23 April 2012

Our ref: ICAEW Rep 59/12

Charities Act 2006 Review
C/O Office for Civil Society
4/16, HM Treasury
1 Horse Guards Road
London SW1A 2HQ

By email charitiesactreview@cabinet-office.gsi.gov.uk

Dear Sirs

Charities Act 2006 Review – Call for Evidence: Mixed motive (or mixed purpose) investment

ICAEW welcomes the opportunity to comment on the *Charities Act 2006 Review – Call for evidence: Mixed motive (or mixed purpose) investment* published by the Cabinet Office in February, a copy of which is attached as an Appendix.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW has a Charities Technical Sub-Committee and a Charities & Voluntary Sector Group with over 3,000 members. Many ICAEW members are active in charities and the voluntary sector; approximately 30,000 are charity trustees, treasurers, school governor and in other voluntary roles.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

Yours sincerely

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APPENDIX

Charities Act 2006 Review – Call for Evidence

Mixed motive (or mixed purpose) investment

Issue:

The Charities Act 2006 Review is considering ways in which greater mixed motive or mixed purpose investment by and into charities could be encouraged and facilitated.

Background:

Charity trustees have a legal power to make investments on behalf of their charity where they consider those investments to be in the best interests of that charity. Until relatively recently, investments were generally justified as either:

- Offering the best financial return for a given acceptable level of risk, that return being spent on furthering the charity's aims (financial investment);
- Offering the best way of directly furthering the charity's aims (programme-related investment)

However, a third category is now developing whereby the trustees consider that the investment is in the charity's best interests even though it cannot be entirely justified on either one of these grounds alone. These investments may, however, be justified in terms of a combined or mixed financial and charitable return (provided there is no other reason for making the investment, such as private benefit). In other words, these investments will enable charities to further their charitable purposes whilst also providing a financial return (albeit likely to be a lower or less predictable financial return than a purely financial investment). Investments that can be justified on these grounds are known as mixed purpose or mixed motive investments; they will be referred to as mixed motive investments throughout this document.

The Charity Commission has recently issued updated guidance on charities' investment powers (CC14), which includes a section on how charity trustees can make mixed motive investments in line with their duties as a trustee. However, this is a developing type of investment and it is not always clear in exactly what circumstances it will be justified; trustees need to take care and are likely to need to seek professional advice on specific proposals.

While decisions as to which investments to make are rightly for charity trustees, social investment could represent an important source of sustainable funding for some organisations as the sector grows in a challenging funding environment. The Social Impact Bond (SIB) being piloted at Peterborough Prison in the delivery of services to reduce reoffending[1] and the £20m bond programme recently launched by Scope[2] are examples of ways in which charities can access new sources of funding outside traditional models.

However, whilst the social investment market in the UK has grown from almost nothing in 2000 to making £165 million of social investments in 2010[3] it is still far below its potential scale, and evidence suggests that front-line social organisations receive less finance than private sector equivalents.[4] In

[1] The six-year SIB pilot scheme in Kalyx-run Peterborough prison, run by Social Finance, will prepare around 3,000 short term prisoners for their lives post-release and will work with them to prevent a return to a life of crime. If these services are successful and re-offending drops by more than 7.5 per cent within six years, investors receive a payment representing a proportion of the cost of re-offending. The payment will increase based on the reduction in re-offending with the total cost of the project capped at £8m. Social Finance has raised capital from social investors that will be used to pay for the services in the prison and outside in the community.

[2] The charity Scope is piloting a £20 million bond programme to generate complementary funding for its charitable activities alongside the traditional donations and philanthropic loans it currently receives. The launch will be in partnership with Investing for Good and the money raised will be used to expand Scope's other income-generating activity; it is therefore intended to generate social as well as financial return for investors.

[3] Young Foundation and the Boston Consulting Group 2011: Lighting the touchpaper

[4] Bespoke econometric analysis of the 2010 BIS Small Business Survey

recent months, a large amount of work has been done by a range of organisations, including Government, to understand the barriers to social investment by and into charities and other social businesses. There is some consensus on the nature of the high-level barriers, which can be loosely summarised as:

- The difficulty of creating attractive products for investors, in terms of pricing levels of risk, generating the right level of return and ease of investment;
- Lack of investment readiness among potential investee organisations;
- Uncertain, possibly low, demand across potential investee organisations;
- Insufficiently robust or well-established measures of social impact, meaning that quantifying social benefit to establish track records and price products is challenging;
- An out-dated legal and regulatory framework that is ill-equipped to facilitate and regulate social investment.

The next stage is therefore to unpick and address the different factors that together create these barriers. As the Charities Act 2006 review is concerned with the legal and regulatory framework for charities, this call for evidence specifically seeks to understand how that framework is contributing to the barriers set out above or otherwise impeding the development of the social investment market, and how these issues might be addressed. However, respondents to this call for evidence should feel free to extend their comments beyond issues strictly of charity law and regulation where they feel it is helpful or appropriate to do so.

Who should respond?

Anyone can respond, and all responses will be considered.
However, we are particularly interested to hear from charities involved in mixed motive investment (whether making such investments or receiving funds through them), charities that have considered mixed motive investments and decided not to pursue it, and from other organisations and individuals involved in making or receiving such investments.

Deadline for responses:

The deadline for receiving responses to this call for evidence is 16 April 2012.

How to submit your response:

Please send your response by e-mail to charitiesactreview@cabinet-office.gsi.gov.uk

Alternatively you can write to:
Charities Act 2006 Review
C/O Office for Civil Society
4/16, HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Question 1: Do you agree with the list of high-level barriers to growing the social investment market? Are there any issues that should be added or removed?

Yes we agree with the list of high level barriers. In addition, we would include the following barriers to the list:

- lack of clarity and understanding on what is meant by social investment
- uncertainty in accounting and tax implications for social investments
- liquidity, ie a market place to trade such investments
- market makers i.e. advisors, brokers and corporate financiers

According to the Charity Commission's CC 14 guidance, 'a charity can engage in social investment by ethical investment, programme related investment and mixed purpose investment'.

Within these broad categories, there is a range of sources for social investments such as charitable bonds, social impact bonds, philanthropist, grant makers, venture philanthropists and so on. Perhaps further guidance is needed to better link sources of funding with types of social investments in order to gain a better understanding of the market and range of opportunities for different legal forms, including charities and other social enterprises.

Question 2: How, in your view, does the legal and regulatory framework for charities impact on their ability to make mixed motive investments? If you have practical examples, please include them in your response.

It is our understanding that the Charity Commission's position is that programme or mission related investment can only be made where that investment fully serves the investing charity's purposes. Otherwise such an investment would have to be justified solely on the basis of financial returns. This means that charities willing to use part of their resources to make mix motive investments are precluded from doing so if those investments do not fulfil their objects or provide commercial returns.

The Minister for Civil Society, Nick Hurd MP, has publically stated that Benevolent Charities should use their resources to benefit the wider sector. However they are precluded from doing so by the law. We are aware of one substantial Benevolent Charity who would like to make mix motive investments but have received legal advice to the contrary. Perhaps a solution would be to relax this requirement and to allow Trustees to use their discretion (as happens in most matters) to make such investments.

Question 3: How could these issues be addressed?

This could be addressed by an express permission in statute that allows charities to invest:

1) for purely financial return, given a reasonable, appropriate level of risk;
2) for both financial return but also in line with an ethical policy or to generate a 'social' or environmental or other return that serves the charitable objectives of the charity;
3) primarily to serve the charitable objectives of the charity in products or instruments that also provide a financial return; and

Further some clarification of when private benefit in investing in whole or in part for charitable purpose is permissible - ideally where it is 'reasonable and proportionate' rather than 'necessary'.

Question 4: How, in your view, does the legal and regulatory framework for charities impact on their ability to raise funds via mixed motive investment? If you have practical examples, please include them in your response. No comments.
Question 5: How could these issues be addressed? No comments.
Question 6: If the issues you have identified were addressed, how significant do you think the impact would be in terms of opening up this area of the investment market? What else would need to be done to maximise the potential of charities to be involved in this field? No comments.
Question 7: What would be the advantages and disadvantages of creating a) a specific legal power for charities to engage in mixed motive investment and/or b) a specific legal power to permit a proportion of permanent endowments to be invested in mixed motive investments? No comments
Question 8: Do you have any other comments on the issue of mixed motive investment and the charity sector? No comments

Respondent details:

Name:	Anne Davis	
Position:	Head of Charity and Voluntary Sector	
Organisation Name:	ICAEW	
Organisation size (income) – charities only	Not applicable	
Is your organisation a charity?		No

What happens next?

- We will acknowledge receipt of all responses, although we cannot provide a detailed response to each individual submission.
- All responses will be considered in forming the report of the review.
- The aim is for the report of the review to be laid in Parliament and published in July 2012.

The small print:

All information in responses, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004). If you want your response to remain confidential, you should explain why confidentiality is necessary and your request will be acceded to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer by your IT system will not, of itself, be regarded as binding on the department. Contributions to the review report will be anonymised if they are quoted, unless we contact you and you give us your permission to use a particular quote.

Individual contributions will not be acknowledged unless specifically requested.