

Charities and investment matters: Consultation response

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Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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General Comment

- CIPFA welcomes the opportunity to comment on the Charity Commission draft guidance on charity investment matters. CIPFA plays an active part in the civil society. As a charity, accounting institute and member based support organisation, CIPFA contributes to developing the capacity of civil society within a rapidly changing economic and social landscape.
- We've responded to the questions raised in the consultation document and we've also included further comments and suggestions for specific amendments/inclusions. You'll find these additional comments and suggestions at the end of this document.

Response to 'general questions'

1. Are the issues and approaches to investment sufficiently clear, easy to understand and to apply?

- 1.1 On the whole yes, although it may be worth revisiting the balance of high level information and the more detailed information, with a view to more clearly identifying the target audience for each component.

2. Is the guidance in a form that is accessible and easily navigable for trustees and those who make decisions on behalf of trustees?

- 2.1 In general yes, although see our responses to questions 7 and 14 and in particular our concern that guidance on cash deposits should have a higher profile and our view that the information on 'mixed purpose investments' is possibly overly complex and potentially of limited use.

3. Does the tone of the guidance strikes the right balance in facilitating charities in furthering their aims while managing risk?

- 3.1 The overall tone of these proposed changes is to make ethical investment more mainstream and to be more explicit about flexibility, for example, in the use of some asset classes. All charities should consider the ethical dimension of investment and we welcome this guidance as a progressive development.
- 3.2 However, we do have some concerns that the reader may get the impression that ethical or social investment is now obligatory. Permanently endowed charities which exist to support charitable causes in perpetuity will still need to focus on maintaining their value and many small charities will simply be looking to park their money safely for a good return. This is not to ignore the relevance of ethical investment but rather to point out that other elements have to be considered, including managing risk and achieving reasonable returns on investments.
- 3.3 It would be helpful to make this clearer and to note that investment goals and conditions do change over time and that charities do still have the option to favour

investment decisions based mainly on, for example, levels of likely return and levels of risk.

4. Is the draft guidance likely to give trustees confidence in making decisions about investments?

4.1 Yes, subject to reservations about clarity of some of the content. See other comments

5. Does the guidance meet the needs of all charities, large and small?

5.1 This is difficult to pre-judge. Besides size, much depends on the nature of the charity, size of reserves, types of assets and the skills, experience and confidence of those tasked with reading and understanding the guidance.

5.2 Perhaps this is something to assess with the aid of a simple online survey tool?

6. Are there additional examples that could be used to illustrate points made or issues covered?

6.1 In relation to '**private benefit**' it would be helpful to have some examples to support the guidance provided and to clarify the points being made.

7. Are there gaps or omissions where further guidance would be helpful?

7.1 The draft guidance does address **cash deposits** but we are concerned that the detail is only to be found at the back of the main publication, under annex 3.

7.2 Furthermore there is no mention of cash deposits in the "at a glance" guidance.

7.3 Very many smaller charities will have bank deposits but no other investments and could easily think that none of this guidance is relevant to them. The inclusion of cash deposits needs to be clearly signposted to this type of charity, both in the "at a glance" guidance and in an earlier section in the longer guidance

7.4 This approach would be reinforced by renaming the guidance as applying to "cash deposits and investments".

7.5 In relation to **stakeholder activism**, Mention is made of this at page 32 of the main guidance but there is no further amplification. More could be said about what may or may not be reasonable for a charity, including for example the following points:

- That, like social investment itself, stakeholder activism needs to be mission-related or not cause financial detriment to the charity

- Time spent on stakeholder activism needs to be proportionate to the benefit to the charity
- That, when exercising a vote as shareholder, all points of view must be considered including specifically the potential effect on the value of the charity's investment
- That stakeholder activism is unlikely to have much effect unless acting in concert with other stakeholders
- That some investment managers have stakeholder activism policies that can be followed on behalf of many clients which may achieve greater effect with some economies of effort
- That there are some umbrella bodies (e.g. PIRC, Fairpensions) which campaign and co-ordinate stakeholder activism on behalf of institutions
- Whether and in what circumstances it is legitimate for a charity to acquire investments when the primary purpose of doing so is to engage in stakeholder activism. Para 6.7 in the "legal underpinning" says when it could be, but this could be brought into the general guidance. The legal underpinning ought also to elaborate on whether in these circumstances the purpose of the share acquisition would harm the charity's tax position.

7.6 We recommend including a definition of 'stakeholder activism' in the annex.

7.7 **Duty of care.** The guidance states " ... a higher duty of care is expected of a trustee who is, or claims to be, knowledgeable about, or experienced in, investing funds". This might be read as allowing recklessness in others, or in deterring of the knowledgeable from contributing at all. Para 3.12 of the legal underpinning puts the point in a better way – that a person who has special knowledge is expected to use it – which is paraphrased in the general guidance at page 14 but that phrasing could be used more generally instead of the one quoted above.

Response to 'specific questions'

8. Do you agree with the approach we have taken in the guidance?

8.1 Please see our response to question 3 above.

9. Have we achieved clarity around the range of options available to charity trustees in the guidance?

9.1 See answer to question 1.

10. Is the approach we have taken here, focusing on investment powers and application of duties, more helpful for charities?

10.1 Yes

11. Is the detail on asset classes and their compatibility with trustee's duties in Annex 1 helpful and necessary?

11.1 To a degree although see our responses to other questions.

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

12.1 There could be further explanation of the complexities of ethical investment and the care needed in assessing to what extent particular investment options really offer 'ethical' investment.

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

13.1 Yes. We've no suggestions for further comment on this topic.

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

14.1 The discussion of 'mixed purpose investment' appears to over complicate what is already a fairly complex picture and we feel that it is not very clear how the guidance on 'mixed purpose investment' helps improve decision making around social and ethical investment.

14.2 We recommend omitting the 'mixed purpose investment' guidance

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

15.1 See 14.2 above.

16. Is our guidance on PRI helpful to charities and our use and definition of the term appropriate?

16.1 Yes

17. Is the section on public benefit helpful in assessing whether private benefit is incidental or recoverable to the charity?

17.1 There is some scope for improving clarity. For example the phrase “recoverable to the charity” is not clear and should be further defined.

18. Is the explanation about how permanent endowment can be used helpful?

18.1 Yes

19. Do examples of PRI in the guidance reflect charity’s current practice? Are there more useful examples we could add?

19.1 The examples appear appropriate.

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

20.1 Yes, subject to comments above and below

21.0 Further comments on specific items in text of guidance

21.1 Page 5, B1 “we use the term investment in its widest sense”.

Some people use the word “investment” to refer to commissioning decisions for services which create no asset and which in accounting terms would always be written off. We don’t condone this parlance but it needs to be clearer that the word in the guidance is never used in that sense.

21.2 Page 9, C1

You could make the point that a charity (which may not even set out to have investments at all) needs to also consider the effective management of working capital. This links to the general point made earlier concerning cash deposits.

21.3 Page 15, ‘Legal definition and trading’

Could clarify that ‘trading’ can also refer to trading in investment securities.

21.4 Page 17

‘Investment risk’

Another way of mitigating the likelihood is by investing in pooled funds that are themselves diversified.

‘Counterparty risk’

After ‘with which the charity does investment business’, add ‘or deposits money’

We suggest you add something to the effect that an investment/deposit can be secure in the long term but not liquid – e.g. even where compensation schemes are in place it can take time to resolve claims and pay out.

21.5 D7

We suggest you add a statement to the effect that who holds investment may affect (one way or another) the eligibility for compensation schemes.

21.6 Page 18, D9

We suggest you add a statement about the tax advantages of being in a Common Investment Fund e.g. exemption from stamp duty: although not as much as they used to be and of course does not outweigh other considerations.

21.7 Page 21, E2

“... the **government**” should be “a government” in order to align with acknowledgement on page 69, that globalisation of investments means non-UK stocks can be a reasonable investment.

We suggest “**regardless of their size**” should be “except the very smallest”. A charity with only £100 to deposit would not be well advised to mix assets.

‘Return’ – You need to explain the difference between ‘return’ and ‘yield’ – not everybody understands this

‘Exchange rate risk’ is relative usually to the currency in which a charity’s economic activities are conducted. Overseas charities in particular need to consider this, but it could apply to, say, a UK charity established to acquire expensive medical equipment which would be acquired from overseas.

21.8 Page 22, E3

Needs more signposting to detail in Annex 4

21.9 Pages 27,28

You could explain here that if trustees have decided, say, on asset allocation, they remain responsible for the consequences of their decisions. If they use investment managers they can only hold the managers accountable within the discretion given to them by the investment management agreement, not for the policy decided by the trustees.

21.10 Page 29, F5

While trustees may have discretion over the terms of an agreement, they may find that investment managers have standard templates which themselves are dictated by regulatory requirements on the managers. This is usually for the protection of investors so trustees should not be dissuaded by these. We suggest you add something to the effect that the custodian of assets may not be the same as the investment manager, indeed there may be separate agreements covering management and custody. Trustees should ensure they understand the arrangements for custody of their assets, and their security.

21.11 Page 30, F6

“The fee is generally percentage of the profits”. This is not the case if profits are defined as the difference between the proceeds of a sale of an investment and its original cost.

Generally fees would be related to the rate of return (if an absolute return fund) or more often the difference between the rate of return achieved and an agreed benchmark rate.

21.12 Page 31, ‘frequency’

It may be helpful here to draw a distinction between routine monitoring of investments (which might be done, say, quarterly) and more thorough reviews of investment policy and performance (say, every few years).

21.13 Page 33

‘The short answer’ - The last bullet point seems to say the same as the first.

'If supporters or beneficiaries are alienated' . The middle sentence applies as a criterion to judge alienating supporters; it does not help judge the question of alienating beneficiaries. 'No significant financial detriment' After "trustees are or not free to use their charity's investment powers" we suggest you add "or to restrict their use"

21.14 Page 37, H2

It would be helpful to point out here that there are some collective schemes which incorporate ethical criteria, also there are some which are restricted to charities and take advantage of tax breaks available to charities.

21.15 Page 38, H4

Without going into detail it would be good if the short answer could spell out that "appropriate manner" would include explicit declarations of interest.

21.16 Page 41

The example in the box – as the guidance goes on to explain how to deal with incidental private benefits, perhaps "only" should be "primarily"

21.17 Page 45, I5

This section might read better if it said that a charity could not use permanent endowment for PRI except in certain circumstances, rather than starting to say it could, then imposing restrictions. The paragraph on justifying PRI as a financial investment means it is not PRI at all, but MCI.

21.18 Page 46, I6

The "*Accounting Requirement*" paragraph refers to "Statement of Financial Accounts". Our understanding is that this should be 'Statement of Financial Activities'.

21.19 Page 48

The phrase "recoverable to the charity" which appears here and elsewhere is not clear and should be clarified.

21.20 Page 65

We suggest you make clear in the paragraph on financial services compensation that these examples are in the UK. Different criteria may apply for overseas/offshore investments.

21.21 Page 69

Some gilts have no redemption date.

As well as rating agencies, Credit Default Swap rates are a means of assessing market perception of risk

21.22 Page 74, Derivatives

Give examples of circumstances in which derivatives can be appropriate:

A charity which, say, was due to spend money in an overseas currency in future might buy forward to reduce its currency risk (not an investment purpose)

A charity which was running a balanced portfolio to specific mandate might buy an index future as an economical way of diversifying (an investment purpose)

21.23 Annex 4

Would benefit from:

- adding an explanation of active versus passive investment approaches.
- Asking is it acceptable to borrow to invest. The 'legal underpinning', 2.5-2.8 says something about this. If it is not acceptable for a charity to borrow to invest, is it acceptable to invest in geared funds which themselves do so?