A brief guide to the investment of charitable funds

The Charity Commission, the regulator of charities in England and Wales has been given the opportunity by the Social Investment Team at the Cabinet Office to comment from its regulatory perspective on the development of co-mingling funds. We welcomed this opportunity to consider and resolve, as far as possible, any barriers that may hinder charities from participating in these new initiatives, while ensuring that trustees are aware of their powers and duties and the requirements of the law.

Here we have set out the key principles involved in investment of charitable funds, decision making and risk assessment which we hope will be of help to trustees considering taking advantage of such different ways of investing charitable funds.

1 Investment by charities – trustees' fiduciary duties

The starting point for trustees in any investment strategy is their duty to exercise their powers in the best interests of the charity and thus its beneficiaries.

Our guidance *Charities and Investment Matters: A guide for trustees* sets out the different investment strategies that may be used by charities. We have produced this guidance to support charities and their trustees in confidently making decisions about investments that comply with their duties. We use the term 'investment' to include any outlay of funds in something which *may* lead to a financial return. It covers:

- investing for the purpose of obtaining the best financial return within the level of risk considered to be acceptable – this includes ethical investment ('financial investment')

- an outlay of funds in furtherance of the charity's aims where a financial return *may* be generated but where the reason for the outlay is to further the aims of the charity ('programme related investment')

- investing where:

    - the investment cannot be justified solely by reference to the impact it has on furthering the aims of the charity; and
    - it cannot be justified as providing an adequate financial return applying the standard investment criteria;

but which is not made for a purpose other than furthering or supporting the aims of the charity or securing a financial return. In addition the use of resources must be justified by the total of the furtherance of the purposes and the financial return. ('mixed motive/purpose investment').

We make it clear that trustees can invest their funds in a way that furthers their aims as well as achieving some financial return and set out the kinds of things trustees will need to consider when thinking about investing in this way.

2 The importance of a charity’s governing document and powers of investment

A charity’s governing document will usually set out its aims, the powers that its trustees have and various administrative provisions.

When making financial investments, the charity trustees may have the general power of investment conferred by the Trustee Act 2000 or will have the scope of their power of investment set out in their charity’s governing document. It is important for a charity’s trustees to know what powers of investment they have and the scope of such powers.

The primary consideration for a charity wanting to make a programme related investment must be the charity’s aims. It can only use its funds to further its charitable aims or any part of those aims. The aims will also be relevant in a mixed motive/purpose investment as the non-financial investment element must fall within the charity’s aims.

Therefore it is essential for a charity to know what charitable aims it is investing in and to be satisfied that it will not be supporting activities that fall outside of its aims. The term ‘social investment’ is a broad one and may include purposes that fall outside the aims that a particular charity was established for, or indeed fall outside an aim that is charitable in law.

3 Private benefit

In the case of an investment which furthers the purposes of a charity, any private benefit arising from that investment, for example to the directors of the company in which the investment is made or to other investors, would need to be incidental to the furtherance of the charity’s aims. Incidental here means not beyond what they consider as necessary, reasonable and in the interests of the charity.

In a purely financial investment, the private benefit conferred by the charity upon the company directors and its shareholders is deemed to be incidental to the benefit to the charity and its beneficiaries arising from the investment.

Where the charity is providing funds in order to further its charitable purposes, it is important to ensure that any private benefit is incidental to the furtherance of those purposes. Accordingly, it would need to be clear that furthering the purposes in the proposed way would be a more effective way of furthering the charity’s purposes than applying the funds in a way which would not confer the private benefit.

4 Decision making and managing risk

The principles in our guidance *Its your decision: charity trustees and decision making* should inform trustees' approach to decision making generally. It is important to apply them when making significant or strategic decisions, including those facing a charity considering making these types of investment. These are principles that the courts have developed for reviewing decisions made by trustees. Trustees must:

- act within their powers
- act in good faith and only in the interests of the charity
- make sure they are sufficiently informed
- take account of all relevant factors
- ignore irrelevant factors
- manage conflicts of interest
- make decisions that are within the range of decisions that a reasonable trustee body could make.

They must be able to show how they have followed these principles. We explain these principles in more detail in section B of the above guidance.

Making decisions is also closely linked to managing risk. It is important for trustees to be aware and informed about risk. This does not necessarily mean avoiding risk altogether - what is key is to recognise and assess risks and take appropriate steps to manage them. There is usually some element of risk in decision making, and sometimes innovation only comes about through informed and measured risk-taking. For further information see our guidance on Risks and how to manage them.

As we have previously said, co-mingling funds appear to offer scope for encouraging private investors to invest for social as well as financial purposes, possibly extending the social impact that charities are able to make. However, charities participating in this type of investment will have to be satisfied that to do so will be in their interests, and be sure of exactly what kind of investment they are making and why.