CAMBRAY
BAPTIST CHURCH
CHELTENHAM
LOVE + GROW + GO

Cambray Place, Cheltenham, GL50 1JS
office@cambray.org
www.cambray.org
01242 584672

Responsible Trustee	Date policy produced	Name of Policy Writer	Frequency of Review	Date reviewed on / by whom	
Treasurer	17/3/2015	Tony Wilkes	3 years	8/7/6202	Tony Wilkes

Guidelines for an Investment policy

What is the trustees' role when making financial investment decisions?

The short answer

Trustees have overall responsibility for the investment of a charity's funds. This means that they have a crucial role to play in making strategic decisions about how to use a charity's assets to achieve its aims.

However, trustees may choose to delegate day to day decisions about investments to a third party.

In more detail

Trustees must:

- Use their skills and knowledge in a way that is reasonable in the circumstances ('the duty of care'). For example, a trustee with investment experience should draw on his or her skills and knowledge of investments when making decisions
- Consider how suitable any investment is for their charity. Trustees must be satisfied that:
- An investment type or class is appropriate for the charity (for example, shares)
- The investment within that type or class is appropriate for the charity (for example, shares in a specific bank)
- Consider the need to diversify investments (for example, owning shares in a number of different companies)
- Take advice from someone experienced in investment matters where they consider they need it; and
- Review investments (and their investment manager) from time to time, changing them if necessary.

If trustees can demonstrate that they have considered the relevant issues, taken advice where appropriate and reached a reasonable decision, they are unlikely to be criticised for their decisions, or for adopting a particular policy.

These legal requirements do not apply to trustees of charitable companies. However, they should adopt these principles as good practice when making investment decisions.

For more information about trustee's duties, see *Legal underpinnings: Charities and investment matters (Part1, section 3)*.

Setting a charity's investment objectives

Trustees should be clear about exactly what the charity is trying to achieve by investing its funds. This will be different for each charity and will depend on its aims, operating model, timescales and resources. For example, the investment objective may be to maximise income, preserve capital or ensure stability of income.

How should a charity set its investment objectives?

The short answer

In simple terms, a charity needs to be clear about what it wants to do, how it intends to do it and what the timescale for delivery will be. These considerations will govern how it decides what its investment objective will be. If a charity is permanently endowed, it will need to consider balancing capital growth and income return in order for the charity to meet its aims and its beneficiaries' current and future needs.

In more detail

The trustees may find it helpful to review the charity's overall financial position and how they are using the charity's assets to achieve its aims when setting the investment objectives. This will mean considering short and long term financial commitments, as well as the charity's anticipated income.

For example, they may want to consider:

- Immediate financial needs - for example, cash required for use in the near future that needs to be sufficient and easily accessible
- Future spending commitments - they should be satisfied that there is sufficient cash available to meet these needs
- Whether the charity has restricted funds - this means that there are limitations on how the funds can be used
- Longer term organisational objectives - for example, projects, initiatives, changes in strategy or other spending that the charity is planning and how they will be resourced
- Past patterns of expenditure and anticipated demand for the charity's support as an indication of future trends
- Unplanned changes in activity or events that may impact on the charity. This includes the wider economic and financial outlook - for example, the likelihood of inflation or deflation, or changes in interest rates.

The trustees should then be able to identify funds that:

- Need to be available on instant access
- Can be used for short term investment
- They can afford to tie up for longer periods of time
- Will be used to react to unplanned events

What risks should a charity consider when making investments?

The short answer

Risk is part of the investment process and there are a number of risks that trustees should take into account – these are explained in more detail below. Before making any investment decisions, trustees should consider what is the appropriate level of risk that they want to, or are able to, accept. As part of their duty of care, the trustees must be satisfied that the overall level of risk they are taking is right for their charity and its beneficiaries.

In more detail

Setting investment objectives is not about avoiding risk, but about recognising and managing it. If a risk materialises and results in a loss to the charity, the trustees will be better protected if they have properly discharged their duties and identified and considered the management of the risk. A loss might mean a low return on an investment or the loss of some, or all, of the amount invested, but it can also be about loss of reputation, perhaps through investing in an unpopular or discredited company. As with any loss or setback, the trustees should review the circumstances of the loss, their risk appetite and how they identify and manage risk generally. They should also take the opportunity to learn from their experiences in order to benefit the charity in the future.

Funds invested for the short and medium term should be relatively risk free as charities will want to avoid sudden drops in capital values which could reduce their available funding. A drop in capital value for funds invested for the longer term is less critical because such investments can be held until their value has recovered.

Although it might be difficult for trustees to justify an investment policy that involves the charity taking on a high level of overall risk, it may be appropriate to include certain high risk investments within the overall portfolio.

Some of the main risks associated with investment and ways that they can be managed are outlined below. Charities should consider these when deciding what investments are suitable for their charity.

Capital risk

There are two main risks to capital:

- Loss of capital: The main risk for charities arising directly from investments is that they could lose capital and/or income as the value of those investments change. All investments involve some degree of risk because their value can go down as well as up. Generally speaking risk and return go together. The more risky the investment, the higher the possible return, but also the greater the possibility of losing money.
- Volatility risk: This is the existence of variability in the price of an asset like a share. Some asset types are more volatile than others, which needs to be taken into account when selecting an investment and considering its place in the overall investment portfolio.

Managing capital risks

Capital risk can be mitigated by having a diversified portfolio of assets - if the investment return from one asset class falls, the losses may be offset by better investment returns in a different asset class. A diverse portfolio can help:

- Reduce the risk that the loss from a single investment, or type of investment, could significantly harm the charity's viability
- Protect the charity's investments from sudden variations in the market by balancing the levels of risk and return in the portfolio; and
- Ensure that the charity's needs for both income and capital growth are met, particularly where permanent endowment is involved.

Liquidity risk

This is about whether a charity will be able to raise the cash to meet its obligations when they fall due or at short notice. Certain types of investment are inherently less liquid than others: for example, land cannot usually be converted into cash as quickly listed shares. Other types may demonstrate different levels of liquidity at different times; this is particularly so where the market conditions are unpredictable.

Managing liquidity risk

Some asset classes are more suitable as short-term investments and others are better for the medium or long term. Charities should consider their time frame for investing and the characteristics of different types of investments.

Market risk

There are different kinds of market risk and these include:

- Inflation risk: If the investment does not at least keep pace with inflation, it will fall in value in real terms
- Interest rate risk: Investments that pay a fixed rate of interest regularly may become unattractive if held for a long period if interest rates available elsewhere rise above that fixed rate
- Exchange rate risk: Assets based in other countries will generally be valued in different currencies. If the currency falls in value relative to sterling, the investment may be worth less, even if its home currency value has increased
- Regulatory and governance risks: Some investments are unregulated or based in countries where the regulation is less rigorous. Some regulated investments also invest in unregulated funds or assets. These non-mainstream funds carry a governance risk. There is a risk of the investment going wrong or falling in value, sometimes significantly, as a result of poor management and lack of regulatory controls.

Managing market risk Trustees should:

- Be aware of likely changes in inflation rates, interest rates and exchange rates
- Consider investing only, or investing substantially, in markets where financial services are closely regulated and compensation schemes are in place

For more information on UK compensation schemes, see *Financial Services Compensation Scheme*

Valuation risk

Some investments such as property are not valued independently on a daily basis. The actual value of these investments will depend on the price that can be realised at the time of sale. There is a risk that the estimated valuation until this time may prove inaccurate. If there is a need to realise capital urgently, it may be that a lower price must be accepted to find a buyer quickly.

Managing valuation risk Trustees should:

- Be aware of valuation risk and of how this risk can be accentuated by other risks
- Consider valuation risk together with the overall financial position of the charity. This might mean consideration of, for example, its risk appetite, its liquidity needs and the diversification of its investment portfolio
- Understand the valuation risk that can be inherent in certain investments and discuss this with investment managers

Counterparty risk

This is the risk that a firm with which the charity does investment business (for example, a bank, stockbroker or investment manager) will default on its contractual obligations.

Managing counterparty risk Trustees should:

- Look at whether the business is regulated
- Look at whether there is any compensation scheme to cover all or part of any loss the charity might incur
- Ensure as far as possible that investments are held with a reputable firm
- Agree performance measures so that all parties know what is expected of them
- Establish monitoring and review arrangements to make sure the charity continues to be satisfied with performance
- Review contractual agreements periodically to make sure that they continue to be appropriate for the charity's needs.

Tax risks

- Although tax legislation places no restrictions on what a charity can invest in, some investments may be treated as non-qualifying expenditure, with tax consequences. The charity may lose exemption from tax on an amount of income or gains equal to the amount invested.
- If making foreign investments, where there are not equivalent tax reliefs for UK charities in the countries concerned, the investment return may be reduced by foreign taxes.

Managing tax risk Trustees should:

- Refer to HMRC's guidance. HMRC Charities: detailed guidance notes. Annex III: Approved charitable investments and loans which may be found at https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iii-approved-charitable-investments-and-loans
- Consider the impact of incurring any tax liability on its investments and take advice where appropriate. It may not always be the case that incurring a tax liability on an investment should mean it is excluded from a portfolio.

Environmental, social and governance (ESG) risk

When considering which companies and organisations to invest in, charities are increasingly taking into account such factors as impact on climate, employment practices, sustainability, human rights, community impact, executive compensation and board accountability. These are all example of ESG risk areas which can have long term impacts and can affect the value of a company's shares positively or negatively depending on how the risk areas are managed.

Managing environmental, social and corporate governance risk Trustees can:

- Decide on the importance and extent of ESG criteria in their investment policy
- Look at the reputational risk to the charity that might arise from their ESG policy (or lack of one)
- Make sure that any investment manager they use is aware of and willing to act in accordance with their ESG policy
- Recognise that the extent to which a company manages ESG risk may have an effect on the returns that it can offer and its long term viability
- Look at whether a company discloses its ESG risk management processes and how it verifies that disclosure

What should an investment policy cover?

The short answer

A charity's investment policy should set out in writing what its investment objectives are and how it intends to achieve them.

In more detail

A charity's investment policy will usually include the following information:

- The scope of its investment powers
- The charity's investment objectives
- The charity's attitude to risk
- How much is available for investment, timing of returns and the charity's liquidity needs
- The types of investment it wants to make, this might include ethical considerations
- Who can take investment decisions (for example, trustees, an executive, an investment adviser or manager)
- How investments will be managed and benchmarks and targets set by which performance will be judged
- Reporting requirements for investment managers.