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The CHIPs are down - a template for improving Charity Investment Practice

ASSOCIATION OF CHIEF EXECUTIVES OF VOLUNTARY ORGANISATIONS

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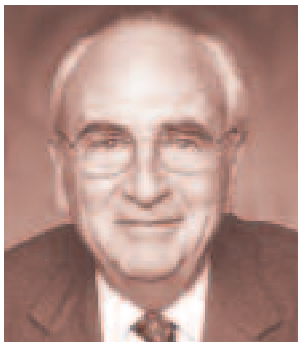
Foreword - Lord Young



Lord Young

The post war settlement, which defined and created the Welfare State, effectively eliminated the work of the majority of charities that had grown so strongly throughout the previous hundred years. The hospitals and many of the schools founded and maintained during those years, were absorbed by the state, their trusts disbanded and their trustees dispersed. The concept of charitable giving withered on the vine. The state was seen as being responsible for us from the cradle to the grave.

Over the last two decades governments of both parties have come to realise the limitations of the state. Partially driven by the increasing complexities of modern life, they are turning to charities to act, either as an agent of the government or to supplement their responsibilities. There can be little doubt that the coming decades will see an increasing role for charities, whether they be operating charities or grant giving bodies. The level of charitable giving is on the increase and governments have done much to both encourage giving and making it easier to give.

It is estimated that the investment funds of charities already amount to £66bn and this will continue to grow over the years. There has been much attention to the role and responsibility of pension trustees recently, but the Myners report implicitly excluded charities.

The difficulty with charities is that they are, by definition, voluntary bodies. We have realised for some time now that, voluntary body or not, they demand the same standard of care and professionalism as any business. Unfortunately not as much attention has been given to those who are responsible for all their activities, the trustee, as has been given over the last decades to the company director. Trustees do not charge for their services, but in truth their responsibilities are greater than any non-executive director, for they share personal responsibility for the activities of the charity with their fellow trustees.

Over the years I have been involved with a number of charities, both operational and grant giving, and when I was approached by ACEVO to chair this committee I readily agreed and I am very grateful to all who have given so much time and effort over the last eighteen months.

We consulted with a very broad spectrum of the voluntary sector, realising the enormous spread and diversity of voluntary bodies today. The result of our work, the Charity Investment Principles, is meant as a practical working guide to assist the Charity Trustee in making day-to-day decisions in what are often difficult and sometimes complex circumstances. We all look forward to hearing from voluntary bodies how well we have accomplished our task.

Lord Young

Introduction

Peter Griffiths
Chairman
Investment Powers Working Group

The Investment Powers Working Group was formed late in 2001 as part of Lord Young's Committee on Charities. The Working Group was charged with conducting a review on behalf of the charity sector into the possible implications for charities and their trustees of the principles developed in the Myners Review[1].

Generally the Myners Review received a welcome response from the pensions sector[2] although some contributors to the debate[3] raised concerns about the practical application of the Myners Principles whilst others[4] agreed with the proposals but concluded they did not address all the relevant issues.

The Government's response[5] to the Myners Review broadly endorsed the Principles and recommended that pension trustees should comply with them on a voluntary basis, although it is perhaps noteworthy that in the 2001 Budget speech the Chancellor intimated that the Government would be prepared to legislate as necessary to achieve the improvements that Myners prescribed.

Melanie Jackson, the Economic Secretary confirmed the Government viewed the Myners proposals in the same light as the earlier voluntary Cadbury Code on corporate governance and hoped the proposals would bring about real behavioural change in pension fund investment practices.

The central tenets of Myners were summarised as:

- decisions should only be taken by those with the right skills and expertise;
- fund managers should be set clear objectives and timescales;
- the performance of all advisers and managers should be measured, and trustees should assess their own performance; and
- the investment strategy and returns of the fund should be reported annually to members and the public, as part of a strengthened Statement of Investment Principles[6].

Since the publication of the Myners Review, the Government has recently published two major reviews of the charity sector in quick succession. The first was issued in September 2002 by HM Treasury with the title "The Role of the Voluntary and Community Sector in Service Delivery : A Cross Cutting Review". The second, entitled "Private Action, Public Benefit : A Review of Charities and the Wider Not-for-Profit Sector" was researched and published by the Strategy Unit (formerly the Performance and Innovation Unit) in the Cabinet Office. We understand the Charity Commission will also be producing an update to CC14 on Charity Investment early in 2003.

In the foreword to the Cross Cutting Review, Paul Boateng, Chief Secretary to the Treasury wrote "this government is passionately committed to the work of the voluntary sector. We believe that the voluntary and community sector organisations have a critical role to play in the reform of public services and reinvigoration of civic life". His foreword went on to state that the Government's aim was to build a new partnership using the charity sector's strengths to challenge and stimulate new ideas and take forward the development of social policy generally. The paper was seen as a review of the role of the voluntary sector, its relationship with Government and the way in which public services might be delivered.

[1] Institutional Investment in the UK-A Review by Paul Myners.
[2] See, for example, the National Association of Pension Funds Guide "The Myners Principles : Rising To The Challenge".
[3] See Tech 6/01 "Institutional Investment in the UK : A Review – a memorandum submitted to the Treasury by the Institute of Chartered Accountants in response to the report prepared by Paul Myners".
[4] Principles of Institutional Investment Decision Taking – Robert Monks and Allen Sykes – May 2001.
[5] Myners Review : Institutional Investment in the UK – The Government's response by HM Treasury and the Department of Works & Pensions.
[6] www.HM-Treasury.gov.uk/press/2001/p32line02.html

Introduction

In light of the current reviews and reforms and the Government's increasing recognition of the importance of the charity sector as a channel of effective social delivery, the Working Group concluded it was vital the sector should actively engage in the current debate and seek to be influential in developing a suitable and appropriate framework for the management of charity investment funds. The Treasury's strong commitment to create a framework in which the sector "can continue to flourish, be strong and independent" was welcomed as was much in the Myners Report, the Strategy Unit's proposals and in the Cross Cutting Review, particularly the proposals for full recovery of charities' core costs. However, the Working Group had some concerns as to the levels of legislation that are currently affecting the sector and which may have consequential implications for its future development and growth. Equally, we recognised the key responsibilities which charities owe not only to their immediate beneficiaries, staff, volunteers and donors but increasingly to the wider community and the various governmental agencies which fund, in part or in whole, some of the statutory services now provided through the charity sector.

The background data provided within the recent reviews and reports, together with that available through NCVO, CAF, publications such as Charity Finance and our own researches, provide some interesting insights into the current size, structure and diversity of the charity and not-for-profit sector.

The total number of organisations in the sector has been estimated at somewhere between 500,000-600,000 although the more narrowly defined group of registered charities in England and Wales totals approximately 185,000 (source Charity Commission); those in Scotland and Northern Ireland total approximately 30,000. The Charity Commission estimates the total annual income of all registered charities as approximately £25bn.

Further analysis suggests:

- approximately 42,000 registered charities have an income of less than £1,000 and a further 60,000 have an income of less than £10,000 per annum – the majority of registered charities have an annual income of £10,000 or less;
- the 372 largest charities have annual incomes in excess of £10m; the five largest charities have incomes in the range of £97m - £220m.

The Directory of Grant Making Trusts : 2001/02 lists approximately 9,000 charitable trusts within the UK and estimates have been made that the top 150 have an aggregate income of approximately £2.2bn.

In charity terms, although the incomes of the biggest charities are relatively large, by commercial, public sector and governmental standards, such charities are still relatively small.

The Strategy Unit review included a number of estimates made by NCVO:

- approximately 750,000 people act as trustees of charities – our own researches show the great majority of trustees act in an unpaid capacity;
- generally charities employ over half a million workers, equivalent to 2.2% of the total UK workforce;
- charities "benefit from the contributions of just over three million volunteers, representing the equivalent of 1.5m full-time equivalent jobs."

We strongly endorse the view that "Britain has a long tradition of voluntary action and service delivery. The philanthropists of the 19th century drove social change and paved the way for tackling illiteracy, poverty and ill-health.[7]" We believe that such traditions continue to work for the broader benefit of the community today and the sector continues to reflect the characteristics noted by the Wolfenden Committee some years ago - "cost effective, innovative, flexible and pioneering"[8] and by the sector's ability to "deliver services more effectively to certain groups because their particular structure enables them to operate in environments which the State and its agents have found difficult or impossible"[9]. However, we also recognise that whilst 30% of the incomes of general charities come from the Government, the sector must become more open, transparent and accountable. Both the recent Government reports indicate that central funding for the sector is now substantial, totalling £2.5bn, excluding contributions to registered social landlords; the net contribution to the sector is funded 22% by the NHS, 42% by local authorities and 36% by central government.

[7] The Role of the Voluntary and Community Sector in Service Delivery, HM Treasury; para 4, page 5.

[8] Wolfenden Committee (1978) The Future of Voluntary Organisations, Croom Helm, London.

[9] The Role of the Voluntary and Community Sector, ibid para 3.9, page 16.

Introduction

The Working Group has undertaken its task over the past twelve months by a process of review of the underlying issues, a comparative assessment of the Principles developed within the Myners Review and through compiling and commissioning a MORI survey of a large cross-section of charities. Our detailed conclusions are set out in the following sections.

A number of general observations and conclusions have influenced and informed our decision process. A key starting point was the identification of a number of marked and significant differences between the charity and pension sectors. The role and duties of pension trustees are inevitably almost wholly focused on overseeing and ensuring the security of each fund's assets and investments and protecting the position and rights of the members. As a result, a particularly important issue for pension trustees is the process of matching and allocating current investment assets against a fund's actuarially assessed future liabilities. In almost all cases, pension fund investments are substantial (in excess of £1m) and held to fund long-term liabilities. By contrast, charity investments are typically much smaller and, in many cases, held with a view to maximising short-term returns to meet immediate operational requirements or finance planned capital projects.

By contrast with a pension trustee, a charity trustee typically owes a duty of care to a wider group of beneficiaries, donors, funders and stakeholders. In many cases, the diversity and size of charities will result in the security and management of investments remaining an important issue but one which is proportionately less important than is typical for pension trustees. Equally, the demands on charity trustees of other regulations such as health and safety, registration and employment, are all proportionately more onerous. Exceptions to these general observations arise in the case of some of the largest charities, which hold significant investments, and for some of the larger endowed and grant-making charities whose primary objective is to manage their endowed investments in order to maximise the grants and funding which are available to support the pursuit of their charitable objectives.

Faced with such diversity, the Working Group considered and rejected a "one size fits all" approach or, alternatively, developing a set of principles applicable primarily on the basis of a charity's size or the value of its investments. Both approaches were rejected as overly complex and failing to meet a primary objective for "proportionate regulation". In this context, we welcomed the broad direction of the proposals in the Strategy Unit review to remove the administrative burden for over 90,000 "small charities" so they will no longer need to remain registered as charities. In light of this proposal we considered whether only charities above a certain size threshold should be asked to consider adoption of the Charity Investment Principles ("CHIPs"). On balance we concluded that, in practice, proposals based on a size test would result in unnecessary complexity and lack of consistency. Consequently, we expressed a strong preference for continuing reliance to be placed on a trustee's general "duty of care" rather than proposing complex structures of regulations and compliance standards.

Our conclusions were influenced by recognition that the charity sector needs to maintain high levels of public trust and confidence; we were pleased to note that in a recent survey, 2/3rds of the respondents expressed high confidence in charities and, as reported by the Strategy Unit, "charities have a strong public image". Nonetheless, against a background of significant change and development elsewhere we were not persuaded to argue for maintenance of the status quo. Generally, we welcomed the main areas of action identified in the Strategy Unit review namely: Government action to modernise charity law and improve the range of legal forms available for charities and small enterprises.

As an extension and development of such reforms the CHIPs outlined in the main sections of this Report will provide a framework to maintain and develop public trust in the sector whilst our "Template for improving Charity Investment Practice" should provide an acceptable and proportionate approach without the need for additional statutory regulation. Adoption and application of the CHIPs by charity trustees should increase general public confidence without unduly increasing the compliance burden on charities themselves. The template framework, with its adherence, where appropriate, to the principles expounded in the Myners Review should result in a sustainable and consistent approach to charity investment practice by trustees.

Importantly, our proposals should not be seen solely as an issue of self-regulation but, again consistent with the Prime Minister's foreword to the Strategy Unit Report, the template should promote an approach which will result in the process and management of charity investment becoming more effective and innovative.

In the section on Investment we have sought to address some of the complex issues which continue to arise over the definition of what, for charity purposes, constitutes an "investment". We acknowledge the continuing difficulties which remain in balancing apparent conflicts between tax and charity issues that the Charity Commission have sought to address in the revised draft of CC14, particularly in relation to what may constitute "trading" or "gambling". The decision tree included on page 29 may provide some general guidance in this legally complex area. We believe our proposals are workable but wider application may require further policy shifts within the Charity Commission and the Inland Revenue.

We commend charity trustees to adopt and implement our "Template for improving Charity Investment Practice" which provide general information guidelines. The CHIPs are not absolute quality or compliance standards, although they should inform trustees as to the nature of the issues they should be considering in shaping their investment policies. As such, we hope they may contribute to an improved quality of decision-making and thereby improve charity investment practices.

Application of the CHIPs should improve investment practices; equally the template should provide a framework for clarity and transparency, guiding trustees to disclose where they are making decisions themselves and where they are delegating them.

The Working Group acknowledges the strong contribution which the Myners Review has made to the development of broader Charity Investment Principles, although, in a number of areas, we have reached different conclusions.

The Cross Cutting review concluded that the Government "must ensure that regulation is proportionate and the independence of this sector is recognised. The greater the regulation the greater the risk that the best features of the sector are smothered"[10]. The CHIPs and the template they provide for improving charity investment practices are a response to that challenge.

Peter Griffiths
Chairman
Investment Powers Working Group

[10]The role of the Voluntary and Community Sector; ibid para 3.15, page 17

1. Effective Decision-making

1.1 Decisions should be taken only by persons with the skills, information and resources necessary to take them effectively. Where trustees take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they receive.

1.2 Trustees should assess whether they have the right set of skills, both individually and collectively, and the right corporate governance structures to carry out their role effectively.

1.3 A charity should appoint an investment sub-committee to provide appropriate focus if it has the capacity and expertise to form such a committee. An investment sub-committee should be formed in the case of all charities with substantial investment portfolios, say, in excess of £10m.

2. Need for Clear Objectives and Statement of Investment Principles

2.1 Charities should have an overall investment objective that:

(a) represents their best judgement of what is necessary to meet the charity's development plans and deliver their charitable objectives over an appropriate timescale;

(b) takes account of their attitude to risk relative to commitments; and

(c) is considerate of stakeholders' views.

2.2 The setting of objectives is an integral part of formulating a Statement of Investment Principles. As a matter of best practice, all charities which have significant investments should have a formal Statement of Investment Principles.

2.3 Charities should be open about their future plans to stakeholders and the implications of their investment strategies on those plans.

3. Asset Allocation

3.1 Charity trustees must ensure that asset allocation receives a high level of attention, fully reflecting the contribution it can make towards maximising investment returns and fulfilling a charity's objectives.

3.2 Strategic asset allocation is a crucial determinant of investment performance and therefore should be reviewed frequently.

3.3 A charity's investment asset allocation should reflect its objectives and requirements, not the average allocation of a peer group of funds.

3.4 Although most investors will tend to be risk averse this should not preclude charity trustees from considering the full range of investment opportunities, once the associated risks have been properly weighed.

4. Activism

4.1 If a charity has sizeable investment funds, say, in excess of £50m, including Common Investment Funds, the charity's mandate should include the principle of the US Department of Labor Interpretive Bulletin on Activism.

4.2 For all other charities, activism should not be mandatory; trustees should consider the issue and reach a position specific to their individual charity. Whilst any action to improve the financial returns on a charity's investments will generally be in the best interests of the charity, it can only be justified if such action is cost effective and liable to have a material impact.

4.3 The onus to vote should lie with the investment fund manager. Therefore, charities wishing to vote should ensure their fund manager has an explicit strategy elucidating the circumstances in which they will intervene in a company, the approach they will use in doing so, and how they will measure the effectiveness of their strategy.

5. Expert Advice and Delegation to Fund Managers

5.1 The role of trustees is to ensure that there is effective and efficient decision-making and where they consider they have insufficient time, resources or expertise, they should delegate discretionary investment management to one

overall manager or to several managers. They may also appoint specialist managers in areas such as property and custodianship.

5.2 The main areas they are likely to delegate are asset allocation and stock selection. Asset allocation can be either strategic or tactical. Strategic allocation generally addresses setting a strategic benchmark related to the long term investment objectives of the charity, including income requirements and time horizons. Tactical asset allocation is generally directed towards improving incremental returns by taking investment positions in different groups of assets.

6. Explicit Mandates

6.1 There should be an explicit written mandate with each individual manager and custodian covering the investment objective, benchmarks or other service level standards and risk control parameters.

6.2 The mandate should cover how the manager will aim to achieve the agreed objectives and the timescale for measurement and evaluation of success.

6.3 The mandate should not be unnecessarily restrictive regarding particular financial instruments, except where these are contrary to the overall objectives of the charity.

6.4 Trustees should have a better understanding of the transaction costs they incur and put in place arrangements to keep them under control. Mandates should identify what costs will be reported as management fees including any indirect benefits such as those attributable to soft commission arrangements.

7. Benchmarks

Charities should establish appropriate investment benchmarks before making any investments which:

(a) relate directly to their investment objectives;

(b) have been agreed by all the relevant parties (including investment managers and consultants); and

(c) reflect key factors such as the time over which the investment is made, the trustees' attitude to risk and any restrictions placed on the investment funds.

8. Reporting

Trustees should ensure that the charity's annual report includes a statement of investment aims and objectives, including, where appropriate:

(a) A summary of the Statement of Investment Principles;

(b) Indicate where the trustees have and have not applied the Charity Investment Principles; in those cases where the CHIPs have not been applied provide an explanation as to why the trustees decided to depart from the application of the relevant CHIP; and

(c) Summarise the investment performance achieved against the charity's selected benchmarks.

9. Investment

When making investments charities must work within their powers of investment.

Section 2 – Summary of recommendations

1. Investments

1.1 There is a need for a clear standard to be developed for charity trustees to help them identify what is, or is not, an investment or what economic activity constitutes an investment activity.

1.2 A modern approach to the classification of assets and activities is required. We consider that the only means by which a trustee might identify what constitutes an investment is by reference to economic substance. Accordingly, we recommend that an "investment" is defined as the purchase or acquisition of an asset reasonably believed to be capable of producing, over time, a return to the charity that will exceed its cost

1.3 Clarification should be given as to a charity's ability to follow a broad ethical policy.

2. Duty of Care

2.1 Myners proposed raising the standard of care where pension trustees are taking investment decisions to that of "someone familiar with the issues concerned".

Given the current difficulties in recruiting charity trustees, we recommend no further increase in the existing standard of duty of care. This was borne out by our survey in which 86% of respondents thought the current standard of care contained in the Trustee Act 2000 was "about right".

3. Remuneration, Tax Credits and Time Off for Charity Trustees

3.1 In general, we do not support the remuneration of charity trustees. This might change the ethos of the voluntary sector and would reduce the funds available for charitable purposes. However, we do recommend that charity trustees should be able to claim tax relief for time devoted to charity activities and strongly urge the Government to pursue this proposal.

3.2 We advocate that employers should be encouraged to give their employees who are charity trustees time off to attend relevant charity training courses.

4. Extending Tax Relief

4.1 The extension of income tax relief on gifts of quoted shares and land to charities has been welcome, but only 4% of the charities that participated in our survey claimed to have noticed an increase in donations as a result.

We recommend the Government should extend tax relief on donations of shares and land to other assets such as art and antiques and should examine other planned products to encourage charitable giving.

5. Trustee Training

5.1 We believe that investment decisions should only be taken by persons with the skills, information and resources necessary to take them effectively.

5.2 Our survey revealed that only 12.5% of charity trustees have investment experience and only a small number had undertaken any training. We therefore recommend that more effort is put into trustee training. Trustees should receive relevant induction and ongoing training, including training on trustee responsibilities, investment and finance matters commensurate with their allocated duties.

5.3 Trustees should review their number regularly to ensure that they have the right skills mix for their charity.

6. Monitoring

6.1 Larger charities should arrange for the investment performance of their funds to be independently measured and monitored.

6.2 Other charities should, at the least, be aware of how similar funds have performed and what comparable returns have been achieved as shown by investment benchmark indices.

Summary

- Decisions should be taken only by persons with the skills, information and resources necessary to take them effectively. Where trustees take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they receive. However, we do not recommend that the current standard of duty of care applicable to charity trustees should be increased.
- Trustees should assess whether they have the right set of skills, both individually and collectively, and the right corporate governance structures to carry out their role effectively.
- A charity should appoint an investment sub-committee to provide appropriate focus if it has the capacity and expertise to form such a committee. An investment sub-committee should be formed in the case of all charities with substantial investment portfolios, say, in excess of £10m.
- Trustees should be able to claim tax relief for their time devoted to charity activities.
- Employers should be encouraged to give their employees who are charity trustees time off to attend relevant charity training courses.

1. The Key Decisions

1.1 The key investment matters for charity trustees are:

(a) to determine who should take investment decisions;

(b) establish the overall investment objectives of the charity;

(c) to develop an appropriate asset allocation strategy;

(d) determination of the charity's attitude to risk;

(e) implementing appropriate management arrangements, such as the mandates to be given to investment advisers and managers;

(f) the formulation of a Statement of Investment Principles covering matters (a)-(e);

(g) the regular monitoring of investment returns, achievement of investment objectives and compliance with the charity's Statement of Investment Principles to ensure that they remain appropriate; and

(h) if investment management is delegated, monitoring the performance of the fund managers on a regular basis.

1.2 Although responsibility for these matters lies wholly with the trustees we do not believe they need to become experts in investment management. There is no reason why they may not obtain and rely upon professional advice before reaching a decision. Indeed, the Trustee Act 2000 requires that before exercising any power of investment, trustees must obtain and consider proper advice unless they reasonably conclude it is unnecessary or inappropriate for them to do so[11] . However, the trustees must be capable of understanding and evaluating critically any advice given to them. Trustees also need to satisfy themselves that they have proper information and resources on which to base decisions.

1.3 The Trustee Act 2000 introduced a new statutory duty of care in relation to the performance of trustees' duties and, where it applies, it has replaced the common law prudent man of business standard. The statutory duty is for a trustee to exercise "such care and skill as is reasonable in the circumstances, having regard in particular - (a) to any special knowledge or experience that he has or holds himself out as having, and (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession"[12]. Myners proposed raising the standard of care where pension trustees are taking investment decisions to that applied in the USA of "someone familiar with the issues concerned". Given the difficulty which already exists in recruiting charity trustees we do not support any increase in the current burden of responsibilities expected of them. This is borne out by our survey in which 86% of respondents thought that the current standard was "about right".

1.4 However, we do recommend that trustees receive relevant induction and ongoing training, including training on trustee responsibilities, investment and finance matters commensurate with their allocated duties. Larger charities may have in-house experts able to provide such training. Alternatively, organisations such as the Charity Finance Directors Group and NCVO run training courses on trustee responsibilities and finance related matters.

[11] Section 5 Trustee Act 2000

[12] Section 1 Trustee Act 2000

2. Skills Audit

Charity trustees do not need to be experts in investment management, but it is important that they should have the right skills mix. Those with financial and commercial awareness capable of understanding investment advice and evaluating it should be combined with those who have greater in-depth knowledge of the charity. We recommend that the trustees should review their number regularly to ensure that they have the right skills mix.

3. Appropriate Access to Relevant Information and Expertise

This is critical to the efficiency with which a charity is managed. Larger or more complex charities may have an in-house support team to ensure that the trustees have all the information they need in order to make decisions; where this is not the case, trustees should ensure they have access to investment related data and expertise on a regular basis.

4. Investment Sub-Committee

An investment sub-committee will normally consist of a small number of trustees who have investment expertise. The sub-committee should make investment related decisions in separate meetings, although major investment decisions should be formally endorsed by all trustees following a report/recommendations by the investment sub-committee. We recommend that all charities should appoint a sub-committee where they have the capacity and expertise to form such a committee. An investment sub-committee should be formed in the case of all charities with substantial investment portfolios, say, in excess of £10m.

5. Remuneration, Tax Credits and Time Off for Charity Trustees

5.1 Currently, charity trustees are not generally compensated for their duties in acting as a trustee; exceptions normally arise when a trustee is appointed to provide a specific service or advice, or where an employee of the charity also serves as a trustee. However:

(a) trustees frequently undertake tasks to which considerable personal responsibility attach. Moreover, they have a general duty of care and are personally liable for their actions;

(b) given the need for effective decision-making, trustees' responsibilities can be time-consuming; and

(c) it is arguable that some form of payment or remuneration might attract a wider range of people and skills, in particular those with investment knowledge, which would be beneficial to a charity.

5.2 For all these reasons the Myners Review recommended that pension scheme trustees should be paid, although the Charity Commission believe that "the principle of unpaid trusteeship has been one of the defining characteristics of the charitable sector contributing to public confidence in charities"[13]. This view was endorsed by the survey we carried out as 79% of respondents did not think trustees should be remunerated for carrying out their duties as trustees.

5.3 However, 62% of the respondents to the MORI survey were in favour of trustees being able to claim some form of tax relief for their time donated to charities; such a change would be consistent with recent changes in Gift Aid arrangements. There are also some wider precedents e.g. trade union officials have a statutory right to reasonable paid time off from employment to undertake training and carry out trade union duties.

5.4 In both "Private Action, Public Benefit" and in its response to the Myners Review the Government has indicated it is keen to promote good governance. In order to aid charities in recruiting suitably qualified trustees, we recommend charity trustees should be able to claim tax relief for the time which they devote to charity activities and strongly urge the Government to pursue this proposal. We suggest those seeking relief would have to prove through meeting notes or an attendance report in a charity's annual report that they had attended a specific number of trustee meetings.

5.5 We also advocate that employers should be encouraged to give their employees who are charity trustees time-off to attend relevant charity training courses.

[13] Charity Commission Statement 11 – Payment of Charity Trustees.

Summary

Charities should have an overall investment objective that:

(a) represents their trustees' best judgement of what is necessary to meet the charity's development plans and deliver their charitable objectives over an appropriate timescale;

(b) takes account of their attitude to risk relative to commitments; and

(c) is considerate of stakeholders' views e.g. donors, funders, beneficiaries and employees.

The setting of objectives is an integral part of formulating a Statement of Investment Principles. As a matter of best practice, all charities which have significant investments should have a formal Statement of Investment Principles.

Charities should be open about their future plans to stakeholders and the implications of their investment strategies on those plans.

1. The Current Position

1.1 The Trustee Act 2000 applies to all charities in England and Wales whose property is held on trust. Accordingly, the Trustee Act 2000 does not apply to most charitable companies as their property is not generally held on trust. However, the Act is clearly of relevance to all charities as it sets standards of best practice and governance which are applicable to all charity trustees.

1.2 The Trustee Act 2000 provides that trustees may not appoint investment managers to manage their assets on a discretionary basis unless they have prepared a written statement that gives guidance as to how their asset management functions should be exercised ("a written policy statement")[14]. It is unclear whether this provision only applies if trustees are using the powers in the Trustee Act 2000 to appoint an investment manager on a discretionary basis, or whether it also covers an appointment under an express power. Prudent trustees will assume the wider application. In any event, it is clearly a standard of best practice which should apply to all charity trustees.

1.3 The Trustee Act 2000 also states that in exercising any power of investment a trustee must have regard to the standard investment criteria[15]. These relate to suitability and risk and are:

(a) the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind; and

(b) the need for diversification of investments of the trust, insofar as is appropriate to the circumstances of the trust.

1.4 With regard to suitability, there are a number of issues to consider when contemplating a specific investment. First is the particular type of investment suitable e.g. are equities or real property appropriate? If so, is the particular area of the equity or property market in which it is proposed to invest suitable? If so, is the particular company or property investment contemplated a suitable investment within that area of the market?

1.5 So far as diversification is concerned, the trustees should establish a balanced portfolio in order to manage risk.

1.6 Accounting and Reporting by Charities: Statement of Recommended Practice (Revised 2000) ("SORP 2000") makes certain recommendations about the contents of a charity's annual report - see Section 10 - Reporting.

2. Clear Objectives

2.1 We recommend that charities should have an overall investment objective that:

(a) represents their best judgement of what is necessary to meet their plan to deliver their charitable objectives over the appropriate timescale;

(b) takes account of their attitude to risk relative to commitments; and

(c) is considerate of stakeholders' views e.g. donors, funders, beneficiaries and employees.

2.2 Responsibility should be assigned for achieving the objectives. The trustees will have overall responsibility, but day-to-day responsibility might be delegated to an investment manager.

2.3 The plan and objectives will clearly differ between charities, for example, an endowed charity has a duty to current and future beneficiaries; large

[14] Section 15 Trustee Act 2000.

[15] Section 4 Trustee Act 2000.

health charities may be looking to hold reserves to maintain research activity or provide for research laboratories; an operational or service related charity will probably need to manage its assets on a working capital basis to cover any potential short-term downturn in levels of donations. However, the general matters which the trustees should consider are the same.

3. Statement of Investment Principles

3.1 The setting of objectives is part and parcel of formulating a Statement of Investment Principles. A properly drawn up statement should cover the following matters:

- who is taking which decisions and why this structure has been selected;
- the charity's investment objective;
- the charity's asset allocation strategy and how the strategy has been formulated;
- the charity's attitude to risk; and
- any management arrangements including the mandates given to advisers and managers, and the fee structures agreed with them.

3.2 Other matters which should be considered are:

- "the suitability to the charity of investments of the same kind as any particular investment proposed to be made or retained" - see paragraph 1.3 above;
- the suitability of that particular investment as an investment of that kind - see paragraph 1.4 above;
- the need for diversification;
- the nature and timing of any liabilities;
- liquidity requirements, including dates of planned expenditure;
- income and/or capital requirements;
- the overall level of return expected and whether there is any yield requirement;
- the time horizon of the charity; is it less than five years, or long-term and the time horizon over which performance will be assessed;
- the ability to distribute capital as well as income i.e. total return. Under the total return approach to investment, the form in which returns are received (dividends, interest, capital gains) are irrelevant and investments are managed to optimise the total return, however it is generated;
- the marketability of the investments (important if capital needs to be raised quickly);
- the frequency with which the investment manager is to review the investments and to meet with and discuss them with the trustees;
- any socially responsible, ethical investment or "reputational risk" constraints;
- other tax and legal constraints e.g. restrictions on minimum holdings of a single stock;
- whether the investment manager is to procure the exercise of voting rights on a particular basis, or only with the specific instructions of the trustees;
- custodianship; and
- any index benchmarks which the managers may be requested to adopt.

Some of these matters are covered in detail in other sections of the Report; please refer to the relevant sections.

3.3 There is obviously considerable overlap with the contents of a well drawn-up policy statement, which is already compulsory if a charity's assets are held on trust (see 1.2 above). Subject to materiality, as a matter of best practice, we recommend that all charities who have any investments should have a Statement of Investment Principles or, alternatively, a policy statement covering the above matters.

4. Transparency

4.1 We recommend that charities should be open about their future plans to stakeholders and the implications of their investment strategies on those plans. Apart from the very largest charities, it is very difficult to see how disclosing planned asset allocation strategies could lead to markets moving against them. The only really contentious area is future investment returns, as this is a forecast and may lead to unnecessary future reporting against "guesstimates". True transparency also requires reporting on future plans although there may be an issue about disclosure, particularly if the information could be commercially sensitive.

4.2 However, in general, we favour transparency. We cannot see any reason why trustees should not disclose their future plans; their attitude to risk and, for example, where material, the basis on which investment managers fees are being paid. Consistent with this approach, Section 10 – Reporting, advocates that trustees should ensure that charity annual accounts include a clear statement of investment aims and objectives including, where appropriate, a Statement of Investment Principles.

Summary

- Charity trustees must ensure that asset allocation receives a high level of attention, fully reflecting the contribution it can make towards maximising investment returns and fulfilling a charity's objectives.
- Strategic asset allocation is a crucial determinant of investment performance and should therefore be reviewed frequently.
- A charity's investment asset allocation should reflect a charity's objectives and requirements, not the average allocation of a peer group of funds.
- Although most charities will tend to be risk averse this should not preclude trustees from considering the full range of investment opportunities, once the associated risks have been properly weighed.

1. Strategic Asset Allocation

1.1 Strategic asset allocation is the division, broadly, between bonds, equities, cash and other assets; the last may well include property, land and agricultural holdings. It is this long-term 'neutral' asset allocation policy that aims to meet the charity's objectives. As such, it is a key investment matter since it ultimately drives the definition of a benchmark. Most importantly, strategic asset allocation is a crucial determinant of investment performance as the right balance of asset class selection is far more likely to have a direct bearing on performance than actual stock selection. Charities should therefore assign strategic asset allocation a high level of attention, which should be sustained with frequent policy reviews.

1.2 Actuarial advice is central to the pension fund industry which devotes considerable resources and attention to asset allocation policy. However, charities are generally far smaller in size than pension funds, and therefore have more limited resources to pay for professional asset allocation advice from qualified third parties. Charities would need to be convinced that the use of specialist investment consultants would result in better asset allocation leading to improved risk controls and performance. Furthermore, unlike pension funds, many charities do not have long-term liabilities, and so do not need to perform complex asset-liability calculations. This allows many of them to 'skip' the use of investment consultants. Instead, charities generally place greater emphasis on liaising with their fund managers to provide a framework for strategic allocation policy.

1.3 Trustees should ensure that all chosen asset classes and investments are prudent and suitable, and that they fall within the investment powers of a given charity. They also have a duty to ensure that the spread of investments provides satisfactory diversification and thus an acceptable degree of risk consistent with maximising returns.

1.4 The two key decisions which need to be taken are:

(a) The balance between "real" assets, such as equities, and "nominal" assets, such as bonds and cash.

(b) The balance between domestic and overseas investments.

1.5 The balance in both the above cases will depend on factors specific to each charity, such as; the time horizon over which funds are being invested; whether the charity is cash positive or negative; any income requirements including the need to adopt a total return policy if appropriate, spending plans and any specific constraints, e.g. income, SRI (Socially Responsible Investment) and ethical issues.

1.6 The main asset categories in which a charity might invest are:

(a) Cash – this is the most liquid of assets with the lowest risk and the lowest real return in the long run, as well as being the cheapest to manage. However, on occasion it may offer only limited protection from rapid changes in inflation and could lead to a shortfall in income when interest rates are low.

(b) Gilts & Bonds (government securities) provide a guaranteed nominal rate of return if held to maturity. Over time their real capital value is eroded by inflation. However, fixed interest securities are an important source of predictable nominal income. Index-linked securities provide better inflation protection but lower levels of nominal income in the near term.

(c) Equities - both domestic and overseas. Often, for smaller charities, these are accessed through pooled investment vehicles to ensure a prudent degree of diversification. Over the longer term equities should produce capital and income growth, and historically have

outperformed other asset classes. In the short term, as demonstrated, over the last twelve months, equities can be volatile and income levels can be at risk.

2. Full Range of Investment Opportunities

2.1 The Myners Review recommended that pension funds should consider a full range of asset classes beyond traditional bond and equity assets and if, after consideration, the trustees decide an asset class is unsuitable for a fund, they should be entitled to reject it. We endorse this view, particularly since potential investment returns from equities may be lower than they were in the 1990s. Consequently, we believe that it is appropriate for charity trustees to give consideration to new asset classes which could reduce the volatility of the portfolio whilst at the same time increasing the potential investment returns.

2.2 Myners placed particular emphasis on private equity. Other alternative assets, which could be considered include hedge funds, high yielding corporate bonds and property etc. In each case trustees should:

(a) Satisfy themselves that the asset represents an appropriate risk. Although many charities will have long-term investment time horizons which are allied to long-term income needs their general level of funding will typically be less favourable than for pension funds. Moreover, since there will normally be no guarantor behind any potential investment shortfall, charities may, justifiably, tend to be more risk averse.

(b) Consider the message that they might convey, to donors for example, if they start to invest in new, higher risk assets.

(c) A particular asset class may have a high minimum level of effective critical mass for diversification, which may be too large for many charities.

(d) Hedge funds and private equity may generally be less liquid investments. There is, therefore, a need to take a sustained long-term approach. Costs of exit and entry will also have to be considered, as these are usually higher than for conventional instruments.

(e) Review the ethics of the underlying investment vehicle.

2.3 When considering these types of asset, it is worth noting that the route via a "fund of funds" vehicle may be more appropriate for charities since it is more diversified and hence less risky. In each asset class trustees should also consider whether active or passive management is likely to produce the best risk adjusted results. See Section 8 - "Explicit Mandates" for more details on these issues.

Summary

- If a charity has sizeable investment funds, say, in excess of £50m, including Common Investment Funds, the charity's mandate should include the principle of the US Department of Labor Interpretive Bulletin on Activism.
- For all other charities, activism should not be mandatory; trustees should consider the issue and reach a position specific to their individual charity. Whilst any action to improve the financial returns on a charity's investments will generally be in the best interests of the charity, it can only be justified if such action is cost effective and liable to have a material impact.
- The onus to vote should lie with the investment fund managers. Therefore, charities that wish to vote should ensure their fund manager has an explicit strategy elucidating the circumstances in which they will intervene in a company, the approach they will use in doing so, and how they will measure the effectiveness of their strategy.

1. What Did Myners and the Government Say?

1.1 *"Effective intervention, when appropriate, is in the best financial interests of beneficiaries. As such it is arguably already a legal duty of both pension fund trustees and their fund managers to pursue such strategies. US legislative guidance makes it clear that activism – where it might add value – is a part of the fiduciary duty of an investment manager"* - the Myners Review[16].

1.2 Myners also states that the US Department of Labor Interpretative Bulletin ("the Bulletin") "correctly spells out the relationship between the investment duties of a manager, and activist behaviour [and]... managers should routinely consider the possibility of intervening in investee companies as one of the means of adding value for their clients"[17]. The Bulletin[18] provides:

(a) "The fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock."

(b) "The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the value of the plan's investment."

(c) "An investment policy that contemplates activities intended to monitor or influence the management of corporations in which the plan owns stock is consistent with a fiduciary's obligations under ERISA when the responsible fiduciary concludes that there is a reasonable expectation that activities by the plan alone, or together with other shareholders, are likely to enhance the value of the plan's investment, after taking into account the costs involved. Such a reasonable expectation may exist in various circumstances, for example, where plan investments in corporate stock are held as long-term investments or where a plan may not be able to easily dispose of such an investment."

(d) "Active monitoring and communication activities would generally concern such issues as the independence and expertise of candidates for the corporation's board of directors and assuring that the board has sufficient information to carry out its responsibility to monitor management. Other issues may include such matters as consideration of the appropriateness of executive compensation, the corporation's policy regarding mergers and acquisitions, the extent of debt financing and capitalisation, the nature of long-term business plans, the corporation's investment in training to develop its workforce, other workplace practices and financial and non-financial measures of corporate performance. Active monitoring and communication may be carried out through a variety of methods including by means of correspondence and meetings with corporate management as well as by exercising the legal rights of a shareholder."

1.3 The Bulletin also articulates the view that managers must not allow themselves to be influenced by conflicts of interest:

"Fiduciary duties... require that, in voting proxies, the responsible fiduciary consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement to unrelated objectives".

[16]Institutional Investment in the UK: A Review; ibid, para 5.89, page 92.

[17]Ibid; para 5.90, page 93.

[18]Interpretative bulletin relating to statements of investment policy, including proxy voting policy or guidance: Code of Federal Regulations Table 29, Chapter XXV, 2509, 94-2, 1994.

1.4 The Myners Report goes on to recommend that all pension fund trustees should incorporate the principle of the US Department of Labor Interpretative Bulletin into fund management mandates. It also recommended that, in due course, the principles should be incorporated into UK law.

1.5 The Government consultation document has taken this point forward and proposes the following duty:

"Any person who is responsible for the investment of the assets of a retirement benefit scheme must, in respect of any company or undertaking (wheresoever resident or incorporated) in which they invest such assets, use such rights and powers as arise by virtue of such investment in the best interests of the members and beneficiaries of such schemes."

1.6 Activism differs from the other Myners Principles in that compliance will be mandatory. The Government has outlined two expectations and will review progress in Spring 2003. These are:

(a) an increase towards 100% in the proportion of mandates incorporating the principle of the US Department of Labor Interpretive Bulletin on Activism; and,

(b) an increase towards 100% in the proportion of funds reporting to their members the strategy of their managers on activism and how they measure the effectiveness of this strategy.

2. The Impact on Charities and Trusts

2.1 The responsibilities of a charity trustee are:

- to act in good faith;
- to exercise their own discretion;
- to act in the best interests of the charity's objectives;
- to act in accordance with the appropriate standard of care, a higher standard being required if the trustee is a professional rather than a lay person; and
- not to have all the necessary expertise, but a duty to obtain information and advice and do the best they can.

2.2 Clearly, improving the financial returns of investments is in the best interests of beneficiaries and members; however, Myners goes further than this to say that, in this light, there is arguably already a legal duty on pension trustees to pursue a strategy of effective intervention.

2.3 However, in that same light, such a strategy can only be in the best interests of beneficiaries and members if the returns are likely to outweigh the costs. Consequently, for many small and medium sized charities, activism to improve investment returns is unlikely to be cost effective, or liable to have a material impact. For charities with sizeable investment funds, we suggest in excess of £50m, intervention is likely to be in the charity's financial self-interest and therefore the charity's managers' mandate should adopt the principles of the US Department of Labor Interpretative Bulletin.

2.4 Many charities invest using a passive strategy through Common Investment Funds or tracker funds. This should not stop trustees requiring investment managers to follow an activist strategy and trustees should be aware of where their funds are invested even when pursuing a passive strategy.

2.5 The lack of specialist skills amongst charity trustees is not an excuse to avoid activism and whilst charity trustees are not required to have expertise, they do have an obligation to obtain information and advice and do the best they can. Therefore, they must recognise the obligation and, if activism is likely to be cost beneficial, they may need to employ competent advisors and effectively "outsource" their obligation.

2.6 The final point concerns shareholdings that are consistent with the objects of a charity and made in order for the charity to further its objectives. This will often occur where a charity has a strong ethical stance. Clearly, in this instance the shares will be held with a view to activism and therefore should either be managed separately by the charity itself, or the charity should specifically direct its manager as to how the shares should be voted.

3. MORI Survey

Three questions in our Survey related to Activism. The key responses to these questions were that:

(a) of 219 respondents only 6% voted on the shares within their portfolio at AGM's in 2001;

(b) only 28% had an existing policy on corporate governance in relation to their investments; and

(c) in response to the question "The Government plans new UK laws requiring pension funds to vote, what is your view?" 18% felt that it should apply to all charities, 11% thought it should not apply to charities, 24% thought that it should only apply to charities with investments over £50m, 5% had other views and 42% did not know.

Summary

- The role of trustees is to ensure that there is effective and efficient decision-making and where they consider they have insufficient time, resources or expertise they should delegate discretionary investment management to one overall manager or to several managers. They may also appoint specialist managers in areas such as property and custodianship.

- The main areas they are likely to delegate are asset allocation and stock selection. Asset allocation can be either strategic or tactical. Strategic allocation generally addresses setting a strategic benchmark related to the long term investment objectives of the charity, including income requirements and time horizons. Tactical asset allocation is generally directed towards improving incremental returns by taking investment positions in different groups of assets.

1. Introduction

1.1 The Myners Review concluded that, historically, pension trustees had devoted insufficient time and resources to the issue of investment asset allocation and that, generally, the fees paid for asset allocation were often much less than for investment management. As a result, the Review questioned whether institutional investors might be devoting insufficient resources to an area which, on the basis of research, had the potential to contribute significantly to investment performance.

1.2 Trustees do not have to delegate. The standard of care required by them is stated in Section 1 of the Trustee Act 2000 as being that of "a person familiar with the issues concerned". Section 11 (3) b permits delegation but assumes that areas such as the selection and monitoring of a manager, their terms of reference and the annual preparation and review of their policy statement remains the responsibility of the trustees.

1.3 Currently, it appears that many charities do not use any specialist advisers, and, where they do, they tend to use consultants or accountants rather than actuaries. Consultants are primarily used for performance monitoring; advice on investment objectives; advice on strategic asset allocation and investment manager selection.

1.4 Many charities, particularly smaller charities, may be reluctant to pay additional fees for investment consultancy advice. A similar position exists in the pension sector where the National Association of Pension Funds (NAPF) has recognised that smaller schemes may find the provision of all their actuarial and investment services from one provider to be the most cost effective.

1.5 Although the Myners recommendations in the area of investment asset allocation are of less relevance to the charity sector, it is hoped that the needs of charities for detailed advice in this area will in future be met by investment consultants, independent advisers and fund managers playing an increased role in the provision of such advice.

1.6 We believe that the type of advice required could well differ for operational and endowed or grant-making charities.

2. Remuneration of Investment Consultants

2.1 Strategic investment advice is, by its nature, long-term and there is a strong case for arguing that it should be monitored and remunerated accordingly. The last decade has witnessed substantial separation of the functions historically performed by investment managers and as a result within the pensions sector, investment asset allocation responsibility has increasingly passed from the investment manager to the investment consultant. This has typically been associated with the issues of strategic allocation, long-term investment benchmarks, and setting parameters for investment managers in the context of an asset-liability modelling exercise. In this latter case, the actuarial assessment of the long-term liabilities of the pension fund is linked to the long term investment characteristics of the different asset classes available.

2.2 Charities do not, in most cases, have a requirement for an actuarial assessment of long term liabilities in the same way as pension funds. However, Myners' recommendations that strategic asset allocation and benchmarks should be determined by reference to the objectives of the fund, and that sufficient weight should be attached to the relative importance of these decisions, is equally applicable to charities.

2.3 The effectiveness of performance-related fees may be questioned but if tied to the development

of appropriate risk adjusted benchmarks, which take account of both planned commitments, such arrangements may provide an appropriate means of balancing risk and reward.

3. Investment Manager Contracts

3.1 Since the events surrounding Maxwell, the fund management industry has become more closely regulated and contracts of appointment have consequently expanded. Following the Pensions Act 1995, Investment Management Agreements became more formalised and pension funds were required to establish formal statements of investment principles. In part, this reflects a more rigorous definition of the relationship between the parties but also the range of services offered by investment managers.

3.2 The provision of a satisfactory level of service in all its forms is the greatest guarantee that an investment manager will retain an account. If contractual security is provided for too long it could lead to some weakening of this objective. As a result, it may be sensible to agree contracts that extend for a minimum period, perhaps of three to five years, which are subject to regular review and include due provision for termination if the investment manager fails to satisfy the agreed objectives or goals. Where such a contract is agreed, trustees might request some level of fee reduction in return for the extra security given to the investment manager.

3.3 Myners raised some concerns about the lack of clarity in the timescales over which an investment manager's performance was judged; it was thought this could contribute to sub-optimal behaviour patterns among investment managers, and the frequently cited perceptions of short-termism, risk aversion and herd mentality.

3.4 The overall purpose of an investment contract should be clarity of relationship, rather than avoidance of liability. It is recommended that trustees should provide fund managers with clarity about the period over which their performance will be judged - and hold to that under the terms of the contract, unless clearly abnormal circumstances arise.

3.5 There has previously been little public debate on the appropriate levels of fees to be charged for investment manager services to the charity sector and reliance has primarily been placed on competitive market pressures to determine the correct levels although, more recently, it appears that the increase in the use of passive products, such as 1% CAT standards for stakeholder products, has resulted in some downward pressures on costs. Anecdotally, it appears that, in general, those charities with large investment funds may be paying less than the CAT level, although, hidden charges may still mean that the aggregate fees paid are higher than suggested by the headline management fee. For example, part of the underlying transaction costs may accrue to the fund manager or custodian through a direct rebate of commissions or indirectly via a margin on the terms secured on deposit interest or foreign exchange dealing, or in services received such as research or technology through a soft commission brokerage agreement.

3.6 Trustees would be well advised to ask for an annual fee declaration that itemises all expenses paid by their investment manager(s) so there is complete transparency concerning the aggregate level of fees paid. Such information would enable them to determine their "total investment expense ratio" and allow them to assess whether their expenses are fair and reasonable in both the context of the services provided and in relation to the level of fees charged in the general market.

Summary

- There should be an explicit written mandate with each individual manager and custodian covering the investment objective, benchmarks or other service level standards and risk control parameters.

- The mandate should cover how the manager will aim to achieve the agreed objectives and the timescale for measurement and evaluation of success.

- The mandate should not be unnecessarily restrictive regarding particular financial instruments, except where these are contrary to the overall objectives of the charity.

- Trustees should have a better understanding of the transaction costs they incur and put in place arrangements to keep them under control. Mandates should identify what costs will be reported as management fees including any indirect benefits such as those attributable to soft commission arrangements.

1. Introduction

1.1 As mentioned earlier, it is common practice for charity trustees to delegate investment management, if not the strategic asset allocation decision.

1.2 In delegating their authority, the trustees still retain ultimate responsibility (e.g. in their selection and monitoring of the investment manager) therefore it is imperative that the delegate understands what is required of them.

1.3 Historically, most mandates were framed around a generic investment objective "to achieve a return above X subject to an acceptable level of risk", where X referred to a peer group or specific index target. Although mentioned, risk was at best an ill-defined term and no consensus existed as to what was acceptable. Generally, no time horizon was attached to the achievement of the objective, although more recently rolling three year targets have begun to become the established norm.

1.4 A focus on asset allocation and the definition of objectives tied to some form of liability or other commitment should make for greater clarity in terms of expected return; expressed either as an absolute measure or relative to other standards or indices. In making this step, trustees should not omit the need to consider risk. Investment risk is the incidence of an undesirable event and the consequences of the risk occurring are not always financial – there may be a public relations impact which may be more sensitive for a charity, for example, than for other investors.

1.5 Risk can be usually attributed to one or more of:

- Manager activity, individual or institution;
- Custodian activity;
- Interest rates;
- Inflation;
- Market volatility;
- Currency;
- Credit default;
- Settlement failure;
- Liquidity;
- Legislative compliance; and
- Effect on a charity's reputation if it is investing in assets inimical to its objectives or the interests of its beneficiaries.

1.6 A mandate should therefore be explicit as to the controls expected to be imposed to minimise the event risk in each of the above areas from developing. Conversely, the mandate should not be so restrictive as to eliminate any scope for out-performance through judicious security selection or choice of assets. To beat any benchmark an investor will need to take positions against it, although the extent of the differences should be controlled having regard to the nature of the appointment and the reasonable and consistent expectation of rewards.

1.7 Before an explicit instruction can be given, there is a prior question to be answered "in whose mandate?". This requires a proper understanding of what the manager and custodian respectively do (and do not do).

1.8 Put simply, the investment manager's scope is limited to the selection of securities within a predetermined universe with the aim of outperforming or equalling that universe's return over time. This will involve quantitative and qualitative research and analysis to screen the universe for opportunities and methodologies to construct a bespoke portfolio with the appropriate expected relative return and risk characteristics. Trading in securities to effect the portfolio construction may be done by the trustees or outsourced. However the bulk of the administration of the portfolio is within the scope of the role of the custodian which encompasses settlement, cash collection and management (including making deposits), tax reclamation, valuation, foreign exchange dealing, voting and other corporate actions.

1.9 Once the scope is properly understood, then specific service level standards and key performance indicators can be agreed. These should define not only what is expected, but also the term over which performance is to be assessed. A mandate would then only be terminated for a material breach or a fundamental change in the circumstances of either the charity or the manager/custodian that rendered continuation of the contract inappropriate.

1.10 Myners has produced a list of questions on transaction costs, which we commend to charities to pursue with their appointed managers. The questions are set out in full in Appendix 3.

Summary

Charities should establish appropriate investment benchmarks before making any investments which

- Relate directly to their investment objectives;
- Have been agreed by all the relevant parties (including fund managers and consultants); and
- Reflect key factors such as the time over which the investment is made, the trustees attitude to risk and any restrictions placed on the investment funds.

1. Targets and Benchmarks

1.1 Benchmarks show what the aims of the fund are and how they are likely to be achieved.

1.2 Targets reflect the aims of the investment manager and are normally defined in terms of out-performing the benchmark by a set amount or percentage.

1.3 The level of risk the trustees are willing to tolerate can be expressed through setting limits on how much the fund can diverge from its benchmark or through limits on the allowed tracking error.

1.4 Charities can use customised or peer group benchmarks.

1.5 Examples of benchmarks commonly used are:

(a) 7 Day Deposit Rate (cash);

(b) FTSE All Share Index (UK equities);

(c) WM Unconstrained Charity Index (balanced unconstrained funds);

(d) Other WM or CAPS indices such as the WM Constrained by Income Index; and

(e) Pension Fund indices such as the WM2000 Pension Fund Index.

1.6 Myners recommended that benchmarks should be set for specific periods so that trustees can review them formally and fund managers know over what period they are expected to perform.

2. Advantages and Disadvantages of Different Benchmarks

2.1 Myners recommended customised benchmarks mainly because they can be designed to meet the precise needs of a particular pension fund. However, there are costs in setting them up and they make comparisons with other funds more difficult.

2.2 Peer group benchmarks are recognised, cheap, easy to understand and highly visible but are less likely to meet the precise needs of a particular charity.

2.3 Hence, where charities have demands highly specific to themselves they should consider customised benchmarks and where they have similar objectives and time frames to other charities they may well be better placed to opt for peer group benchmarks. In general, operational charities are more likely to fit in with the second group and long-term grant making and endowment charities the first.

2.4 The "Constrained by Asset Mix" benchmark was set up for charities restricted by the Trustee Investments Act 1961 and has largely become redundant.

2.5 Peer group benchmarks act best at the broad asset level. In particular the amount that charities invest in overseas assets, both for diversification purposes and to try to enhance performance, may be of more interest than the amount invested in a particular region, such as the US.

3. Performance Measurement

3.1 Trustees should have a system for formally assessing how their investment manager has performed and should decide beforehand at what point they might want to intervene or recommend action be taken.

3.2 SORP 2000 recommends that charities comment on their performance suggesting that Annual Reports should contain "where applicable, the investment policy and performance against policy"[19].

[19] Paragraph 31(c).

3.3 In assessing performance trustees should consider:

(a) How the figures were produced and whether they have been independently monitored.

(b) Over what period performance should be judged. This should depend on the objectives of the fund but in general more attention should be paid to longer-term figures (3 or 5 year figures) than shorter-term figures (typically 3 or 6 months).

(c) Whether the performance has been achieved within the agreed level of risk.

(d) When to take action in the event of under-performance. The easiest way of doing this is to agree at the outset tolerance levels within which performance (even sub par) is acceptable because it is close enough to the trustees' requirements.

(e) Whether any restrictions placed on the fund have influenced its performance.

3.4 An example of a suitable target might be, "The aim of the fund is to outperform the WM Unconstrained Charity Index by 1% pa and not to under-perform this index by more than 3% in any one year".

3.5 Where performance falls outside agreed tolerance levels the trustees might want a letter from the investment managers explaining why and what action, if any, has been initiated. This can help the trustees assess their own response and whilst the onus is not necessarily to take action the trustee may need to consider whether further action is needed.

3.6 Trustees should consider both the performance of individual funds but also the charity's overall position including any other assets such as property.

Summary

Trustees should ensure that the charity's annual report includes a clear statement of investment aims and objectives, including, where appropriate:

(a) A summary of the Statement of Investment Principles;

(b) Indicate where the trustees have and have not applied the Charity Investment Principles; in those cases where the CHIPs have not been applied provide an explanation as to why the trustees decided to depart from the application of the relevant CHIP; and

(c) Summarise the investment performance achieved against the charity's selected benchmarks.

1. Background

1.1 Charities must comply with the reporting requirements set out in the Charities Act 1993 and the Charities (Accounts and Reports) Regulations 2000. These require a charity to prepare an annual report in respect of each financial year which must include a description of the policies (if any) which have been adopted by the charity trustees for the selection of investments for the charity. Where the charity has gross income in excess of £250,000 the report must include a statement regarding the performance during the financial year of the investments belonging to the charity (if any). The reporting requirements do not apply to all charities and some categories of charity e.g. charitable companies are also subject to specific legislation appropriate to the category of charity.

1.2 SORP 2000 is applicable to all charities and the Charity Commission expects charities to comply with it. SORP 2000 came into effect as from 1st January 2001 and applies to accounting periods starting on or after that date. Certain requirements and recommendations are only applicable to charities with an income of more than £100,000 and to all charitable companies.

1.3 SORP 2000 recommends that the trustees of all charities prepare an annual report and that the report should contain both statutory disclosures referred to above, whether there is any legal obligation to make them or not.

1.4 In its Statement of Financial Activities a charity with gross income in excess of £100,000 or a charitable company is required by SORP 2000 to disclose both its realised and unrealised investment gains and losses (paragraphs 153-156) and any investment management fees within the heading of "costs of generating funds"; such costs may require further disclosure separately in the notes to the accounts depending on the materiality of such costs within the heading. Paragraphs 231-241 SORP 2000 extensively cover the valuation and disclosure of investment assets in charity accounts.

2. Recommendations

2.1 In light of the existing extensive reporting and disclosure requirements little additional reporting is required. However, where the level of investments is material in relation to either the charity's total assets or its total reserves we recommend that the annual report should:

- provide a summary of the Statement of Investment Principles;
- indicate where the trustees have and have not applied the CHIPs; in those cases where the CHIPs have not been applied provide an explanation as to why the trustees decided to depart from the application of the relevant CHIP; and
- summarise the investment performance achieved against the charity's selected benchmarks.

Summary

- When making investments charities must work within their powers of investment.
- There is no clear standard for charity trustees to use to help them identify what is or is not an investment or what economic activity constitutes an investment activity.
- The lack of a clear standard means charities must operate without clear boundaries for both legal purposes (e.g. diversification) and practical purposes (e.g. asset allocation). The boundaries set for tax purposes are not clear or straightforward.
- A modern approach to the classification of assets and activities is needed.

1. Why definition is important

1.1 A charity can only invest in accordance with such power of investment as is available to it either by virtue of its constitution, or under the general law. The constitution of a charity, or the terms of gifts to it, can impose restrictions upon what a charity can hold as an investment (a modern example being the imposition of ethical investment criteria). However, generally speaking, most modern constitutions give charities the same power to invest as a private individual. The general law also provides the trustees of most charitable trusts with the power to invest in any kind of investment that they could make if they were absolutely entitled to the assets of the trust.

1.2 Fundamental to any power of investment is that it is a power to "invest". For a charity to be able to make sense of the exercise of this power (i.e. what can the charity buy or sell using this power?) charity trustees need to understand what an investment is in legal terms. In making any investment decision, it is clearly undesirable for trustees to be in any doubt as to where the boundaries of the type of asset that constitute an "investment" lie. Charity trustees cannot ask themselves what they should invest in, without knowing what they can invest in.

1.3 The problem is that the law is very bad at providing an answer. There is no straightforward modern precedent defining what constitutes an "investment". To demonstrate the range of opinions that exist on the subject:

(a) Traditional trust experts refer to a 1919[20] case in which the judge suggested that one meaning of the verb "to invest" was "to apply money in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of the income which it will yield". This is interpreted to mean that an investment must be income producing.

(b) Such modern decisions as comment at all on this subject tend to do so in very loose terms. One recent case[21] appears to suggest that an investment can at least be regarded as something that produces an income or capital return.

(c) The Charity Commission (in the new edition of CC14) defines investment as "the process of acquiring an asset with the aim of obtaining a financial return (whether from income or capital growth) from that asset". However, in its guidance the Charity Commission then goes on to limit interpretation of this definition by suggesting that in order for an asset to be an investment "funds must at some stage have been provided by an investor to an 'investee' who agrees to provide some form of benefit in return for the use of these funds". This approach is considered by the Commission to be necessary to exclude assets where the purpose of acquisition is the exercise of a trade or gambling. The Commission consider that by definition this excludes from "investment" assets such as commodities, works of art, premium bonds and derivatives. Derivatives can only be bought as an ancillary part of the investment process in order to hedge against risk or to reduce costs.

(d) Expenditure of charitable funds on investments that fall outside the categories prescribed by paragraphs 2-8 of Schedule 20 of the Income and Corporation Taxes Act 1988 will result in the charity losing tax relief on those funds unless the Revenue agree that the expenditure is investment and that the investment is for the benefit of the charity (and not for the avoidance of tax). However, the Revenue will no longer give advance clearance for any proposed expenditure.

[20] Re Wragg [1919] 2 Ch 58.

[21] Harries v Church Comrs for England [1993] 2 All ER 300.

(e) The SORP 2000 does not define investment assets. However, it does refer to investment assets generally being held "for the continuing benefit of the charity in the form of income or capital appreciation".

(f) The Financial Services and Markets Act defines investments but for the purposes of that Act only.

1.4 The views put forward by the Charity Commission appear to rely upon the tax treatment of a charity's activities; in other words, if the Revenue tax an activity (such as property development) as non-primary purpose trading then it cannot be an investment activity. Certainly, the tax consequences of any activity are an important element of an investment decision. However, others take the view that tax policy is not a good determinant of whether an asset can be an investment. Also, the assessment of the method by which an asset is employed (and thus whether the activity is taxed as investment, trading or gambling) is not straightforward. For example the Revenue's current statement of practice on the taxation of futures and options (SP3/02) accepts that "whether or not a taxpayer is trading [in futures or options] is a question of fact and degree".

2. A new approach?

2.1 As a general principle it must be imprudent for a charity to stray away from compliance with the views of its regulator. Charity Commission guidance certainly make sense in terms of identifying what is not an investment activity (i.e. trading, gambling, and seeking donations). Elsewhere it differentiates between genuine investment and other forms of expenditure in furtherance of charitable objectives, such as social investment. However, the Charity Commission's approach raises questions as well as answering them.

2.2 For example, in the Commission's guidance land can be an investment but commodities are not "because 'there is no investee' where the trustees simply purchase an asset in the speculative hope that they will eventually be able to obtain a higher price from a purchaser than they have paid for the asset". In other words, the very nature of an asset can prevent it ever being an investment. However:

(a) whether or not an asset is speculative is in our view more of an issue of suitability than whether or not the asset is capable of being an investment in the first place; and

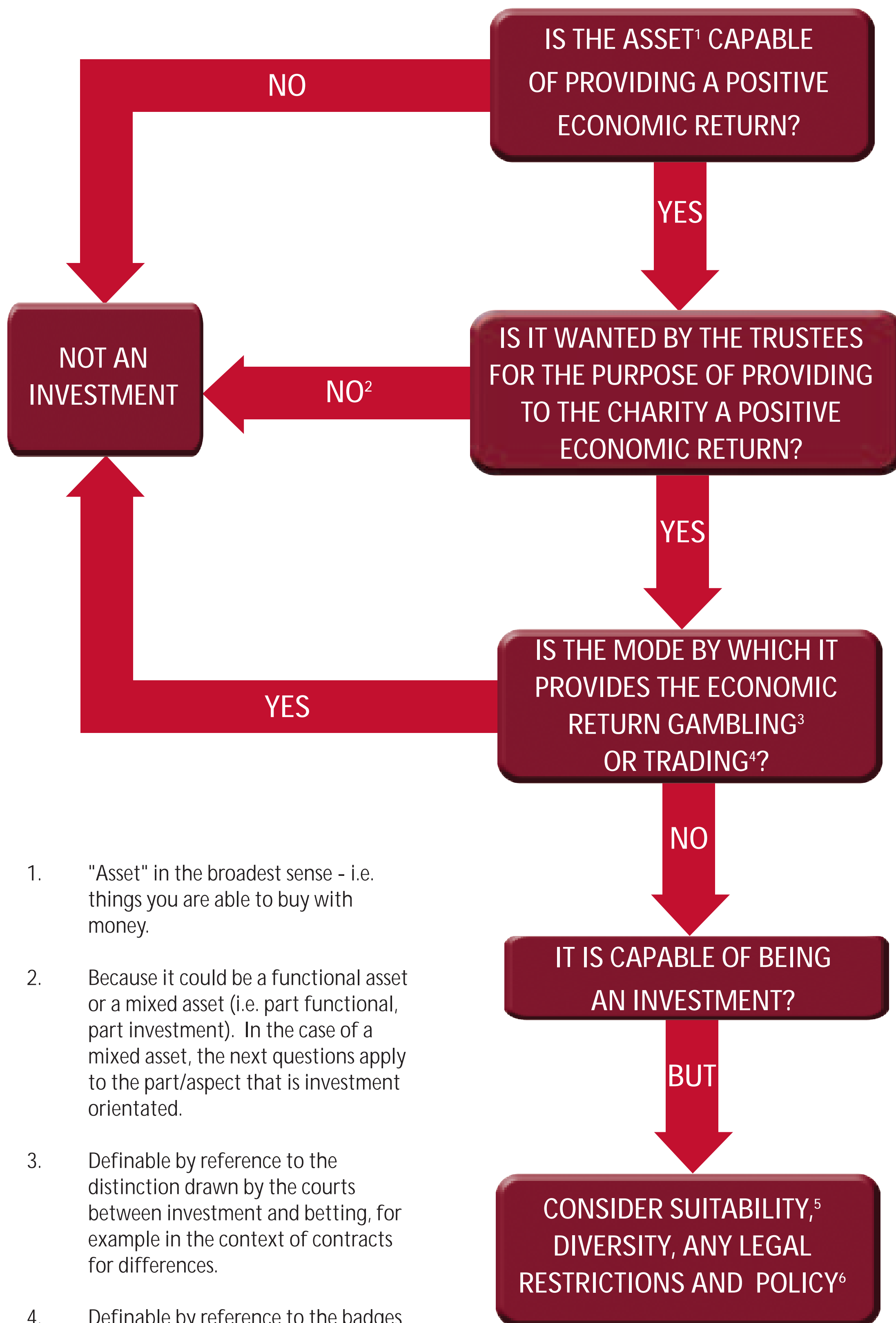
(b) any asset can be bought with the intention of deriving a return by virtue of the asset rising in value, that asset also being capable of providing a different (income) return. For example, works of art can be loaned to exhibitors for a fee; commodities can be loaned to a third party for an agreed return.

Is it right that land can be investment but commodities can only ever be functional assets or stock in trade?

2.3 A simpler and perhaps more modern approach might be to move away from trying to describe investments in terms of identifiable products. These days, generally speaking, the legal form and the economic substance of an investment can be separately addressed and separately combined, such that, almost any economic form can be given almost any legal form.

2.4 If this is the case, the only way that any trustee might successfully identify what constitutes an investment is by reference to economic substance. This suggests the definition of investment as the purchase of an asset reasonably believed to be capable of producing, over time, a return to the charity that will exceed its cost. After considering the mode by which those assets provide the prospective return (investment, gambling and trading being different activities), which particular assets to acquire is then primarily a matter of "suitability" (i.e. "Is this the type of investment we should hold?" and "Of that type of investment is this the one we should hold?"). The formation of a reasonable belief on the part of the trustees would be a matter of the trustee duty of care.

2.5 This approach can be summarised in the form of the diagram that follows.



1. "Asset" in the broadest sense - i.e. things you are able to buy with money.
2. Because it could be a functional asset or a mixed asset (i.e. part functional, part investment). In the case of a mixed asset, the next questions apply to the part/aspect that is investment orientated.
3. Definable by reference to the distinction drawn by the courts between investment and betting, for example in the context of contracts for differences.
4. Definable by reference to the badges of a trade.
5. Including tax implications.
6. "Policy" meaning the Charity's investment policy including any proper ethical criteria.

Appendix 1 - Summary of survey results

In July 2002, MORI conducted a survey of all ACEVO members on matters relating to investment. The survey, which was sponsored by The John Ellerman Foundation, was undertaken as part of a fact-finding mission to help the Young Committee co-ordinate a response from charities to the Myners Review on institutional investment in the UK. 219 charities replied to the survey and, perhaps not surprisingly, there was a bias amongst respondents to smaller operational charities.

A survey undertaken as part of the Myners Review was targeted at pension fund trustees and their knowledge of investment issues. The Young Committee's survey has focused on the charity sector and amongst its findings were that a significant number of trustees did not have specific knowledge of investments and that many charities still had to develop their thinking on issues of corporate governance. It also highlighted that an important distinction can be drawn between grant-making and operational charities and between large and small charities. Whilst a number of reports on this sector such as "Private Action, Public Benefit" have already commented on the considerable size disparity between large and small charities, and therefore on the burdens that should be placed on the two different types of charities, few have noted the differences between grant-making and operational charities. We considered that charities which rely for their funding on grants or donations are different to those making grants and therefore rules that could be useful for increasing public confidence in one type of charity might be less relevant for another.

Some of the key findings were:

1. The vast majority of charities still view cash donations as their principal source of charitable income with 80% of charities receiving cash donations.

   The proportion of charities receiving the following types of donation were:

Cash	80%
Legacies	47%
Shares	16%
Other	18%

2. Whilst many respondents had received other forms of donations most (66%) felt recent legislation had not led to any increase in share donations. This provides further evidence that Government initiatives to encourage tax efficient giving have not been taken advantage of with only 4% of charities claiming to have noticed any increase. Of those that expressed a preference, and over half of charities did so, 96% felt there was a need for new planned giving products. Many also felt that similar tax legislation should be extended to other assets such as art and antiques.

   (We recommend that the Government should extend tax relief on donations of shares to other assets such as art and antiques.)

3. The chief causes of realisations or drawing on capital were:

   - Money being expended on property and other projects;
   - The costs of complying with new legislative requirements;
   - Staffing costs; and
   - Income shortfalls.

4. According to most surveys and to firms, such as WM, that monitor performance the average charity investment mix for a charity with long-term objectives is approximately 60% UK equities, 15-20%, overseas equities, 20-25% cash and fixed interest.

   Whilst most charities held a diverse mix of assets only 2% admitted to having any of the following assets:

   - Venture Capital / Private Equity Trust;
   - Physical Assets/Works of Art;
   - Commodities;
   - Hedge Funds; and
   - only 2% used derivatives or options.

5. Policy on Reserves

   We were pleased to note that 79% of charities said they had a policy on their level of reserves. In general, operational charities targeted that reserves should cover between six months and two years expenditure; alternatively, a minimum reserve level was set. The lowest level of reserves stated was 2 months operating costs although, in

some cases, the level of reserves was said to be "aspirational". Reserves were also said to be needed in case government grants or "promised monies" came in late.

6. In response to surveyed questions on corporate governance, 17% of charities claimed to have an ethical screen and 5% a SRI (socially responsible investment) screen. A large number of charities excluded tobacco, arms, alcohol and animal testing investments. In some instances, charities justified their policy because, for example they were a health charity or a charity whose caseload was influenced by factors such as alcohol abuse. Other charities felt activities such as gambling were not consistent with their aims and values.

   (The Strategy Unit Report recommended that further clarification be given as to a charity's ability to follow a broad ethical policy. We welcome this and suggest that until this happens the ruling in Harries v Church Commissioners (1992) should be followed. This states that trustees must secure the best possible returns unless investment in particular stocks runs contrary to the charity's objectives.)

7. Most charities drew a distinction between ethical investment and shareholder activism. Few reported that their investment managers voted at annual general meetings (only 6% said yes) and less than 1/3rd (28%) said they had an existing policy on corporate governance. When asked whether charities should vote at AGMs 42% were not sure and only 18% felt they should. The most popular response was to suggest that only large charities ought to vote. In general most respondents felt existing legislation as set out in the Trustee Act 2000 was about right (86% of respondents).

8. The average charity now has more than 12 trustees with several charities having more than 30. Only a tiny minority of these trustees are paid. Most charities have one trustee with relevant investment experience. Approximately 12.5% of trustees have investment experience and only a small number had undertaken any training.

   (We consider more effort will need to be put into trustee training.)

9. Most respondents were against trustees being remunerated (79% said "No") but of those that expressed a preference most (62%) felt they ought to be able to claim some tax relief for their time donated to charities. The way in which this would work was not stated but a possibility would be for those seeking relief to prove through either meeting notes or an attendance report in a charity's annual report that they had attended a specific number of trustee meetings.

10. Only 22% of charities had separate investment committees.

    (We recommend that charities have an investment sub-committee if the charity has a substantial investment portfolio in excess of £10m.)

11. Some charities use advisers other than investment fund managers who are generally used for asset allocation, investment manager selection, writing objectives, performance measurement and monitoring.

12. Most also use investment fund managers with one or two managers being the norm for larger charities but with quite a few smaller funds claiming not to use any managers. (This may be influenced by the nature of charities that were surveyed with a large number of the charities being of an operational nature, holding principally cash investments).

13. When asked how long they had been with their investment fund manager, the replies ranged from less than one year (9%) to over 5 years (41%). 51% said they had been with their main manager for less than 5 years. 2/3rds (65%) had reviewed their performance in the last year but again there was a wide range of dates for those who had put these services out to tender, with 15% having re-tendered within the last year and 50% within the last 5 years.

    (Charities do therefore appear to realise the need to review their arrangements from time to time.)

14. Most gave their managers full discretion (80%) and most said they monitored their fees and transaction costs (89%). Only 10% thought they paid soft commission. Surprisingly, most felt their stocks were in their own name (55%). Other surveys suggest that in general most trustees use the custody arrangements chosen by their investment manager's firm.

(We concluded that issues such as custodianship and soft commission were not well understood.)

15. The number of benchmarks used by charities was surprisingly wide with:
- 16% claiming to use an independent peer group benchmark such as WM or CAPS;
- 12% using the FT All-Share;
- 4% using cash; and
- 12% using a customised or mixed benchmark.

Larger charities (over £10m) were more likely to use a recognised benchmark:
- 30% claim to use WM or CAPS;
- 22% claim to use the FT All Share;
- 34% claim to use a customised or mixed benchmark;
- 4% claim to use another benchmark; and
- 11% claim not to have a benchmark at all.

The answers given by larger charities were similar to those given in other surveys.

16. Most claimed their figures were not independently measured by an external body. This could again be a reflection of the size of the charities surveyed and the costs involved. However, we were disappointed that only 33% of charities indicated they had their performance figures independently measured. This suggests that charities may not be receiving a sufficiently accurate picture of how their investments are faring. Most endowed and larger charities did say they met their managers and had done so within the last year, but 20% had not seen their manager in the last year.

(We strongly recommend that larger charities arrange for the investment performance of their funds to be independently measured and monitored. Smaller charities should, at the least, be aware of how similar funds have performed and what returns have been achieved on comparable investment benchmark indices.)

17. Many charities have written investment guidelines or objectives, although many appear to be short or of a fairly vague nature.

Examples were:
- "To create sufficient income and capital growth to enable the charity to carry out its purposes consistently year by year";
- "To maintain the long-term value of the investments in real terms and produce sufficient income for distribution to the value of 4% per annum"; and
- "To achieve 1% better than the FTSE over a 3 year period."

(We concluded that a large number of charities may need to update and set formal investment guidelines.)

Appendix 2 - Glossary of terms used in the survey

CAPS

The Combined Actuarial Performance Service is owned by Russell Mellon and provides a similar service to WM.

CAT Standard

Charges, access and terms - the CAT Standard is a scheme introduced by the Government to provide low cost pension and savings arrangements. The standards are intended to provide consumers with some benchmarks to use when comparing comparable saving and investment products.

Common Investment Funds

A unit trust set up specifically for charities and which is itself a charity.

Soft Commission

These arise where an investment manager receives a service from or through a broker in exchange for placing transactions, and so commission, through the broker.

WM

The WM Company is a member of the Deutsche Bank Group. The WM Charity Fund Service measures the performance of UK charity funds managed by 40 investment managers. The charity funds are split into 3 groups:

(i) Unconstrained - those funds with discretionary mandates and no meaningful restrictions.

(ii) Constrained by Income - those funds that have a specific income target and who normally need an income at least 20% above that of the average unconstrained charity.

(iii) Constrained by Asset Mix or stocks – those funds that have other constraints such as a requirement to keep a large amount in bonds. Historically funds governed by the Trustee Investments Act were part of this group.

Appendix 3 - Transaction Costs - Indicative Set of Questions to ask Fund Managers

1. What is your best view of the level of transaction costs - including not only commission but also market impact and opportunity cost - borne by our fund during the reporting period?

2. What action have you taken to minimise transaction costs while still dealing effectively?

3. Please explain any major differences between the level of costs incurred by you on our behalf and those incurred by other managers in reputable surveys.

4. Were commission rates uniform across all transactions, and if not, what determines the commission rate on a transaction?

5. Which dealing ventures and methods did you choose for our portfolio? Why? How did your choices affect our dealing costs?

6. Which brokers did you deal through and how did you select them?

7. Where you are not using an execution-only broking service, please list other services that you buy or benefits that you receive from the broker concerned (such as research and access to IPOs). Please explain how you evaluate the benefit these generate for us relative to the cost.

8. If you make use of both external research and in-house research, explain what distinguishes the two and how you decide which to use?

9. Explain your rules on entertainment of your staff by brokers and those with whom you transact on our behalf where we bear the cost. Make available the records you keep, your policy guidelines and the approximate number, type and overall value of the events attended.

10. If you wish to make a case for soft commission arrangements, explain how our interests are better served by the broker providing you with services rather than securing lower commission costs for us.

Appendix 4 - Charity Investment Principles – a Simplified Template

The only legal requirements for most charities are that they should ensure they purchase suitable investments and that they have adequate diversification. In practice most charities will want to consider the following issues in making any investments, setting investment objectives and appointing investment advisers.

1. Agree your objectives

1.1 What is the ultimate aim of your fund? Where you have a mixture of aims, have you considered whether setting up separate investment funds would be a more effective and efficient method of achieving your overall aims and objectives.

1.2 Over what time period are you investing your money?

1.3 What are the likely cash outflows?

1.4 What are the likely cash inflows?

1.5 Are there any factors specific to your charity that need to be taken into account such as legal, ethical or liquidity requirements?

1.6 Do your objectives satisfy your different stakeholders?

2. Design a strategy to meet your objectives ensuring:

2.1 Your assets are suitable.

2.2 Your assets are sufficiently diversified.

2.3 Your strategy can meet your stated objectives based on forecast returns.

3. Decide whether you can outperform your objectives by considering:

3.1 What risk you are willing to accept?

3.2 What duties you are going to delegate and to whom?

3.3 How active you want your managers to be?

3.4 Whether you wish to vote on your holdings and, if so will you want to undertake this role or is it to be delegated to your investment manager.

4. Check your guidelines are clear

4.1 Does everyone understand their roles?

4.2 Are the charges clear, transparent and all encompassing?

4.3 Have your managers been given sufficient freedom to outperform?

4.4 Is the review process clear? Ideally reviews should be undertaken on a periodic basis or because performance has varied outside agreed benchmarks.

4.5 Where are your assets held? Do you feel you have a suitable custodian?

5. Monitoring and Reviewing – ensuring you are meeting your objectives.

5.1 Has performance been within the agreed guidelines?

5.2 Do you need to ask any questions or take any corrective action?

5.3 What will you report to your stakeholders?