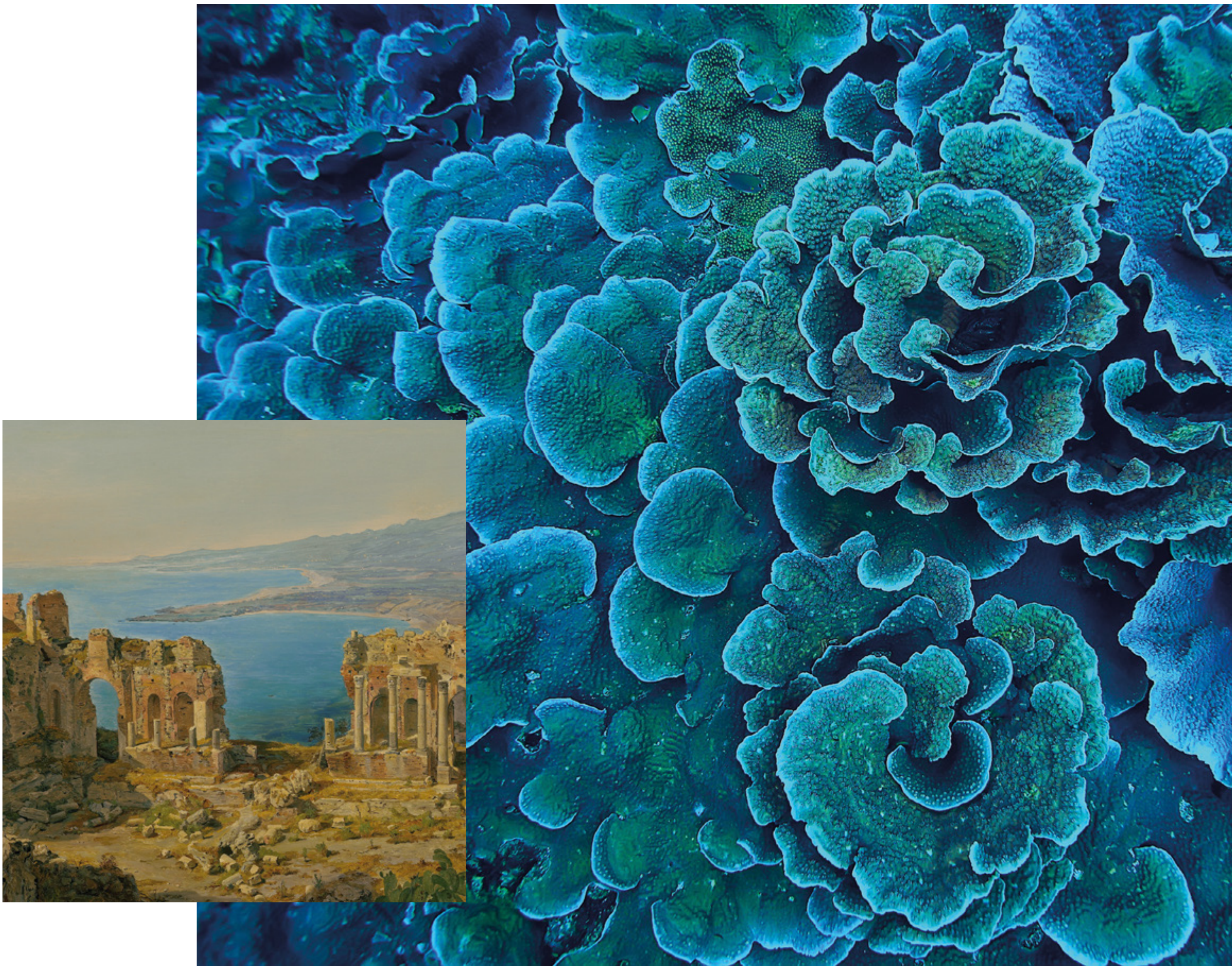
Wealth
Management

Policy matters

How to write your charity's investment policy statement



Forward-looking
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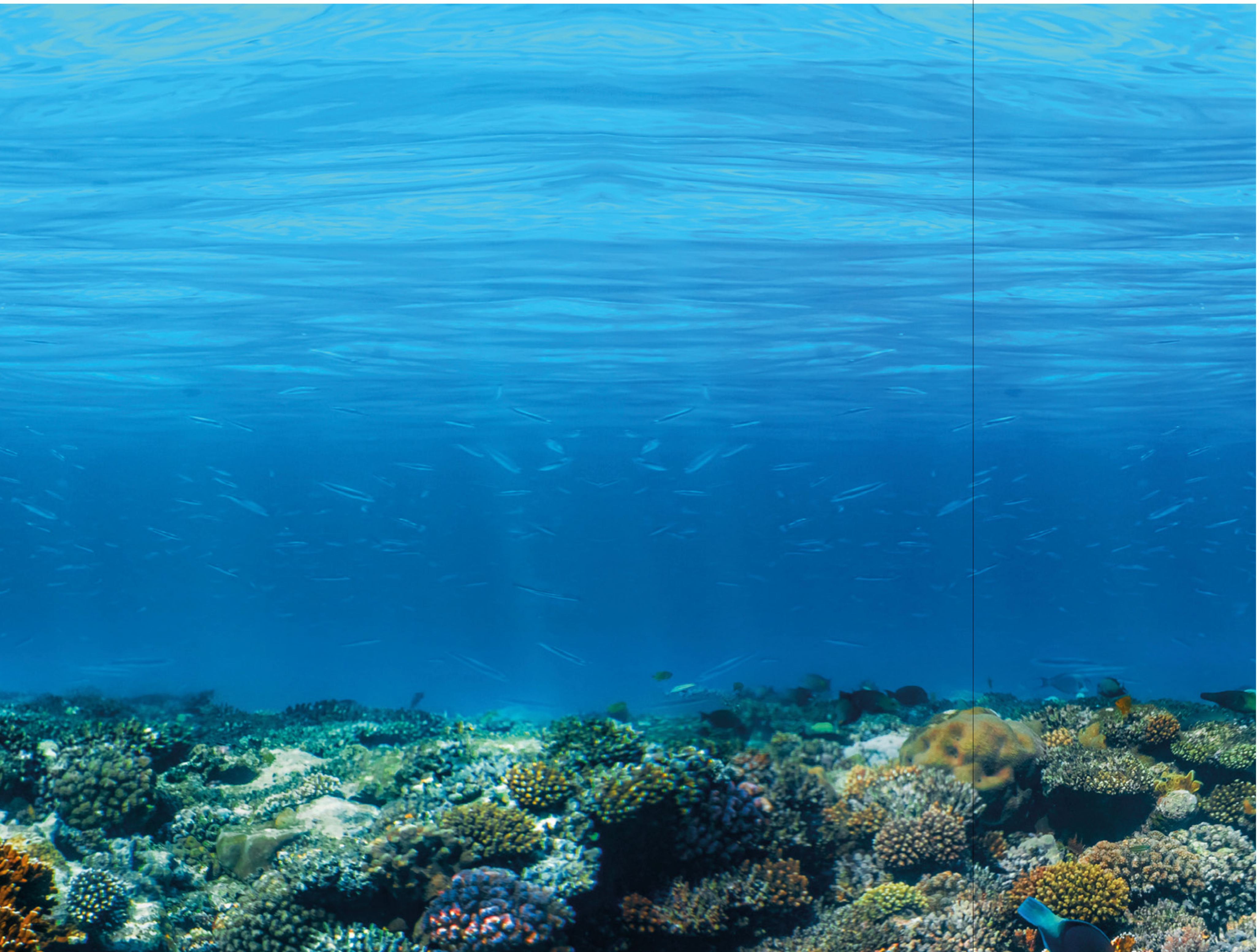

Cover image
Ferdinand Georg Waldmüller, detail from "The Ruins of the Greek Theatre at Taormina on Sicily," 1844

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Welcome

We understand the barriers facing charity trustees at the moment of financial transition: when a charity moves from holding cash to investing for the first time.

Within this guide, we hope to provide guidance and practical support to trustees when they are considering creating an investment policy statement.

The end goal is clear enough. Trustees need to arrive at a collective view on how to define the framework that applies to the charity's investments. That framework is the charity's investment policy statement. The question is – how to get there?

Trustees need to be mindful of aligning their investments with their charitable purposes, to avoid investing in areas that contradict their values. It's also important to consider any risk management steps needed to minimise potential reputational damage, which may prompt further discussions about screening.

Another pertinent question to ask is: how do you turn good intentions into reality? This guide can help you translate ethical concerns into an actionable investment policy.

Supporting charities is what we do, both in our day jobs at LGT Wealth Management and outside work. All four of us have experience as charity trustees and finance/investment committee members of various charities ranging from grant-makers to universities and conservation charities. This guide brings together our collective insight and experience to help organisations develop and update their investment policy statement. We hope you find it useful. If you have any questions about the guide or how to use it, please do get in touch.

> **"If you've never written an investment policy statement before, it may be difficult to know where to start. This guide will take you through the areas to consider, whether you are creating one from scratch or updating an old policy.**
>
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Using this guide

This guide is relevant to you if your charity holds investments already or is about to invest for the first time. Page 8 touches on some of the legal points arising, where we cover different information for trustees in Scotland, England and Wales, and Northern Ireland.

This guide is intended for use by trustees throughout the UK, as the steps involved in creating or updating an investment policy statement usually have a more practical focus.

A further practical aspect to an investment policy statement is the role it can play in trustee induction and training. Over time, when new trustees join a charity board, an investment policy statement can be useful in helping new trustees quickly get up-to-date on this aspect of the charity's finances.

There is no set format for an investment policy statement. The template at the end of this guide is one example, but you should tailor this to reflect the needs of your own charity.

Getting your governance right

Something to consider when looking at investment decision-making is: do you have the right mix of people around the board table, committee meeting or sub-group? The trustees collectively share final responsibility for decisions affecting the assets of the charity, including its investments. It is certainly true, however, that many charities make use of a structure that involves sub-committees, such as a finance committee. For larger charities, this may involve a dedicated investment committee, in order to delegate detailed scrutiny to a smaller group.

As you look at preparing your own investment policy statement, this may prompt a discussion about whether it's time for a sub-committee to be formed, to consider financial matters in more detail. Or perhaps you could strengthen an existing committee with new appointments. Depending on the charity's governing document, this may also present an opportunity to co-opt additional expertise onto such a sub-committee. That way, one or more individuals with relevant experience could participate in the work of the finance/investment committee, albeit without being trustees.

It's unlikely that all trustees will be involved in writing the investment policy document itself. That work usually falls to a smaller group of some kind. Your Finance Director may also be involved in providing support. You may seek external insight to access specialist input. However you choose to go about writing your investment policy statement, the 'buck stops with the trustees' who are ultimately responsible for the policy.

Finally, it's important not to think about your investment policy statement in isolation. It may need to sit within the broader policy framework of the charity. This can help ensure a 'good fit' with your reserves policy and any overall ethical policy or corporate donor acceptance policy. Ultimately, how you use your investments can contribute towards delivering your charity's strategy. We explore this further on page 10.

Case study 1

A health-focused charity with an investment portfolio valued at £8m has a board of trustees and no separate finance committee. The charity employs a full-time Manager who has finance and risk-management experience. All trustees discussed the potential content of their new investment policy statement, which was subsequently written-up by the Charity Manager. The draft was then put to the full board for discussion, amendment and adoption.

Case study 2

A conservation charity is investing for the first time and creates a new investment committee. The Chair of the investment committee takes on the role of writing-up the draft investment policy statement. They also receive input from the CEO, Chair of the charity and other members of the investment committee, who are also trustees. The final draft of the investment policy statement was put to the full board for discussion, amendment and adoption.

Trustee duties – the legal and regulatory backdrop

An up-to-date investment policy statement is important because it helps to evidence that you have fulfilled your trustee duties. Your trustee duties always involve acting with care and diligence and in line with the charity's purposes. You also need to act in line with the powers you have as trustee. That means means checking what the charity's governing document says about trustee investment powers. There may also be default investment powers you can rely on in your jurisdiction.

There is no specific investment guidance from the Charity Commission for Northern Ireland.

Is an investment policy statement mandatory by law?

The answer is yes, in some situations.

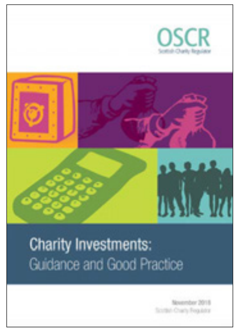
In England, Wales and Northern Ireland, there is an additional legal obligation on charity trustees where the charity's underlying legal structure is a trust. Section 15 of both the Trustee Act 2000 and the Trustee Act (Northern Ireland) 2001 applies where the investments are being delegated to an investment manager. In that situation, the trustees must put in place an investment policy statement and the policy document must include wording to the effect that the investment manager will "secure compliance with the policy statement."

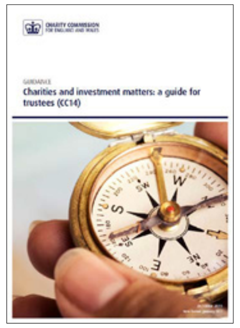
Scottish law does not create this legal obligation. However, the Office of the Scottish Charity Regulator (OSCR) charity investment guidance makes clear that an investment policy statement is viewed as good practice.

In England, Wales and Northern Ireland, even if your charity is not a trust, it would still be good practice to create an investment policy statement.

The trustees' annual report

Your investment policy statement is also extremely helpful as a reference point when writing your annual report. The second edition of the Charities Statement of Recommended Practice (FRS102), published in October 2019, covers ethical investment policies at section 21.13. It states that "investment policies must be explained in the trustees' annual report and the value of investments held in pursuit of particular ethical investment policies may be identified separately in the note to the accounts." This is a reminder that your investment policy statement does not exist in isolation. You should refer to your investment policy, and any ethical criteria, in your trustees' annual report.





For trustees in Scotland, OSCR, the Scottish Charity Regulator, has a guidance booklet called *Charity Investments: Guidance and Good Practice.* For trustees in England and Wales, the Charity Commission has a guidance booklet called *Charities and investment matters: a guide for trustees (CC14).* There is no specific investment guidance from the Charity Commission for Northern Ireland.

> **"Even if your charity is not a trust, it would still be good practice to create an investment policy statement.**
>
> Julie Hutchison, Technical Director - Charities

Goals and objectives

The next stage in the process is to make the link between your investments and how they are helping deliver your charity's strategy and goals.

This will prompt you to address certain questions about your financial needs. For example:

- What level of income do you need to generate from your investments to continue to meet beneficiary needs?
- If you are a grant-making charity, what target level of grants do you wish to make each year?
- If you are a membership organisation, which member services need to be supported on an ongoing basis?

To illustrate another scenario, let's imagine you deliver specialist support services from one location. Your strategy includes plans to open a second centre in three years' time. This kind of capital project will have its own financial goals sitting around it. These need to be referred to in the investment policy statement, since this is likely to influence how cash or a particular 'investment pot' may be set aside for that specific capital project. The timescales for accessing that 'pot' are likely to be shorter than for investments that are not immediately required and likely to be held for the longer term.

You may find it helpful to separate your goals into short, medium and longer term and group them accordingly.

You should also specify instructions about income. For example, should dividends/interest be reinvested or paid out to the charity? The level of income achievable from an investment portfolio is normally around the 2.5% to 3.5% range. This generally means the effective target from a portfolio may be a measure of inflation. For example CPI (Consumer Prices Index) plus a level of income around 2.5% to 3.5%.[1]

Short-term goals
Short-term goals here are likely to include retaining a level of cash for normal operational expenditure.

Medium-term goals
You might have money set aside for an extension or building project. This is not needed immediately, but is likely to be needed within the next five years.

Longer-term goals
A typical time horizon here reflects an intention to leave funds invested for at least five years.

Goal setting is individual to each charity and will depend on your own strategy and financial position.

[1] Income is not guaranteed and will vary over time but income within this range may be achievable for a portfolio with a benchmark split of 75% equities, 20% fixed interest and 5% cash.

Risk and asset allocation

Once you have identified your key goals, the conversation moves onto risk. One way to think about 'risk' is to consider how resilient your charity's finances would be if the investments went down in value. Can you withstand the ups and downs of the stock market? For charities taking a longer-term view, the answer tends to be 'yes'. It involves accepting a degree of risk of shorter-term volatility in the value of your investments.

Charities frequently wish to exist for many years to provide ongoing support for their beneficiaries. Other charities may look to exist in perpetuity. As such, they cite the impact of inflation on their long-term assets as a key risk.

With this kind of long-term outlook shaping a charity's thinking, it is normal for there to be a significant allocation to 'real' assets in its investment portfolio. 'Real' assets are ones that tend to increase in value in line with inflation. These include equities (company shares), property and infrastructure (e.g. investments connected to renewable energy).

Many charities will look for the capital value of their portfolio to increase in 'real' terms (in line with inflation) while also providing an income to support their day-to-day operations or grant-making. In general terms, the more equities held, the greater the risk. However, this needs to be taken in context, keeping in mind the timeframes set by the charity.

A permanently endowed fund (where the capital cannot be spent) may consider 100% equities to be acceptable. The following table illustrates one example of defining risk levels relative to the amount of equities.

Risk level	Equity exposure
Low	Less than 30%
Low to medium	30% - 50%
Medium/moderate	50% - 70%
Medium to high	70% - 90%
High	90% - 100%

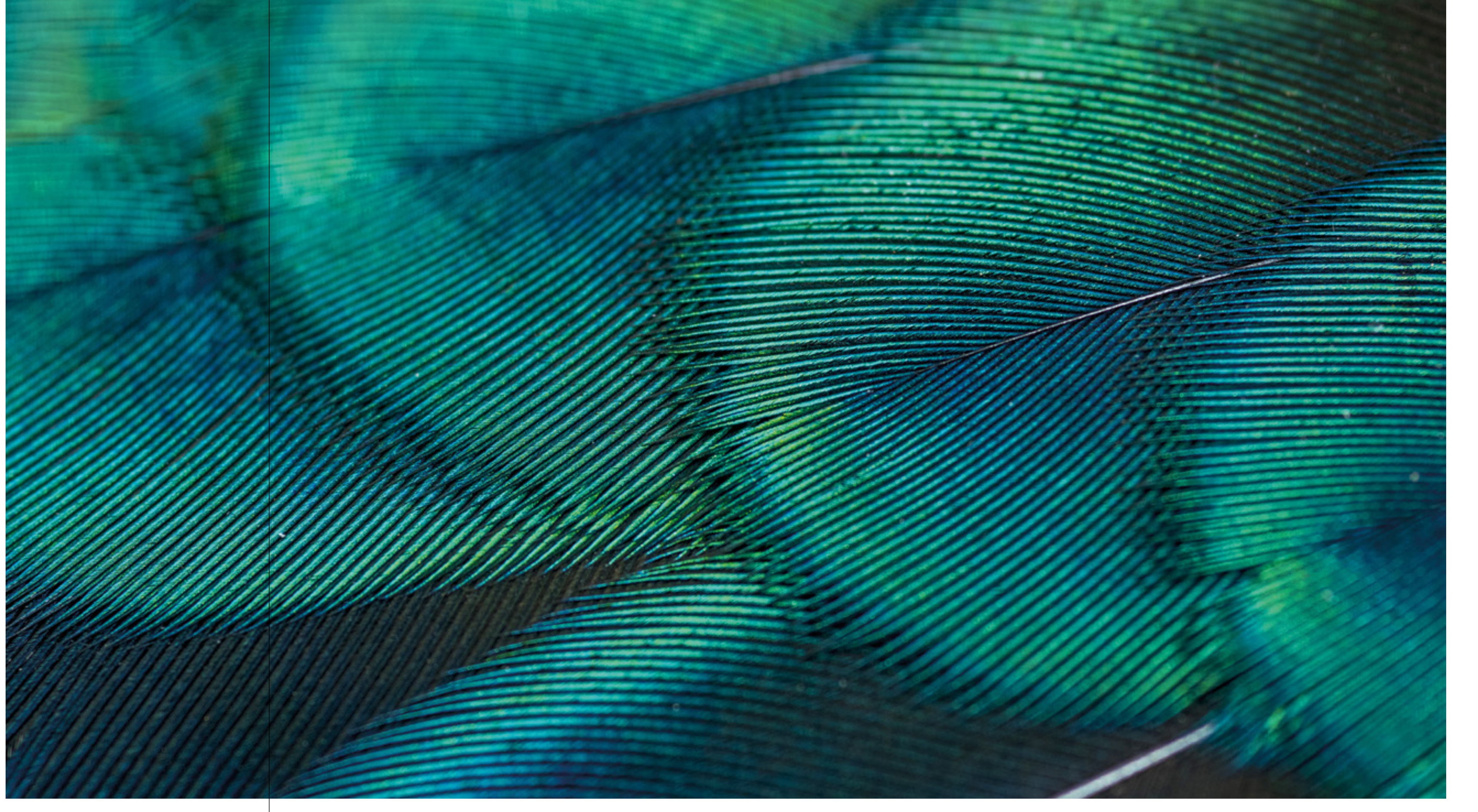
Source: LGT Wealth Management September 2023

"One way to think about 'risk' is to consider how resilient your charity's finances would be if the investments went down in value.

Julie Hutchison, Technical Director - Charities

Ethical screening

There are a range of ways in which a charity can seek to align its investments with its charitable purposes and strategy. Some of these may be straightforward, others may prompt much discussion and debate. Such discussion is a positive signal that trustees are fulfilling their dutiesby considering the merits of the options before them.



Creating alignment between your investments and your charitable purposes

Looking at trustee duties for a moment, there is a relevant consideration at this point. Trustees should not make decisions that conflict with the purposes of the charity. We set out some examples of how we have seen this applied in practice.

- A hospice would tend to exclude investment in tobacco manufacturers, since tobacco causes cancer, a disease which creates beneficiary harm leading to the need for hospice care.

- Charities with a focus on education or young people often exclude tobacco manufacturers from their investment portfolio. We have also noted a recent move by some charities in this sector to invest in a more 'climate aware' way. This excludes investment in certain sectors noted for their negative carbon impact, or emphasises the role of engagement with such companies, depending on the preference of the charity. This is on the basis of climate change concerns that these charities view as having the greatest negative impact on younger generations' prospects (which their purposes focus on).

- A charity with a focus on biodiversity may exclude investment in armaments on the basis that spent ordnance can pollute and damage soil health.

- A charity with health-related purposes could look to exclude investment in companies that focus on gambling, reflecting the charity's view on the link with debt and poor mental health.

- A charity with a focus on international development may exclude mining companies due to the charity's view that opaque supply chains may hide child labour in the extraction process.

It is for trustees to identify what causes the harm experienced by those being supported by the charity, and to judge if the connection is material enough to apply a screening exclusion.

Further to the 2022 High Court decision in England and Wales in the case of Butler-Sloss, it would be sensible for trustes to record their rationale for applying any screens, for example by adding an appendix to their investment policy. This would be good practice throughout the UK.

Risk and reputation management, supporting donor/member confidence

Once you have identified those areas that cause beneficiary harm and are in conflict with your charitable purposes, the next task is to identify areas of concern that could cause reputation damage material enough to negatively impact the charity.

Views will differ here. Typical themes to arise under this heading are tobacco, alcohol, gambling, pornography and armaments. However, there could be others depending on the nature of your charity's operations and purposes.

Above all, collective decision-making is a key concept to keep in mind. That is, all trustees share responsibility for board policy decisions. It is important that all trustees can stand behind the policy and feel ready to justify it if challenged.

Making the strategic link with your corporate donor and fundraising policy

The concept of 'alignment' has broader implications, when considering whether to apply a negative screen.

For example, if your charity would accept a donation of £1m from a local alcohol manufacturing company, it may be inconsistent to apply a screening exclusion on alcohol manufacturers in your investment portfolio. The same is true in reverse. If your charity would decline a corporate donation from a company in a certain sector, yet at the same time your charity's investment portfolio includes shares in companies operating in that same sector, that lack of alignment could prove harmful for the charity's reputation.

ESG factors and active stewardship

Environmental, social and governance (ESG) and active stewardship may be relevant considerations for your charity, regardless of whether or not you have selected ethical screening criteria.

ESG factors are research criteria that enable a broader view of the risks and opportunities of a potential stock as part of the investment decision-making process. If you place importance on ESG factors, you probably view companies that operate in ways mindful of their environmental and social impact, and that have good governance, as being more promising investment prospects than companies that don't do this. An ESG approach includes analysing investments through a lens that looks at pollution (E), human rights (S), and board diversity and structure (G) among other themes.

LGT is a signatory of the UN Principles for Responsible Investment. This global initiative seeks to drive responsible investing by encouraging actions to incorporate ESG matters into investment practice. Your charity can decide whether or not it wishes to include UNPRI signatory status as qualifying criteria in its investment policy statement. More information on this can be found at **www.unpri.org**.

Active stewardship is a related ESG activity. The second of the six UNPRI principles commits a signatory to being an "active owner". This means engaging with investee companies and voting at AGMs, to influence for better outcomes. Investment firms approach this in different ways, with varying sizes of teams devoted to this kind of activity. If you have particular requirements around advocacy and voting, reflecting your charity's own campaign work for example, it would be important to mention this in your investment policy statement. This could be another example of aligning your investment policy with your charitable purposes. It could also be an indicator in favour of holding a directly invested portfolio, compared to one where you are invested in a single pooled fund. A directly invested portfolio allows more control over how the votes connected to your shareholding are placed.

Monitoring and measuring performance

There are a number of ways to monitor and measure the performance of your investments. Whatever approach you settle on, any benchmarks need to be relevant, measurable and agreed with all parties.

Looking back at page 10, if you have different investment goals with different timeframes, you will most likely want different benchmarks to reflect that.
For long-term investments, a relevant measure is the impact of inflation on the charity's spending power.

For example, we often see CPI + 3% as a common benchmark selected by charities. We normally find performance is measured against this over a rolling 3-5 year period, reflecting the impact that short-term volatility can have in isolated short timeframes.

Peer group comparisons

A useful approach to monitor and measure performance is to look at how other portfolio managers are performing. Asset Risk Consultants (ARC) provides performance figures in the form of an index of four different risk categories. This helps charity trustees to identify how their portfolio manager is doing against other managers. These indices comprise performance information from over 30 leading charity investment firms that collectively submit actual portfolio performance figures covering over 1,500 charity clients. The indices are available free of charge to charity trustees through a web-based subscription service.

Measuring investment portfolios' performance comes down to understanding what the objectives are in terms of risk profile, income requirements, investment restrictions, ethical criteria and time horizon. Any comparator should therefore be relevant to the requirements of your charity.

A final area for reporting relates to investments that may be aligned to a 'climate aware' approach. It is possible to report on a portfolio's carbon footprint, and show this relative to a benchmark. This is likely to be an area of continued development as interest in lower carbon investments continues to grow.

Appendix

The sample investment policy statement illustrates one potential approach for a hypothetical medical charity.

Investment Policy Statement XYZ charity

1 **Background**
The XYZ charity was set up in 1985. It is a company limited by guarantee and trustees have flexible powers of investment. The registered number for the charity is xxxxxx. The charitable purposes are to focus on research and treatment for a range of medical conditions linked to xxxxx. Our current strategic priorities are xxxxxx. Further to the sale of the original head office building in 2020, and purchase of a smaller new office space, funds have become available for investment for the first time.

2 **Contact information**
The trustees of the charity have delegated the detailed scrutiny of investment matters to the Finance Committee. The signatories on the investment portfolio account are to be the Finance Director plus any one of the following trustees, as approved in a board minute dated xxxxxx. The charity address for postal communications is xxxxxxx.

3 **Goals and time horizon**
The XYZ charity has a long-term time horizon and does not anticipate calling on the capital within the portfolio within the next five years. There is no known cure for the medical condition xxx and research continues to improve effective treatment options. Our strategy outlines a desire to make grants to fund research projects to the tune of £x each year tipping over the next five years. Income is a priority for us, protected against inflation, to underpin this research programme. We require income arising in the portfolio to be paid to us quarterly.

4 **Risk appetite**
We have a reserves policy and our cash balance reflects that our reserves are funded at 100% of their target level. The trustees are therefore prepared to invest, taking some risk in exchange for the potential for better returns.

5 **Ethical criteria**
As a medical charity with a focus on research and treatment into condition xxxxx, tobacco and alcohol are known risk indicators for patients with the condition. We therefore wish to exclude tobacco and alcohol manufacturers from our investment portfolio. Over time, other causes of condition xxxxx may become known and we will notify these to our investment manager. We also wish to screen out pharmaceutical companies implicated in aggressive pricing policies, which may limit patient access to drugs. Research indicates that poor air quality has a negative impact on patients with condition xxxxx. We wish to discuss this further with our investment manager, to better understand our options in this area as regards the application of exclusions linked to fossil fuels, or the prospects for engagement in this area.

6 **Environmental, social and governance factors and active stewardship**
We prefer to work with an investment manager who is a signatory to the UN Principles for Responsible Investment, as a sign of best practice in this area.

7 **Restrictions**
We do not wish complex or opaque investments in our portfolio, as we value transparency and reassurance that our ethical criteria are being implemented with integrity.

8 **Liquidity**
At least 80% of our portfolio should be invested in assets that are readily realisable within one week. We understand that some property funds may only have a quarterly trading date, and note these are unlikely to form a large part of the portfolio.

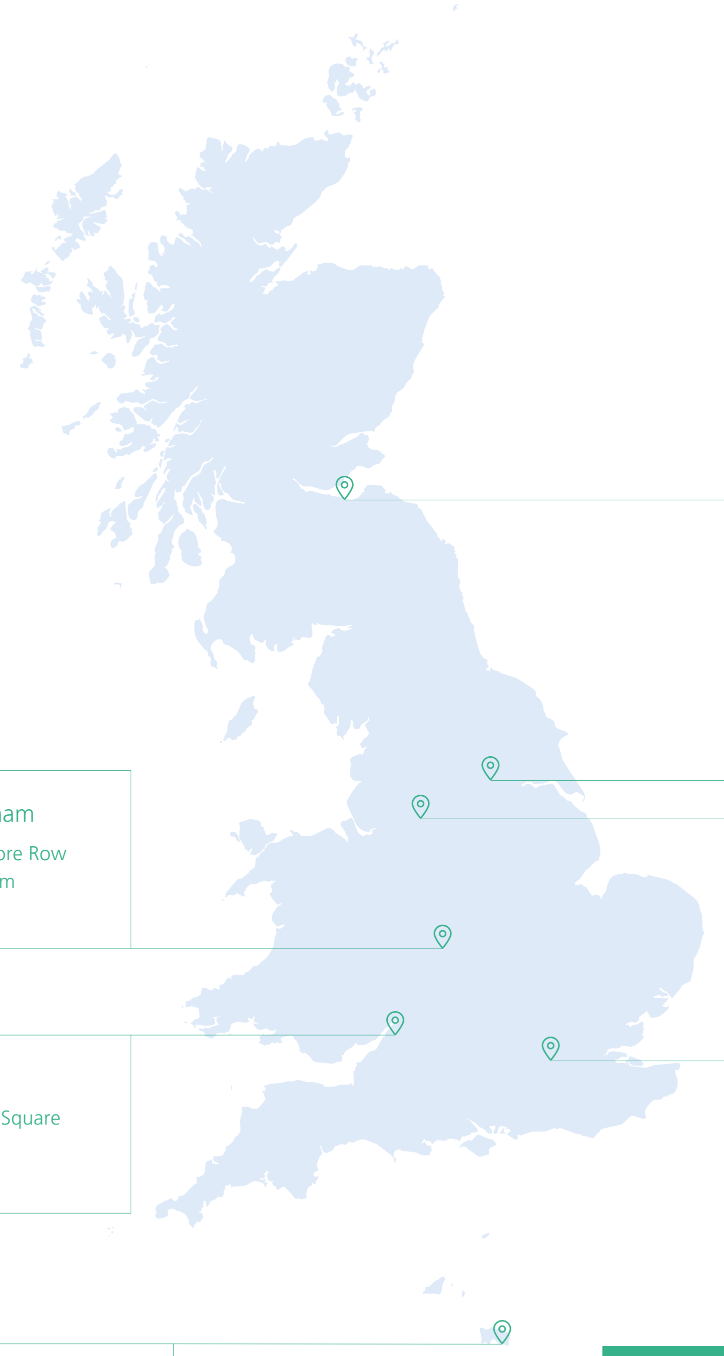
9 **Currency**
We operate in the UK and all our spending is in sterling.

10 **Reporting**
We require an online log-in facility to monitor portfolio valuations. Our Finance Committee meets four times a year and our investment manager is invited to attend one meeting a year, together with one meeting of the full board. We are aware we will receive quarterly and annual reports.

11 **Review process**
The Finance Committee's remit is to keep this investment policy statement under ongoing review. The full board will review and approve this investment policy every two years.

12 **Date of last sign off**
This investment policy statement was approved at a board meeting held on xxx date.

Our locations



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Capital Square
58 Morrison Street
Edinburgh
EH3 8BP

Leeds
Minerva House
29 East Parade
Leeds
West Yorkshire
LS1 5PS

Birmingham
103 Colmore Row
Birmingham
B3 3AG

Manchester
Orega Arkwright House
Parsonage Gardens
Manchester
M3 2LF

Bristol
15 Queen Square
Bristol
BS1 4NP

London
14 Cornhill
London
EC3V 3NR

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