact and potential financial return of the PRI?
- Have the charity's staff involved in authorising the PRI had appropriate training? How will decisions be supervised and monitored?