CHARITY COMMISSION
FOR ENGLAND AND WALES

Legal underpinning

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

Preliminary statement

a) This document is intended to be a summary of the Charity Commission's view of the law underpinning its publication **Charities and investment matters: a guide for trustees (CC14)** ('the guidance') and necessarily uses more technical language.

b) This analysis is not intended to be a comprehensive legal digest, but a useful reference point for trustees, their advisers and the public. It is intended to reflect law and practice at October 2011. It is not binding in law. It should be borne in mind that it offers a general analysis of the law but whether the analysis is appropriate in a particular case will depend on all the facts of that case.

c) The commission will take the same approach as the courts and the Tribunal in applying the law.

Introduction

(i) This legal underpinning of the investment guidance is concerned with the duties and obligations of trustees of charities. The position described is based on the law relating to trust law except where otherwise indicated. As such this guidance does not directly apply to directors of charitable companies. However, as directors of a charitable company are also acting in a fiduciary manner in furthering charitable purposes, they have similar responsibilities. They are within the description of 'charity trustees' as defined in section 177 of the Charities Act 2011.

(ii) In the guidance, the commission uses the term 'investment' to include any outlay of funds in something which it is hoped will lead to a financial return. This definition covers a wide range of strategies used by charities in employing their funds. It covers investing for the purpose of obtaining the maximum financial return consistent with commercial prudence ('financial investment'). It covers investing for the best return excluding investments which would conflict with the aims of the charity or investing for the best return avoiding investments which might hamper the work of the charity, or investing for the best return avoiding some investments on moral grounds where this does not involve a risk of significant financial detriment ('ethical investment').

(iii) It covers investing for the best return concentrating on investments which help the charity to achieve its mission where this has no significant financial detriment ('mission connected investment'). It covers an outlay of funds in furtherance of the charity's purposes where a financial return may be generated but where the reason for the outlay is to further the purposes of the charity ('programme related investment').

(iv) The meaning given to 'investment' at common law is generally limited to those factors constituting a financial investment eg 'property held by the trustees for the purpose of generating money, whether income or capital growth, with which to further the work of the trust'[1]**.** However, in a New Zealand case **Culverden Retirement Village v Registrar of Companies** [1997] 1 NZLR 257, 261 the Privy Council said:

"........one of the everyday meanings of investment is the laying out of money in the acquisition of property in the hope of return. The return may come in the form of capital or income or both. It may be in cash, or it may be in kind such as the provision of services."

(v) In the case in question it was considered that buying a town house in a retirement village on terms that the purchaser will occupy it, with necessary services provided, for so long as they wish and that they then get back all or a large part of their outlay was properly regarded as an investment. In particular, the court stated:

"The return from their outlay is to be found in the totality of these benefits, not just the financial payment at the end."

(vi) It is similarly conceivable that, in considering a charity laying out funds in a company the operation of which will further the charity's purposes and which may also provide a financial return, a court may take the view that both the social outcome, the furtherance of the charitable purpose, and the financial return together constitute the aggregate return on the investment. However, in the absence of such a definitive decision, the commission has taken the view that the legal meaning of investment is a financial investment and that programme related investment does not fall within this.

(vii) The starting point for trustees in all of these 'investment' strategies is the duty of trustees to exercise their powers in the best interests of the charity.[2] In the case of financial investments this will usually involve seeking the maximum return consistent with commercial prudence[3]. In the case of a programme related investment, the 'investment' in question will be pursued where that is an effective way of achieving the charity's purposes.

(viii) There is an important distinction to be made between 'financial investments' (which include ethical investment and mission connected investment) and 'programme related investment' which would not be an investment in the legal sense. As will be seen, investments in the legal sense are made for the purpose of a financial return and any other purpose is ancillary to that. This does not mean that funds which are available for the furtherance of the charitable purpose cannot be employed in order to further the charitable purpose in a way which may give rise to a financial return to the charity. It does however mean that programme related investment is not investment in the strict legal sense and so could not be considered as an exercise of a power of investment such as that referred to in the Trustee Act 2000. Similarly, funds held on a trust for investment could not be used in this way unless there was no significant financial detriment in comparison with investing on the basis of the best return.

1 **Harries v Church Commissioners** [1992] 1 WLR 1241

2 In **Cowan v Scargill** [1985] Ch 270 the Vice-Chancellor, Sir Robert Megarry, considering the law relating to trustees' use of a pension fund stated: "The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries." In the case of a charitable trust this translates into "the duty of the trustees to further the charitable purposes".

3 See **Harries** above

Part I Financial investment

1. What is an investment?

Maximum financial return

1.1. There is no statutory definition of investment although there is authority in case law for what is meant by the term. In **Harries v Church Commissioners** the Vice-Chancellor Sir Donald Nicholls referred to "property held by the trustees for the purpose of generating money, whether income or capital growth, with which to further the work of the trust". He characterised this as "property held by the trustees as an investment".

1.2. The Vice-Chancellor was clear that where property is held as an investment, "prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, consistent with commercial prudence". The guidance uses the term 'best financial return....appropriate to risk'. The commission considers this means the same as the formula used in the **Harries** judgment set out in 1.1 ie "maximum return, whether by way of income or capital, consistent with commercial prudence."

1.3. The power to invest in the Trustee Act 2000 is likewise concerned with investment made for the purpose of achieving a financial return. It is also the case that funds held as permanent endowment on a trust for investment are, subject to any specific provisions in the governing document, held for the purpose of securing a financial return which can be applied in furtherance of the charity's purposes. The funds cannot, in the absence of specific provisions to that effect, be used in a way which would erode the capital of the fund.

1.4. However, without such a specific legal authority and having considered the existing case law, the commission considers that the investment responsibilities of charity trustees currently relate only to investment in order to obtain a financial return. This does not mean that charity trustees may not use their powers to further their charitable purposes. It is still possible for charity trustees to lay out their funds in furthering their charitable purposes, for example by way of loan, but with the possibility of some financial return. However, this will be justified in terms of whether the decision to use funds in this way was within the range of decisions a reasonable body of trustees might take in seeking to further their purposes.

Tax and investment

1.5. Trustees will wish to ensure that as far as possible they do not have to pay tax on their investments. Under section 543(1) of the Income Tax Act 2007 a charitable trust is treated as incurring non-charitable expenditure if it make any investments or loans that are not approved charitable investments or loans as defined in sections 558 and 561 Income Tax Act 2007 respectively. Under section 496(1) of the Corporation Tax Act 2010 a charitable company is treated as incurring non-charitable expenditure if it makes any investments or loans that are not approved charitable investments or loans as defined in sections 511 and 514 of the Corporation Tax Act 2010 respectively.

1.6. Section 558 of the Income Tax Act 2007 and section 511 of the Corporation Tax Act 2010 set out details of investments that are automatically treated as approved charitable investments and these include shares in, or securities of, a company which are listed on a recognised stock exchange. Investments, including loans made as investments not specified in those sections may be treated as approved charitable investments if HM Revenue and Customs (HMRC) are satisfied that the investment or loan is made for the benefit of the charitable trust or charitable company and not for the avoidance of tax (whether by the charitable trust or charitable company or any other person).

1.7. Section 561 of the Income Tax Act 2007 and section 514 of the Corporation Tax Act 2010 address loans made by charitable trusts and charitable companies. Loans may be treated as approved charitable loans if they are not made by way of investment and either fall within certain specified categories or HMRC are satisfied that they are made for the benefit of the charitable trust or company and not for the avoidance of tax.

1.8. The term 'for the benefit of the charity', as used previously, has traditionally been regarded by HMRC as having different meanings depending on whether they are dealing with investments (including investment loans) or loans not made as investments. Investments (including investment loans) used to have to benefit the charity as a financial investment. For non-investment loans HMRC expected the benefit to be related to the charity's objects. More recently, HMRC have accepted that the term 'for the benefit of the charity' has a wider meaning and can extend to equity-type investments that give a below market rate of return where the investment furthers the charity's objects. They also accept that loans that further charitable objects and which also give some financial return may qualify.

1.9. From the above it is clear that in considering what investments are approved charitable investments, HMRC will take into account not just investments made to maximise the charity's income or to secure a reasonable return on its capital but also investments made in the knowledge that they provide a below market rate of return but which further the charity's objects. Loans made to further charitable purposes but which may yield a financial return may also be accepted as being approved charitable loans.

1.10. The last 2 instances are examples of what is often termed 'programme related investment'. HMRC are of course only concerned here with the tax position not with the scope of the investment powers of trustees. As mentioned above, the legal authorities on what constitutes an investment within the power of charities to invest have been concerned with investments in order to provide the charity with a financial return and not with an outlay of funds in order to further the purposes of the charities but which may also generate a financial return.

1.11. Clearly a charity can outlay its funds on furthering its charitable purposes where they are available for that purpose. However, in doing so, they will not be exercising their power of investment. Having said that, ethical investment and mission connected investment are both in appropriate circumstances ways of exercising the trustees' power of investment.

Distinction between investment and trading

1.12. There is a distinction between an investment and a trading venture although on occasion it may be difficult to make. Generation of an income may be a feature of both an investment and a trading venture. The 2 may be treated differently with regard to taxation so it is important to be clear whether a particular outlay of funds is on an investment rather than a trading venture.

1.13. The commission previously took the view that an investment required an investor and an investee. Not everyone considered this definition was accurate as a matter of law. Some liked it as providing a means of distinguishing between investment and trading.

1.14. However, the commission seeks to be clear exactly what the legal obligations are and what is just good practice. The commission considers that what is a proper investment for charities is related to the proper exercise of the trustees' power of investment.

1.15. It is not unusual for investment powers to define the term 'investment' widely to include commodities, works of art, futures etc. The case law certainly suggests that buying commodities is capable of being 'the subject matter of an investment' although it is often more in the nature of an adventure in trade. A transaction entered into on a short-term basis for the purpose of making a profit out of the purchase and sale of a commodity is likely to be considered an adventure in trade.[4] Accordingly, any use of commodities under a power of investment has to be done very carefully if it is not to constitute trading.

1.16. Her Majesty's Revenue and Customs (HMRC) produce **guidance on the badges of trade**. However, in practice there are occasions when it is not obvious whether an investment is being made or a trading activity is being conducted. Where it is not clear, the intention of the investor/trader may be crucial[5].

1.17. In **Trustees of BT Pension Schemes & Others v Clark (HM Inspector of Taxes)** 2000 WL 552 the Court of Appeal followed this approach in considering whether income from sub-underwriting activities was trading income or income from investment. Robert Walker LJ said:

"If the legal or commercial characteristics of a transaction point unequivocally to trading, the trader's subjective purpose or motivation cannot change the character of the transaction. But the character of the transaction may be ambiguous until resolved by reference to purpose or motivation."

1.18. In support of this Robert Walker LJ cited Lord Reid in **Iswera v CIR** [1965] 1 WLR 663, 668 saying

"If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effect of all the circumstances."

4 **Wisdom v Chamberlain (Inspector of Taxes)** [1969] 1 All ER 332; **Edwards (Inspector of Taxes) v Bairstow** [1956] AC 14

5 **Davies (HMIT) v Shell Company of China** (1951) 32 TC 133; **Trustees of BT Pension Schemes & Others v Clark (HM Inspector of Taxes)** 2000 WL 552; **Iswera v CIR** [1965] 1 WLR 663

1.19. Robert Walker LJ contrasted 2 examples – one of a firm of marketing consultants who open and run a supermarket solely to observe the reactions of consumers to different types of display. This involves selling real goods to real customers for real money. That profit is taxable as trading income and that liability is not avoided by the fact that the firm running the business were not in the least concerned with making a profit.

1.20. The other example given was a person who buys an attractive house for their own occupation but before completion receives an offer so extravagant she or he cannot refuse it. The contract to buy and the rapid re-sale may appear at first sight to be an adventure in the way of trade but closer investigation shows this is not the case.

1.21. Accordingly the court considered that it was necessary to look at the relationship between the trustees' sub-underwriting and investment activities and the weight to be given to their intentions. The starting point for the trustees was the index tracking system of investment. The court found that this was the antithesis of short term opportunism. Accordingly, the court held that the underwriting income was investment income.

1.22. It is sometimes said that the speculative nature of a transaction is likely to make it trading rather than investment. However, the courts have referred to both speculative trading and speculative investing so the speculative nature of the transaction is not in itself determinative as to whether it is trading or investment.

1.23. Subject to the following paragraph, an investment which by its nature is 'a gamble' or 'a hazardous speculation' is not likely to be considered a proper investment for a charity.[6]

1.24. Lord Nicholls of Birkenhead in an article in 1995 quoted in Lewin on Trusts paragraph 35-65 stated:

"Different investments are accompanied by different degrees of risk, which are reflected in the expected rate of return. A large fund with a widely diversified portfolio of securities might justifiably include modest holdings of high-risk securities which would be altogether imprudent and out of place in a smaller fund.

In such a case it would be inappropriate to isolate one particular investment out of a vast portfolio and inquire whether that can be justified as a trust investment. Such a 'line by line' approach is misplaced. The inquiry, rather, should be to look at a particular investment and enquire whether that is justified as a holding in the context of the overall portfolio. Traditional warnings against the need for trustees to avoid speculative or hazardous investments are not to be read as inhibiting trustees from maintaining portfolios of investments which contain a prudent and sensible mixture of low-risk and higher risk securities. They are not to be so read, because they were not directed at a portfolio which is a balanced exercise in risk management."

1.25. The commission's previous guidance stated that derivatives could only be used as ancillary to the exercise of an investment power. It may well be that in some cases use of derivatives in a way which is not ancillary to the exercise of an investment power could be regarded as trading rather than investment. However, there are many derivative products and some may be so analogous to investments as to be lawful as an exercise of the investment power in their own right. This will depend on the nature of the derivative product and the considerations in using that product as an investment. In particular, they are only likely to be used if they constitute a small proportion of a large fund available for investment.

6 **Bartlett v Barclays Bank Trust Co. Ltd** [1980] Ch 515

2. Investment powers

2.1 Many charities have express powers of investment set out in their governing documents. In any event, the Trustee Act 2000 confers a general power of investment on trustees. This is stated to be that '*a trustee may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust*'. Trustees have to exercise their powers in the interests of the charity. What this means with regard to investment powers is explored later in this section.

2.2 This is a very wide power but only financial investments are within its scope. It is also necessary for trustees to bear in mind the tax issues and the distinction between activities which are investment and those which are trading. Carrying out transactions that fall outside the legal definition of an 'investment' cannot be justified as an exercise of an investment power. Programme related investment is justified as furtherance of the charitable purpose not as an exercise of the investment power.

2.3 The general power of investment conferred by the Trustee Act 2000 does not permit trustees to make an investment in land other than in loans secured on land. However, section 8 of the Trustee Act gives trustees the power to acquire freehold or leasehold land in the United Kingdom as an investment.

2.4 The courts have always permitted express powers of investment to either restrict the general trustee powers of investment or to widen them although express powers of investment are strictly construed by the court.[7]

2.5 Although the court strictly construes express powers of investment, it does not have a duty to put an unduly restricted construction on an investment clause[8].

2.6 Under section 99 of the Charities Act 2011 the powers of investment of a charity include power to participate in common investment funds and common deposit funds unless the power is excluded by a provision in its governing document specifically referring to common investment funds or common deposit funds

Common investment funds

2.7 Common investment schemes are collective investment funds established by a scheme made by the commission (or the court) under sections 96-97 of the Charities Act 2011 in which only charities established in England and Wales and those established in Scotland and Northern Ireland can invest. They are deemed to be charities. More information can be found in the guidance Common investment funds: a basic guide to their regulation.

2.8 Common deposit funds (CDFs) are deposit-taking schemes set up by schemes made by the commission under section 100 of the Charities Act 2011. They are deemed by law to be charities themselves. They are therefore eligible for registration as charities in their own right. More information can be found in the guidance Common deposit funds: a basic guide to their regulation.

7 **Ovey v Ovey** [1900] 2 Ch 524; **Re Harari's Settlement Trusts** [1949] 1 All ER 430; **Brown v Gellatly** (1866-67) LR 2 Ch. App. 751

8 **Re Peczenik's Settlement** [1964] 2 All ER 339

Borrowing to invest

2.9 From time to time the commission receives enquiries about the extent to which it is possible to borrow money in order to invest it. Usually, this will not be a prudent use of the funds in question as the return on them will not necessarily cover the costs of borrowing. However, there is also an issue as to whether this is covered by the power to invest.

2.10 Even where it is in the charity's interests to borrow and invest, it will only be able to do so if there is a specific power to borrow in order to invest. In **In re Suenson-Taylor's Settlement Trusts** [1974] 1 WLR 1280 Foster J considered a proposal by trustees to use their borrowing powers to raise funds for the purpose of investment. Their investment power appeared to be very wide, namely:

"The trustees shall have the same unrestricted power of investment of moneys requiring investment under the trusts hereof as they would have if they were a sole absolute and beneficial owner of the trust fund."

2.11 The court considered that 'moneys requiring investment' referred to the capital of the trust fund and that borrowed funds were not part of the trust fund and so not within the power of investment. This is not to say that it is not possible to have express powers to borrow and invest borrowed funds only that express powers of trustees will be strictly construed.

2.12 Where borrowing in order to invest is permitted, it will be necessary for the trustees to ensure they are acting in accordance with their duties in the interests of the charity.

3. Trustees' duties (exercising a power of investment)

3.1 The general power of investment conferred by section 3 of the Trustee Act 2000 does not of course affect the duty of a trustee in exercising the power of investment to "*take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide*" (**per** Lindley L.J. in **In re Whiteley** (1886) 33 Ch.D. 347, 355).

3.2 In **Learoyd v Whiteley** (1887) 12 App. Cas 727, 733 Lord Watson said:

"Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard."

3.3 In **In re Godfrey** (1883) 23 Ch.D. 483, 493 Bacon V-C said:

"No doubt it is the duty of a trustee, in administering the trusts of a will, to deal with property intrusted into his care exactly as any prudent man would deal with his own property. But the words in which the rule is expressed must not be strained beyond their meaning. Prudent businessmen in their dealings incur risk. That may and must happen in almost all human affairs."

3.4 For private trust cases, balancing the interests of the tenant for life and those entitled in remainder was an important aspect of the trustees' investment duties. In **JW v Morgan Trust Co of the Bahamas Ltd** (2001-2) I.T.E.L.R. 541 the Supreme Court (Bahamas) held that trustees were expected to consider total return on trust assets as the yardstick for their investment performance without prejudicing the position of a life tenant or a remainderman. Trustees have to strike a fair balance between fixed interest securities, favouring the life tenant, and stocks and shares which, with their potential for capital growth, favoured the remainderman interested in capital where there is a low dividend policy.

3.5 In charity law this equates in the case of permanent endowment to considering the furtherance of the charitable purpose both now and in the future. With regard to charities without permanent endowment, there is not necessarily such a balancing process. The main criteria is the furtherance of the charity's purposes whether this is best served by investing for a financial return to be applied for the purposes or applying the capital directly in furtherance of the purposes.

3.6 In **Cowan v Scargill** [1985] Ch 270 Sir Robert Megarry V-C quoted with approval the words of Sir James Wigram V-C in **Balls v Strutt** (1841) 1 Hare 146, 149:

"It is a principle in this court, that a trustee shall not be permitted to use the powers which the trust may confer upon him at law, except for the legitimate purposes of his trust;........."

3.7 Megarry V-C went on to say:

"Powers must be exercised fairly and honestly for the purposes for which they are given and not so as to accomplish any ulterior purpose, whether for the benefit of the trustees or otherwise...."

3.8 In **Trustees of the British Museum v H.M. Attorney-General** [1984] 1 WLR 418 Sir Robert Megarry V-C set out five matters as being among those to be considered by the court when considering conferring investment powers:

3.8.1 "The court is likely to give great weight to the width and efficacy of any provisions for advice and control."

3.8.2 "Where the powers are of great width.....there is much to be said for some scheme of fractional division, confining part of the fund to relatively safe investments, and allowing the other part to be used for investments in which the greater risks will be offset by substantial prospects of a greater return."

3.8.3 "What the court has to judge is the combined effect of width, division, advice and control, which all interact, together with the standing of the trustees."

3.8.4 "The size of the fund in question may be very material. A fund that is very large may well justify a latitude of investment that would be denied to a more modest fund; for the spread of investments possible for a larger fund may justify the greater risks that wider powers will permit to be taken."

3.8.5 "The object of the trust may be very material. In the present case, the desirability of having an increase of capital value which will make possible the purchase of desirable acquisitions for the museum despite soaring prices does something to justify the greater risks whereby capital appreciation may be obtained."

3.9 The degree of control envisaged by 3.8.2 mirrors the approach taken in the Trustee Investment Act 1961 which was in force at that time. However, even though the general power of investment is broad, a governing document may still impose a more restrictive approach.

3.10 The Trustee Act 2000 imposes specific duties on trustees with regard to the exercise of their investment powers. In particular, under section 4 the trustees must review the charity's investments from time to time and, having regard to the standard investment criteria, vary them if appropriate. These criteria 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

(b) the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust

3.11 In addition, under section 5(1), 'before exercising any power of investment.......... a trustee must (unless the exception applies) obtain and consider proper advice about the way in which, having regard to the standard investment criteria, the power should be exercised'. Proper advice is 'the advice of a person who is reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial and other matters relating to the proposed investment' (section5(4)). The exception is 'that a trustee need not obtain such advice if he reasonably concludes that in all the circumstances it is unnecessary or inappropriate to do so' (section 5(3)).

3.12 The duty of care under section 1 of the Trustee Act is also applicable to any exercise of the power of investment or when carrying out the duties to consider the standard investment criteria or to take advice. The duty of care is 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

(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

3.13 It has long been the case that a higher duty of care applies to those who for profit hold themselves out as having special knowledge. Brightman J in **Bartlett v Barclays Bank Trustee Co. Ltd** (see above) said:

".....I am of opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management."

3.14 Trustees in making their investment decisions will be subject to the duty to avoid conflicts of interest (see *A guide to conflicts of interest for trustees* which is available on the GOV.UK website). In addition, they should be careful not to take into account factors that are not relevant to the decision in question nor to fail to take into account an aspect that is relevant.

4. Ethical investment

4.1 The issue with ethical investment is how ethical considerations interact with the general powers and duties of trustees regarding investment.

4.2 Charities may choose to invest in a narrower range of investments than they might do either because their objects justified the restrictions (or for the other 'Bishop of Oxford' reasons set out in the following paragraphs) or because the charity trustees considered investment was appropriate on financial considerations.

4.3 Ethical investment is investment in the financial sense, and the usual duties with regard to investment apply to it (see Trustees' duties).

4.4 The governing document of a charity sometimes imposes ethical restrictions on the scope of the general power of investment. These restrictions cannot, consistently with the body being regarded as a charity, go beyond those which are compatible with the principles which are discussed in this section. Such restrictions must, of course, be observed by trustees.

4.5 More commonly, it will be the trustees themselves who decide to adopt an ethical investment policy. In doing so, they need to keep in mind the underlying principle that their power of investment has to be used to further the purposes of the trust, and that those purposes will normally be best served by seeking the maximum return consistent with commercial prudence. As the Judge put it in the case of **Harries (Bishop of Oxford) v Church Commissioners [1992] 1 WLR 1241** (commonly known as the 'Bishop of Oxford' case), "most charities need money; and the more of it there is available, the more the trustees can seek to accomplish".

4.6 An ethical investment policy may be entirely consistent with this principle of seeking the best returns. For example, there is an increasingly held view that companies which act in a socially responsible way are more likely to flourish and to deliver the best long term balance between risk and return. Trustees are free to adopt any ethical investment policy which they reasonably believe will provide the best balance of risk and reward for their charity. As with any other investment strategy, they must be careful to discharge the duties referred to previously. In particular, they must review their investments considering suitability and the need for diversification and vary if appropriate. They should take advice where appropriate.

4.7 The next question is how far trustees can allow their investment strategy to be governed by considerations **other than** the level of investment return. The Bishop of Oxford case recognised three situations where they can properly do so.

4.8 First, there are cases where investment in a particular type of business would conflict with the aims of the charity. A charity with objects for the protection of the environment and wildlife may decide not to invest in businesses which pollute what the charity is trying to protect. But the point here is a **practical** conflict with the charity's aims and activities; not just **moral** disapproval. Where the judgment is a moral one, the trustees' room for manoeuvre is more limited.

4.9 Secondly, a charity can avoid investments which might hamper its work, either by making potential beneficiaries unwilling to be helped because of the source of the charity's money, or by alienating supporters. This requires a balancing exercise. On one side are the difficulties which the charity would encounter, or the likely cost of lost support, if it were to hold the investments. On the other side there may be a risk of financial underperformance if those investments are excluded from its portfolio. The greater the risk of underperformance, the more certain the trustees need to be of the countervailing disadvantages to the charity of such an exclusion before they incur that risk.

4.10 Thirdly, even if an investment does not come into either of the previous two categories, trustees can accommodate the views of those who consider it to be inappropriate on moral grounds, provided that they are satisfied that this would not involve 'a risk of significant financial detriment'. In many cases, trustees may be able to conclude, after taking advice where appropriate, that a particular ethical policy is likely to perform as well as an unrestricted policy. But trustees are not free to use their investment powers to make moral statements at the expense of their charity.

4.11 The key here is for charities to make a judgment in the light of their own circumstances, rather than trying to conform to a supposedly homogeneous 'public opinion'. Here are some pointers for trustees:

- consider the aims and objectives of the charity
- keep in mind the fundamental principle of maximising return; if an ethical policy is adopted, it should be set out in writing and should be clear both on positive aims and any exclusions
- if companies or sectors are excluded, the reasons for exclusion should be clearly thought through; the more restrictive the policy (in terms of exclusions), the greater may be the risk to returns

4.12 Trustees need to evaluate the effect which any proposed policy may have on potential investment returns, and this will usually require expert advice.

Part II Programme related investment

5. Programme related investment

5.1 The commission uses the term 'programme related investment' to characterise the use of expendable resources by a charity in a way which may generate a financial return but is principally for the furtherance of the charitable purpose or purposes of the charity. Examples of this include the provision of loans, loan guarantees or the subscription or purchase of shares or through the letting of land and buildings by a charity.

5.2 The furtherance of a charity's purposes by activities such as providing loans has a long history as is made clear in the commission's decision in the case of **Garfield Poverty Trust** (1990)(Decisions of the Charity Commissioners Volume 3 – January 1995). This referred to Sir Thomas White who in 1566 established loan charities in 24 of the major cities of England (see Volume 8 pages 585 to 590 of the Printed Reports to Parliament (1823) of the Commissioners appointed under two Acts of Parliament. Those loans were simply to poor young men resident in those cities and were clearly to enable young men to set up in business by providing them with loans until they became established.

5.3 In **In re Monk** [1927] 2 Ch 197 a fund for the purpose of making loans to poor and deserving inhabitants of the parish of Foxton was considered to be charitable. Similar income generating activities have also been considered to further charitable purposes eg low interest or interest free loans to assist poor people to purchase freehold or leasehold housing accommodation (**Garfield Poverty Trust** – see 5.2).

5.4 In **Joseph Rowntree Memorial Trust Hospital Association v AG** [1983] Ch 159 providing low cost housing for purchase by older people was considered to be charitable as meeting the needs of older people.

5.5 There are also charities which further their charitable purposes by investing in a trading company which conducts primary purpose trading and covenants its profits back to the charity. This may be in order to manage the risks of the trading and safeguard the assets of the charity. In **The Abbey Malvern Wells Ld. v Ministry of Local Government and Planning** [1951] Ch 728 a charitable trust carried out its charitable purpose through a company wholly controlled by it. The school was considered to be held for charitable purposes even though held by the company.

5.6 The commission has previously considered the case of a charity whose objects included an object for the promotion of ethical and religious principles in industry with a view to ensuring the discharge by persons engaged in industry of their social obligations for the welfare of the communities within which they operate. The charity had a large shareholding in a manufacturing company with a particularly innovative ethical control structure and that holding was justified on the basis of the furtherance of their purposes.

5.7 Some charities may hold shares not as financial investments but to allow them to attend shareholder meetings and 'hold the company to account'. In certain circumstances this will be a means of supporting the furtherance of the purpose of the charity and so be acceptable.

5.8 The holding of land as a financial investment is permitted by section 8 of the Trustee Act 2000. However, many charities also hold land and use it as a means of furthering their charitable purpose eg a charitable registered housing provider which lets property to people in need, an almshouse charity which provides housing for older people at a low accommodation charge. These clearly generate some funds for the charity but the purpose in carrying out these activities is not the income but the furtherance of the charitable purpose of relieving people in need.

5.9 The commission does not consider that programme related investment is investment at all because it is about applying funds to further the purpose of the charity and does not accord with the common law definition of investment eg **Harries v Church Commissioners**.

5.10 However, as was stated in **Cowan v Scargill**, "the starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust". In the case of a charitable trust this translates into 'the duty of the trustees to further the charitable purposes'. These can be furthered either by applying the funds directly for those purposes or by investing the funds and applying the return in furtherance of those purposes. Directors of charitable companies have a duty to act in the way they consider in good faith would be most likely to achieve the charitable purposes of the company (section 172 Companies Act 2006) which is similar to the test derived from **Cowan v Scargill**.

5.11 Programme related investments are not made under the trustees' powers of investment. They are made in accordance with the powers and duties of the trustees to further their purposes.

5.12 The term 'social investment' is sometimes used interchangeably with the term 'programme related investment but it is also used in a wider context than that which applies to charities. In these cases it is about investing funds in an enterprise which will achieve a social impact or return rather than a financial return. It is often represented that charities are for the public benefit, and as social investments are for the public benefit, therefore there should be no problem with charities making social investments.

5.13 However, the matter is not as straightforward as that. Social investments differ from programme related investments in that the term 'social investment' is sometimes used to cover investments which can be justified on financial return grounds but which also deliver some social return. It also includes investment products which may give a lower return but deliver some social return. However, the analysis which needs to be made is whether the outlay of funds is justified as a financial investment or as means of furthering the charity's purposes. In the latter case there must be no undue private benefit and the outlay of funds must be justified by the extent to which the objects are likely to be furthered.

Private benefit

5.14 In the case of an investment which furthers the purposes of the charity, any private benefit arising from that investment, for example to the proprietors of the company in which the investment is made or to other investors, would need to be legitimately incidental to the furtherance of the charity's purposes. Any private benefit must be a necessary part of a course of action which is determined by the trustees to be an efficient and effective way of furthering the charity's purposes or it must necessarily result from such a course of action[9].

9 See **Analysis of the law underpinning Charities and Public Benefit** Paras 3.77 to 3.95

5.15 Where there is non-incidental private benefit arising from a programme related investment by a charity, one means of eliminating this is for the recipient of the benefit to surrender it to the charity.

5.16 The court has held that a charitable company could not give away its assets to a non-charitable body[10]. It further considered that the giving of a gratuitous guarantee was 'on the same footing'. This was even though it was given in order to allow the non-charitable body to carry out a project which the charitable company considered would further its own purposes.

Can trustees invest in the equity capital of a non-charitable company?

5.17 It follows from the last paragraph that investing in the equity capital of a non-charitable company not for a financial return but in order to further the charity's purposes is likely to meet similar treatment to the gratuitous guarantee. In general, investment in the equity of a private company will not merely be furthering the charitable purpose of the investing charity but will also be furthering the generation of a financial return for the shareholders or some other non-charitable purpose of the company. This will usually mean that the investment is not furthering exclusively charitable purposes. The court has indicated that if the non-charitable company was controlled by the charity, the position may be different[11]. Accordingly, it may be possible for trustees to invest in a non-charitable company where it is controlled or wholly owned by the charity.

5.18 Where the non-charitable company is not owned or controlled by the charity it is only likely to be possible for trustees to invest in the equity capital of such a company as a way of furthering their purposes in exceptional circumstances. These circumstances are only likely to arise when there is a correlation between the social purposes which the non-charitable company will achieve and the charity's aims.

5.19 In such cases the trustees need to be satisfied that:

i) there is a correlation between the charity's aims and the social mission of the non-charitable organisation in which the trustees wish to invest

ii) any private benefit derived from the programme related investment will be purely incidental (it arises as a necessary but incidental consequence of any decision by the trustees to further their charitable purposes)

iii) any private benefit will not be excessive and the investment is clearly for the public benefit

5.20 Where there is potential for considerable economic gain, the commission expects the trustees to also ensure that the charity benefits from this economic gain and puts in place appropriate mechanisms to achieve this as otherwise it could not be satisfied that any private benefit is purely necessary and incidental. There must be adequate safeguards in place in order that non-incidental private benefit does not arise.

5.21 An example of where it was appropriate for a charity to invest in equity capital to further its purposes is a medical research charity that wished to further the application of research for the public benefit by facilitating its commercial development. The commission satisfied itself that the trustees understood their duties with regard to ensuring any private benefit was legitimately incidental.

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10 **Rosemary Simmons Memorial Housing Association v UDT** [1986] 1 WLR 1440, 1446
11 Ibid [1986] 1 WLR 1440, 1446

5.22 In the commission's guidance on investment, there is an example of programme related investment which involves the purchase of shares in a commercial organisation run by and only employing people with disabilities where the benefits to the shareholders were considered to be incidental to the furtherance of the charity's purpose which was relieving need arising from disability.

5.23 Neither of these examples necessarily means that investing in the equity capital of a private company which operates partly for the benefit of the community will only involve incidental private benefit. Whether the private benefit is incidental will depend very much on the circumstances of the case.

5.24 So far this discussion has been about programme related investment and private benefit. Clearly within the context of mixed motive investments, it is the private benefit arising from the programme related element of the investment that may cause difficulty. The commission would expect charity trustees to apply the principles set out previously with regard to programme related investment and private benefit.

Investing in social enterprises

5.25 The commission is increasingly being asked whether it is acceptable for charities to invest in a social enterprise ie a business which operates mainly for the benefit of the community. This is likely to depend on whether such investment can be justified as a proper discharge of the investment responsibilities of the trustees having regard to the likely financial return and the risk profile.

5.26 Some charities may wish to invest in social enterprises in order to further their charitable purpose. Some models do permit a distribution of profits, whether by dividend or enhanced capital value, and such models cannot be charities. Accordingly, where a charity wishes to support a social enterprise, it needs to ensure that any funds provided by the charity on the basis that this furthers the charity's purposes will be used solely to further those purposes. Sometimes of course the trustees may be able to justify an investment in a social enterprise on the basis that the extent to which the charity's objects are furthered is reasonable for the amount of funds provided and that any private benefit, eg to those controlling the social enterprise, is incidental to the furtherance of those objects. However, where this is not the case, the trustees will have to justify any investment in a social enterprise by reference to the financial return applying the standard investment criteria.

5.27 The fact that a proposed investment is in a social enterprise, does not necessarily mean it is appropriate either as a programme related investment or as a mixed motive investment. Particular corporate structures have been created to encourage such enterprises ie the Community Interest Company (CIC). Such a company is not a charity but it can have charitable purposes. It is possible for a charity to become a CIC but, if it does so, the assets it holds for its charitable purposes are subject to an asset lock and will be held on trust for those purposes.

5.28 The reason for the asset lock is that a CIC does not exist totally for the benefit of the community only mainly. Accordingly, there is a degree of private benefit permitted which goes beyond the incidental private benefit permitted to a charity. If a charity could get round the statutory asset lock by 'investing' its funds in the social enterprise, that would defeat the whole purpose of the asset lock and seriously compromise the important principle of charity law that a charity must have exclusively charitable purposes.

5.29 Some commentators have advocated that charities should be able to support social enterprises even where their purposes are outside the charitable purpose of the charity. It would require a change in the law to permit charities to apply funds in achieving social impacts which are not within their charitable purposes. This is contrary to the current framework of charity law and trust law. This guidance is necessarily focused on the law as it is at present.

5.30 Some charities have general charitable purposes and it is clearly easier for them to be involved in a wide range of programme related investments than for charities with more limited objects.

Outcomes-based finance

5.31 There has recently been some interest in the ability of charities to invest in social impact bonds. This is where a project aimed at achieving some form of desirable social impact receives a return of funds if the desired outcome is achieved. A social impact bond in respect of a project which is in furtherance of the charity's purpose may well be a programme related investment. An example of this would be a project to reduce the number of persons contracting a certain illness which may be in furtherance of a purpose for the advancement of health. It is not yet clear whether these could ever be considered appropriate financial investments for a charity (as opposed to a programme related investment).

Part III Mixed motive investment

6. The scope for mixed motive investment

6.1 The commission uses this term 'mixed motive investment' to apply to the following situation ie where the investment:

(I) cannot be justified solely by reference to the impact it has on furthering the purposes of the charity

(II) cannot be justified as providing an adequate financial return applying the standard investment criteria

but which

(III) is not made for a purpose other than furthering or supporting the purposes of the charity or securing a financial return

Clearly where the proposed investment is for a purpose other than furthering or supporting the purposes of the charity or securing a financial return, it is not likely to be within the powers of the charity trustees to make it.

6.2 This is then essentially where an investment is made for a mixture of two reasons:

(i) to generate a financial return

(ii) to finance activities which will further the charity's purpose.

6.3 In these cases it is not always clear what part of the funds laid out by a charity is for the purpose of furthering its purposes and what part of the fund is justified as producing a financial return.

6.4 The issue becomes therefore how the trustees consider whether putting the necessary resources into such an investment is justified. The danger is that the investment is not justified by the financial return nor by the impact on the furtherance of the charity's purposes but that this is hidden by the trustees maintaining they are doing both.

6.5 One way of proceeding is as follows. The trustees should first consider the extent to which the outlay of funds will further its purposes or is ancillary to the furtherance of the purpose and, in the light of this, what proportion of the charity's resources it would be reasonable to commit to the project. Clearly, where the activities are directly furthering the purposes, a higher proportion may be justified than where the activities merely support the purposes.

6.6 Having considered this, the trustees will then need to consider the balance of the resources they will need to commit to the proposed 'investment'. The issue for the trustees will be whether the expected return from the use of the total 'investment' is justified as a return on the outlay of the difference between the total amount of the investment and the amount it is proportionate to commit to the furtherance of the purposes.

6.7 In considering whether the programme related investment element furthers the purposes of the charity, the trustees must consider any private benefit arising from the 'investment' and ensure this is legitimately incidental to the furtherance of the charity's purposes (see paragraphs 6.14 to 6.22).

6.8 Alternatively, some trustees may prefer to consider the financial investment element first and assess what proportion of the proposed investment can be justified by the likely return. They could then consider whether the balance of the investment could be justified by the extent to which it will further the charity's aims.

6.9 Accordingly, with a mixed motive investment the trustees are making two decisions using different criteria and should minute these decisions carefully to make this clear. HMRC will need to be satisfied that the investment element is an approved charitable investment and that it and the charitable element account for the whole outlay of funds.

6.10 In either method, the division into programme related and financial investment is purely notional and is an analytical tool for justifying the full extent of the funds applied. The conclusions reached should be properly minuted so that the trustees have evidence of the process of consideration. It is important that this process should be carried out before the investment is made rather than as an exercise in finding a justification for a past investment.

6.11 Concerns have been raised with regard to the accounting treatment of mixed motive investments. It may be that they will need to be accounted for as financial investments with disclosures which show the justification for the lower return. It has been suggested that the commission should not produce its guidance until an accounting treatment is fully worked out. However, this guidance is concerned with legal powers rather than the accounting treatment.

Part IV Other issues relating to the trustees power to make financial investments

7. Liability for breach of trustees' duties

7.1 If trustees act in breach of their investment duties, they may be liable to the charity for any loss. In **Nestle v National Westminster Bank plc** [1993] 1 WLR 1260 trustees misunderstood their power of investment and did not invest in the full range of investments that they might have. However, no loss to the trust was proved so there was nothing for which they were liable.

7.2 The court takes a different approach to trustees depending on whether they are lay trustees who are unremunerated or trustees who are remunerated and in that position because of special skill and knowledge. In the first case the court is more likely to accept that trustees should be excused from being liable for any loss to the charity provided they have acted honestly and in good faith.[12]

7.3 As Brightman J indicated in **Bartlett v Barclays Bank Trust Co. Ltd** [1980] Ch 515:

"The distinction is between a prudent degree of risk on the one hand and hazard on the other. Nor must the court be astute to fix liability upon a trustee who has committed no more than an error of judgment, from which no businessman, however prudent, can expect to be immune."

7.4 Brightman LJ then cited Lopes LJ in **In re Chapman** [1896] 2 Ch 763, 778:

"A trustee who is honest and reasonably competent is not to be held responsible for a mere error of judgment when the question which he has to consider is whether a security of a class authorized, but depreciated in value, should be retained or realized, provided he acts with reasonable care, prudence, and circumspection."

7.5 In the case of **Stanway v A-G and others** 5 April 2000 Chancery Division No. HC0000852 the Vice-Chancellor, Sir Richard Scott, found in the circumstances of a case involving trustees who had acted honestly and without reward that an action *"should not be brought against them, or any of them, unless it can be seen to be a good action – not just a possible action, not even just an action more likely to succeed than to fail, but an action which looks pretty copper bottomed."*

7.6 Of course, each case depends on its facts and trustees do need to ensure that they comply with their duties as trustees. However, an honest and reasonably competent trustee is unlikely to be held liable for any loss.

12 Re Evans [1999] 2 All ER 777, 788

8. Holding financial investments

Who can hold investments for an unincorporated charity?

8.1 Unincorporated charities do not have their own legal identity, and therefore the charity trustees will have to hold the investments in their own names or appoint one or more people or a corporate body to hold investments on behalf of the charity.

Who can hold investments for a charitable company?

8.2 Charities which are companies are corporate bodies and therefore have a legal identity. As a result, they can hold investments in the company's own name. They may decide that this is not the best option for them and opt to delegate the holding function to a nominee.

Can trustees appoint nominees and custodians?

8.3 A nominee is a person appointed to hold assets in their name on behalf of the charity.

8.4 A custodian is defined in section 17(2) of the Trustee Act 2000 as someone who undertakes the safe custody of the assets or any documents or records concerning the assets.

8.5 Under section 16 of the Trustee Act 2000 trustees may appoint a person to act as nominee of such assets as they decide except that they cannot do so in respect of settled land. The assets can be vested in the nominee[13]. Such an appointment must be in writing or evidenced in writing[14].

8.6 Under section 17 of the Trustee Act 2000 trustees may appoint a person to act as custodian in relation to such assets as they may decide.

8.7 Accordingly, it is possible for a charity to have a nominee and a custodian in respect of the same assets. However, where a charity has a custodian trustee it cannot appoint either a nominee or a custodian. It can also not appoint a nominee or custodian in respect of any assets vested in the Official Custodian.

8.8 Under the Trustee Act 2000 the term 'custodian trustee' has the same meaning as in the Public Trustee Act 1906. However, that act does not define 'custodian trustee' as such. Section 4 states that the Public Trustee may be appointed as a custodian trustee and sets out the powers she or he will have. It also states that this will apply to '*any banking or insurance company or other body corporate entitled by rules made under this Act to act as custodian trustee*'.

8.9 So, it would appear that where the term appears in the Trustee Act 2000 it refers to a situation where the Public Trustee or a corporate body is the custodian trustee.

8.10 The term 'custodian trustees' is sometimes used for persons appointed under a governing document to hold property on behalf of the managing trustees. As with the situation set out in section 4 of the 1906 Act, usually they are required to deal with the property in any way they are instructed to do by the managing trustees. However, as section 4 does not expressly govern such a situation, they will only have the powers conferred by the governing document. This is indistinguishable from the position of holding trustees.

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13 s16(1)(b)
14 s16(2)

9. Total return

9.1 There is a line of cases in private trust law which deal with the allocation of investment returns. Some types of investment return are allocated to income (the trust for application) and some to capital (the trust for investment). A total return approach to investment is where both the income return and any capital uplift are amalgamated as the total return.

9.2 Charities without permanent endowment do not have restrictions on spending their capital and they can spend the total return on furthering their purposes as well as the underlying capital. Permanently endowed charities can usually only spend the income from their capital on furthering their purposes. If they wish to take a total return approach to investment, this has to be authorised by an order or scheme of the commission depending on the circumstances.

9.3 The commission for some years has been prepared on certain conditions to authorise trustees to take a total return approach. This allows the two types of return to be put together as unapplied total return. The trustees can then decide what amount of the total return should be allocated as income and what should be retained as unapplied total return. Unapplied total return is dealt with as capital ie it is invested until the trustees wish to apply it.

9.4 The commission's jurisdiction to do this is based on the case **In re Laing** [1983] 3 WLR 886. In that case the court considered a trust provision that a large amount of capital be spent by a certain date. The court drew a distinction between the purposes of the trust and administrative provisions. While the purposes could only be changed on a cy pres occasion, the court could change administrative purposes under its inherent jurisdiction. If having to spend the funds by a certain date is an administrative provision, not being able to spend the capital but only the income is also likely to be an administrative provision. Under section 69 of the Charities Act 2011 the commission has concurrent jurisdiction with the High Court for certain purposes.

9.5 This issue was considered by the Law Commission who produced a report (no. 315) called 'Capital and Income in Trusts' published on 7 May 2009. Following this a consultation was carried out by the Ministry of Justice on a Trusts (Capital and Income) Bill which closed on 14 June 2010. This proposed that charity trustees have the power to take a total return approach to investment in accordance with regulations made by the Charity Commission.

9.6 One of the issues arising from this is that the Charity Commission's exercise of its jurisdiction to permit a total return approach does not permit any increase in the amount of capital which cannot be spent. Some charities have expressed a wish to ensure the real value of their capital is not eroded by the total return approach. The unapplied total return is treated as capital but it can if appropriate be allocated as income. Accordingly, that does not deal with the issue of safeguarding the capital which cannot be spent. This issue will be addressed in any commission consultation on the regulations which the bill is proposing.

Part V Other issues relating to the trustees' power to make financial investments and to their power to make programme related investments

10. Gifts of shares

10.1 Donors to charities may give donations by way of shares, sometimes in a family company in which the founder of the charity has a significant interest. The duty in respect of such shares is for the trustees to decide whether it is in the interests of the charity to hold and retain the shares. In some cases the relevant considerations will relate to programme related investment, as with the example in paragraph 5.6 where retaining the shareholding was justified by its furthering the purposes of the charity.

10.2 In the case of shares held as financial investments, the standard investment criteria will apply so that the trustees have to review the holding of the shares from time to time and, having regard to the investment criteria, to vary them if appropriate. Accordingly, the trustees will have to have regard to suitability and the need for diversification. Having said this, where there is a gift of shares, other factors may also require consideration such as the likelihood of the donor making further donations to the charity and whether the advantages of this outweigh any risks involved in continuing to hold the shares.

10.3 Sometimes donors impose a condition on a gift that the trustees cannot sell the shares without the agreement of the donor. The commission takes the view that this veto by the donor is a fiduciary power which has to be exercised in the interests of the charity and not in the donor's interests. In any event, the trustees' duties will still be to review the investments. If they consider they need to diversify but the donor refuses consent, the trustees may wish to apply to the commission to vary the governing document of the charity.

10.4 Charities will also be aware of the 'tainted donations' provisions introduced by section 27 and schedule 3 of the Finance Act 2011 which are intended to catch donors who, in respect of a donation to charity, have entered into arrangements with the purpose of receiving an advantage from the charity.

10.5 Where a gift of shares results in the charity owning a majority shareholding the responsibilities of the trustees are to manage that in the interests of the charity. Similar considerations arise to those described in the section on trading companies established by a charity for income generation purposes.

11. Trading Companies

11.1 Many charities have trading companies. This may be for the purpose of income generation or for the purpose of conducting activities which further the purposes of the charity. Any provision of funds for such a trading company has to be justified as either a proper exercise of the general power of investment or as a means of furthering the purposes of the charity. In the case of justification as a financial investment, if the return from the trading company does not justify the investment in it, then the charity trustees need to attend to this.

11.2 The duty of trustees with regard to a company in which they are the sole or majority shareholder were set out in **In re Lucking's Will Trusts** [1968] 1 WLR 866, 874 where Cross J said:

"Now what steps, if any, does a reasonably prudent man who finds himself a majority shareholder in a private company take with regard to the management of the company's affairs? He does not, I think, content himself with such information as to the management of the company's affairs as he is entitled to as shareholder, but ensures that he is represented on the board. He may be prepared to run the business himself as managing director or, at least, to become a non-executive director while having the business managed by someone else. Alternatively, he may find someone who will act as his nominee on the board and report to him from time to time as to the company's affairs. In the same way, as it seems to me, trustees holding a controlling interest ought to ensure so far as they can that they have such information as to the progress of the company's affairs as directors would have. If they sit back and allow the company to be run by the minority shareholder and receive no more information than shareholders are entitled to, they do so at their risk, if things go wrong."

11.3 Directors of non-charitable companies may commit their companies to ventures which would be too speculative for trustees to undertake directly. However, the creation of a wholly or majority owned company by trustees does not discharge the trustees from responsibility for the decisions of the company. The Garfield Weston Foundation Regulatory Case Report in 2010 is an example of the commission applying the principle that trustees of a charity that owns a controlling interest in a company have a duty to the charity to exercise that control so as to safeguard the interests of the charity. In **Bartlett v Barclays Bank Trustee Co. Ltd** (see above) Brightman J said

"The bank, as trustee, was bound to act in relation to the shares and to the controlling position which they conferred, in the same manner as a prudent man of business. The prudent man of business will act in such manner as is necessary to safeguard his investment. He will do this in two ways. If facts come to his knowledge which tell him that the company's affairs are not being conducted as they should be, or which put him on inquiry, he will take appropriate action. Appropriate action will no doubt consist in the first instance of inquiry of and consultation with the directors, and in the last but most unlikely resort, the convening of a general meeting to replace one or more directors. What the prudent man of business will not do is to content himself with the receipt of such information on the affairs of the company as a shareholder ordinarily receives at annual general meetings. Since he has the power to do so, he will go further and see that he has sufficient information to enable him to make a responsible decision from time to time either to let matters proceed as they are proceeding, or to intervene if he is dissatisfied."

11.4 Sometimes charities set up companies (whether charitable or not) for the purpose of furthering their purposes rather than for the purpose of income generation. The reason for doing this may be to protect the main charity from any liabilities arising from a particular activity of the charity. However, it must still be borne in mind that the trustees will still have responsibility for the activities of the company so that setting up a company to do things the trustees themselves did not have the power to do is not likely to succeed except where the funding of the company is justified as a financial investment.

11.5 In **Abbey Wells Malvern Ltd v Ministry of Local Government and Planning** [1951] Ch 728 Danckwerts J said

"Therefore, while the company theoretically has the power to apply its property and assets for the purpose of making profits and devoting the resulting profit to the distribution of dividends among the members, when I proceed to inquire who are the persons who regulate the operations of the company, I find that they are not free persons unrestricted in their operations, but are the trustees of the trust deed, who may only act in accordance with the provisions of that deed, may only use the property of the company in a particular way, and must not make use of the assets of the company for the purpose of a profit-making concern."

12. Delegation of investment management

12.1 The Trustee Act 2000 gives trustees certain powers to delegate management of their investments. These powers are in addition to any powers of delegation that are stated in a charity's governing document.

12.2 The powers for trustees to appoint agents in section 11 of the Trustee Act 2000 include appointing an agent to carry out 'any function relating to the investment of assets subjects to the trusts (including, in the case of land held as an investment, managing the land and creating or disposing of an interest in the land'.

12.3 Under section 13(1) of the Trustee Act 2000 a person who is authorised under section 11 to exercise the general power of investment is subject to the duty to have regard to the standard investment criteria when exercising any power of investment. Such a person is also subject to the duty to review the investments of the trust from time to time and consider whether, having regard to the standard investment criteria, the investments should be varied.

12.4 Under section 14 the trustees may authorise a person to exercise such a function on such terms as to remuneration and other matters as they may determine. With regard to terms which

a) permits the agent to appoint a substitute

b) restricts the liability of the agent or his substitute to the trustees or any beneficiary

c) permits the agent to act in circumstances capable of giving rise to a conflict of interest

the trustees may not authorise a person to exercise such a function as their agent unless it is reasonably necessary for them to do so[15].

15 Section 14(2) and (3)

12.5 Section 15 sets out limitations on the appointment of an investment manager. There has to be an agreement in or evidenced by writing. The trustees must have prepared a policy statement giving guidance as to how the function should be exercised. The agreement must include a term that the agent will secure compliance with the policy statement (which must also be in writing or evidenced by writing). The trustees must formulate any guidance given in the policy statement with a view to ensuring the functions will be exercised in the best interests of the trust.

12.6 The previuos provisions relate to the delegation of the financial investment of assets. It does not authorise the delegation of programme related investment. The delegable functions set out in section 11(3) of the Trustee Act 2000 are:

"(a) any function consisting of carrying out a decision that the trustees have taken

(b) any function relating to the investment of assets subject to the trust (including, in the case of land held as an investment, managing the land and creating or disposing of an interest in the land)

(c) any function relating to the raising of funds for the trust otherwise than by means of profits of a trade which is an integral part of carrying out the trust's charitable purpose

(d) any other function prescribed by an order made by the Secretary of State."

12.7 Programme related investment does not fall within (b) or (c) or (d). Where trustees have made a decision regarding programme related investment, it would appear that the function of carrying out that decision could be delegated as falling within (a). It is also possible that the delegation of programme related investment could be delegated under an express power in the charity's governing document. Trustees should ensure that any decision regarding programme related investment will further the charity's purposes and that any private benefit is legitimately incidental.

12.8 Under section 25 of the Trustee Act 1925 a trustee may, by power of attorney, delegate the execution or exercise of all of any of the trusts, powers and discretions vested in him or her as trustee either alone or jointly with others. The section sets out the form the deed should take and various matters regarding it.