28 February 2011

Our ref: ICAEW Rep 17/11

Sam Younger CBE
Chief Executive
Charity Commission
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By email: investment@charitycommission.gsi.gov.uk

Dear Sam

CONSULTATION ON CHARITIES AND INVESTMENT MATTERS

ICAEW is pleased to respond to your request for comments on the Charity Commission's consultation on charities and investment matters.

Please contact me or Anne Davis (anne.davis@icaew.com) should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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Chair
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ICAEW REPRESENTATION

CHARITY COMMISSION CONSULTATION ON CHARITIES AND INVESTMENT MATTERS

Memorandum of comment submitted in February 2011 by ICAEW, in response to the Charity Commission's consultation on *charities and investment matters* issued in December 2010.

Contents **Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the Charity Commission's consultation on charities and investment matters*.*

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our membership includes numerous audit committee chairs, finance directors and members involved in investment management activities as well as auditors. Members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

4. The ICAEW Charities Sub-Committee is responsible for co-coordinating the technical considerations of the charity sector with respect to Chartered Accountants working within or for charities. Its membership represents the interests of practitioners, their clients and Chartered Accountants employed in financial roles within charities.

GENERAL COMMENTS

5. Overall, we welcome the Charity's Commission's revision and consolidation of its existence guidance into two documents: *Charities and investment matters: at a glance* and *Charities and investment matters*. The guidance clarifies different approaches to investment by charities which is particularly useful, since it tries to incorporate the everyday, wider interpretation of investment available in the market place.

Q1. Are the issues and approaches to investment sufficiently clear, easy to understand and to apply?

6. Yes, the issues and approaches are easy to understand. However, the differences in approaches between ethical investment and mission connect investment is not always clear (see paragraph 23) nor could we think of examples of mixed purpose investments (see para X).

Q2. Is the guidance in a form that is accessible and easily navigable for trustees and those who make decisions on behalf of trustees?

7. The *Charities and investment matters: at a glance* will be extremely useful to trustees and others, since it provides enough information to be able to ask the right questions relating to key investment matters.

8. As currently drafted, it is not clear that *charities and investment matters: at a glance* is an executive summary of the larger document, since it is included as part of the larger document (section B). It would be more effective if the two documents were issued separately, perhaps cross-referring to one another on the website by using hyperlinks.

9. We have mixed views about whether the style of this document is appropriate. On the one hand, the short answer and in more detail approach makes it easy to find answers to particular questions. However, if the document is read from cover to cover, it is quite repetitive for example, types of investments is mentioned in two or three places. In order to address this, we would suggest that the Charity Commission prefaces the document by explaining that the lengthier charities and investment matters document is a reference document, to be referred to as appropriate, rather than to be read from cover to cover.

10. The identification of legal or regulatory requirements with the letter L is a very good idea since it makes it very clear what the compulsory requirements are relating to investment matters. When the final document is published we suggest that it would be helpful to include the Charity Commission's views of the law underpinning its investment guidance in an appendix.

Q3. Does the tone of the guidance strikes the right balance in facilitating charities in furthering their aims while managing risk?

11. The guidance strikes a good balance for encouraging charities to use their investments to further their aims, while taking into account different types of risks. However, the types of risks trustees need to be aware of are different depending on which bit of the guidance you are reading. Section D6 states that the main two types of risks that trustees should be aware of when making investments are investment and counterparty risk. While there are two types of risks there are also other significant risks which may affect the charity as highlighted in E 2.

12. We would suggest that section D6 is reworded something along the following lines….' the main types of risks that trustees should be aware, irrespective of their investment approach, include but are not limited to, investment and counterparty risk. Further information on risks associated with different types of investment is available in E2. "

Q4. Is the draft guidance likely to give trustees confidence in making decisions about investments?

13. The guidance is very comprehensive and is likely to give trustees confidence in asking the right questions and making decisions about investment matters. However, in certain places, the guidance undermines the trustees confidence in making investment decisions because it states that professional advice must be obtained, irrespective of whether it is needed.

14. For example, D3 states that "Before exercising any power of investment and when reviewing the charity's investments, trustees must obtain and consider advice from someone experienced in investment matters, unless they have good reasons for not doing so." As currently worded, there is a presumption that trustees must obtain investment advice. This is not necessary in all cases, for example, opening a bank account in the UK. Therefore, we suggest that this should be reworded as follows 'Trustees must consider whether it is in the best interests of the charity to take advice…'

15. Other examples where trustees are encouraged to take advice can be found in I4 relating to programme related investments and J3. We are of the view that trustees should use their judgement as to when professional advice is required. It should be a consideration in light of the best interests of the charity rather than a presumption that it must be obtained, irrespective of need.

Q5. Does the guidance meet the needs of all charities, large and small?

16. The guidance is most useful to smaller charities since they are not likely to have the access to professional advice and an in-house treasury, risk management and internal audit departments. In places, the guidance is over simplistic and in some places unnecessarily

restrictive for larger charities. For example, Annex 3 on Cash Management requires that deposits of funds into bank accounts should be authorised by two trustees. This may not be necessary in charities where there are strong internal controls and segregations of duties.

17. Furthermore, the guidance in Annex 3, ignores money market funds and short term certificates of deposits and treasury bills which may be part of a larger charities cash management policy.

Q6. Are there additional examples that could be used to illustrate points made or issues covered?

18. We have no further examples that could be used to illustrate the points made or issues covered.

Q7. Are there gaps or omissions where further guidance would be helpful?

19. As noted in paragraph 32, it would be helpful if the guidance contained some examples of mixed purpose investments to enhance understanding of this type of approach and where it might be applicable.

SPECIFIC QUESTIONS

Q8. Do you agree with the approach we have taken in the guidance?

20. As currently drafted, the guidance is likely to become out of date very quickly since certain areas contain a significant amount of detail e.g. Annex 3 and 4. As new investment products and services are developed, this guidance will become out-of-date very quickly. A possible solution to this is to include a preface in Annex3 and 4 stating that annex 3 and 4 are guides not definite guidance on how cash should be managed or what products or services are available in the market.

21. Annex 3 and Annex 4 could also be combined to avoid duplication.

Q9. Have we achieved clarity around the range of options available to charity trustees in the guidance?

22. We are supportive of the guidance explaining the different investment approaches. However, it is difficult to establish the difference between mission connected investments and investments which are positively screened. Also, please see comments in paragraph 20 above.

Q10. Is the approach we have taken here, focusing on investment powers and application of duties, more helpful to charities?

23. The focus on investment powers if very helpful to charities. It is important to highlight that some charities do not have investment powers in their governing documents.

Q11. Is the detail on asset classes and their compatibility with trustee's duties in Annex 1 helpful and necessary?

24. Annex 1 is very useful summary of the legal framework for different investment approaches.

Q12. Is there anything further to add to the guidance on ethical investment?

25. The guidance permits trustees to make ethical investments if the trustees can justify a lower return because there is no significant financial detriment. It would be helpful if the Charity Commission clarified what is meant by significant financial detriment and if this not possible, list factors that trustees should consider when making such an assessment.

26. It could be argued that if charities are set up to further their public benefit aims, then they must always consider ethical and mission connected objectives when making their investments. However, we would not like charities to be restricted to these types of investments since this could affect their financial return.

Q13. Do you think this recognition of MCI in our guidance is a constructive step and is there anything further we could say?

27. We don’t think the section on mission connected investment is necessary since it is difficult to separate this investment approach from ethical investment which is positively screened. Also, it refers to balancing charity aims, risk and return which covered by the investment approach and policy.

Q14. Is the framework we have set out in the guidance for mixed purpose investments helpful and likely to be of use to charities?

28. We welcome the additional guidance on mixed purpose investment. This allows trustees to consider investments which have elements of obtaining the best rate of return, appropriate to risk and furthering the charity’s aims.

29. In terms of monitoring mixed purpose investments, it is important to emphasise that monitoring should involve quantitative and qualitative information. The current guidance tends to focus on the financial aspects. It would be useful to include additional guidance for monitoring mixed purpose investments which focuses on qualitative aspects for example, improved facilities at a property.

30. It would be helpful if the Commission could provide guidance and examples of mixed purpose investments. Some possible examples of mixed purpose investments might be:

30.1. A charity owns a property which needs refurbishing. Since the charity cannot afford to refurbish the property, it has identified a company which would lease the property and manage it on less than commercial terms but in a way that would continue to deliver the charity’s mission.

30.2. Commercial company refurbishing a property e.g. Victorian Hall which is owned by the charity in order that it can be used more effectively. The commercial deal would include a guarantees on level of charges and community access.

30.3. A charity wishes to let a commercial company manage a sports ground on terms that offers reasonable rates to local sports clubs, schools etc.

30.4. Investing in The Charity Bank may support the charity’s aims of lending to other charities and social enterprises and provide the charity with a potential return.

Q15. Are there examples of mixed purpose investment that you are aware of that charities have made that could be included as case studies?

31. No.

Q16. Is our guidance on PRI helpful to charities and our use and definition of the term appropriate?

32. The requirement to be able to ensure an exit will not always practical with this type of investment since the investment may be illiquid. The guidance should be amended to requiring charities to consider exit mechanisms instead of requiring charities to have exit mechanisms in place.

33. We are concerned about the interpretation of “incidental” in relation to the private benefit derived from the programme related investment. It is not clear at what point in the programme related investment this assessment has to be made – is it across the life of the project or on a yearly basis? There is no such requirement for any private benefit to be incidental in relation to financial investments.

34. Further advice needs to be given to Benevolent Charities who may want to make programme related investments to benefit the wider charity community but are unable to do so because of narrower objects and beneficiary classes. This has been subject to ministerial comment and clear guidance needs to be given by the Commission as to how such charities could use their considerable resources without falling foul of charity law.

Q17. Is the section on public benefit helpful in assessing whether private benefit is incidental or recoverable to the charity?

35. This section is too wordy and doesn't actually help in the decision. It would be better to illustrate the point by using examples, but we could not think of any.

Q18. Is the explanation about how permanent endowment can be used helpful?

36. This section is already dealt with in the SORP and other guidance. We suggest that the charities and investment guidance cross-refers to other sources of information in this area.

Q19. Do examples of PRI in the guidance reflect charity's current practice? Are there more useful examples we could add?

37. No comments.

Q20. Do you agree that these accurately describe the ways that a charity can make social investments? Is our guidance on this helpful to charities?

38. The guidance is helpful because it clarifies the links between social investment and different investment approaches (financial, ethical, mission connected and programme related).

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