

## Investment strategy for charities

Charities can have very different investment needs to other investors, particularly in terms of the certainty, size and nature of their future income and expenditure. While charities may have restrictions, either legally or self-imposed, on where or how they can invest, they generally have more freedom in investment terms than other institutions and so may explore a wider variety of asset classes. It is therefore important to set your charity's investment strategy taking into account your own circumstances and avoiding a one-size-fits-all solution.

## How and why do charities invest?

Charities choose to invest for a variety of reasons, but the central reason will normally be to further their aims over the longer-term. Without suitable investment, your charity may see the value of their reserves, and any income, reduce in real terms over time. This will in turn reduce the funds available for future expenditure. If the short-term volatility of your chosen investments is too high, this will also make planning difficult.

The Charity Commission identifies two ways a charity can invest: "financial investments" are made in order to generate returns over time and thereby increase the funds available for future projects; "programme-related investments" relate directly to specific projects which will not only further the charity's aims, but may also generate returns. The Charity Commission defines an investment which could fall into both of these categories as a "mixed-motive investment".

Barnett Waddingham's expertise lies in providing investment and strategy advice to charities on financial investments.

## What is your charity's current situation and future needs?

Barnett Waddingham's approach is to try to understand exactly what your charity is trying to achieve with their investments. At a preliminary stage, this will involve discussing and analysing your charity's current and future spending plans, looking at the certainty and size of future income, and exploring any other factors which will influence how you invest (such as risk appetite). Other important information will include any restrictions on where you may invest.

## Barnett Waddingham LLP

**Integrated advice:** A key differentiator of our investment services is that our investment consultants look at asset allocation strategy with reference to the payments that a charity plans to make from those assets rather than focusing on returns in isolation. This provides a helpful approach to understanding the interaction between investment strategy and meeting obligations. This is central to our methodology.

**Bespoke solutions:** We listen to our clients to understand their objectives and risk concerns. No two charities are the same and our advice will be tailored accordingly to give a distinctive investment strategy. We do not have our own products to sell to clients.

**Simple but not simplistic:** We will aim to find the simplest practical solution to meet your need. Complex investment strategies which require a lot of monitoring are not necessarily better and the appropriate approach will vary depending on the investment expertise and risk appetite of your trustee board.

**Engagement:** A key factor in setting an investment strategy is understanding your charity's needs and priorities. This is a two-way process to make sure that we reflect the circumstances of your charity in our advice. We strive to build a relationship which allows you to determine your own strategy with our support.

**Partner responsibility:** As a partnership, each client of Barnett Waddingham is looked after by a partner who has a personal long-term commitment to developing the client relationship. The partner is supported by a team of actuaries and assistants.

# What are your charity's investment aims and objectives?

Once we have investigated your charity's future expected needs, we can begin to discuss your investment aims and aspirations. These can then be translated into a list of realistic investment objectives. These objectives will set out why you are investing and the goals of these investments, what returns you might expect from your investments, and how much risk you are prepared to take in order to achieve these objectives.

Your charity also needs to decide how to monitor the continued appropriateness of these objectives and whether they remain realistic and achievable. Agreeing a "governance budget" of resources to be dedicated to monitoring performance against these objectives is important as the level of resources may restrict the options for your investment strategy.

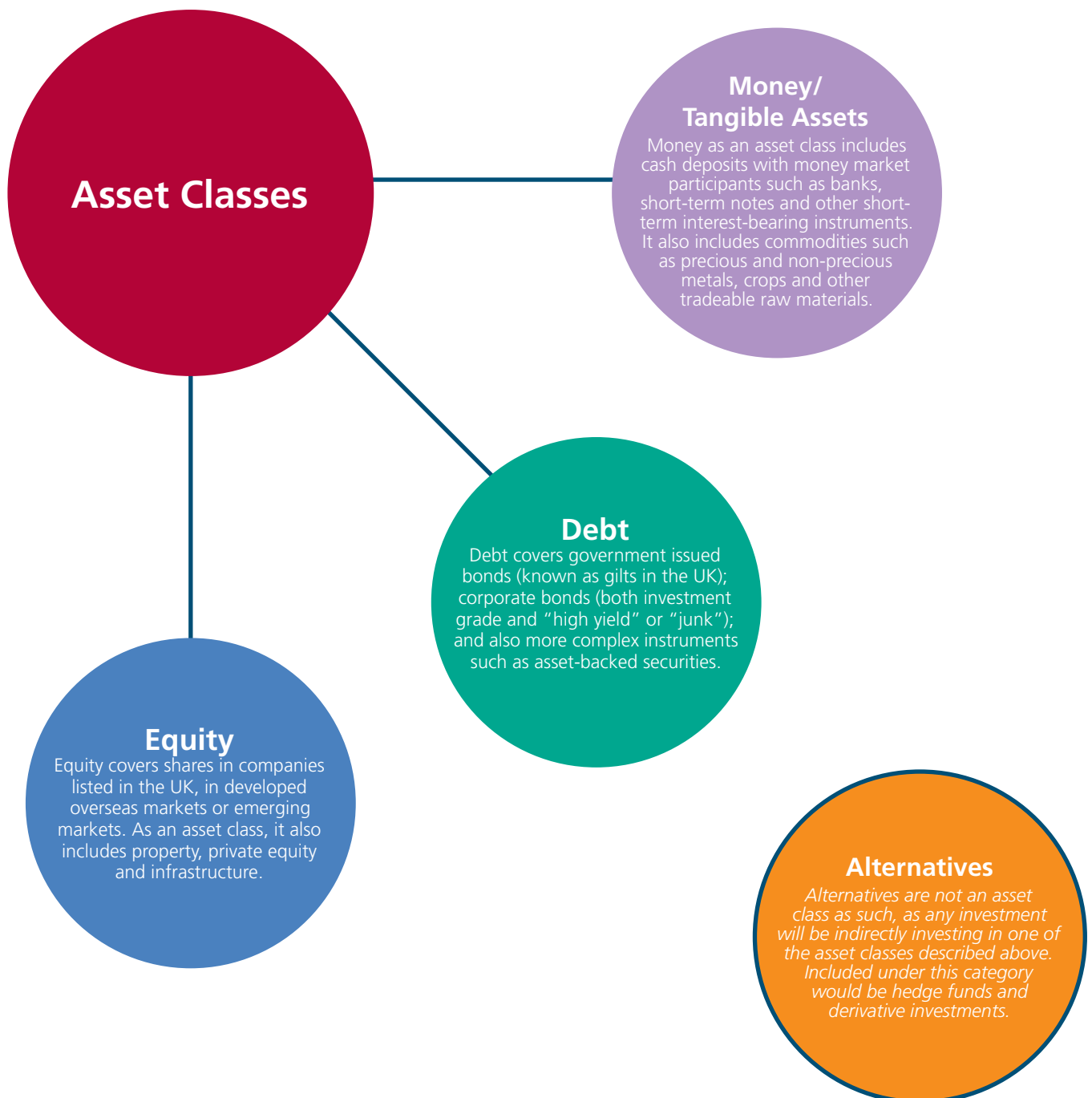
It may also be appropriate to document these objectives in a statement of investment principles which can be referred to and updated as appropriate in the future.

Once you have established the objectives, we can then explore how these can be achieved by looking at the available asset classes for investments.

# What are the possible asset classes for financial investments?

The asset classes in which your charity can invest will vary according to your constitution and governing documentation but most charities will be able to make a wide range of financial investments. The diagram illustrates the various asset classes.

Within each asset class there exist various sub-categories in which charities may consider investing:



## Risk analysis and asset allocation

Asset classes can broadly be split between growth and defensive. While investment in any asset class has some degree of associated risk, growth assets are generally ones with greater risk and uncertainty. Investors will expect to receive higher returns over the long-term in return for taking this risk. On the other hand, the greater degree of certainty associated with defensive asset classes allows charities to better plan their future expenditure.

Determining a suitable allocation to growth and defensive asset classes can represent a challenge for charities, particularly given the uncertainty associated with future income and spending. As investment advisors, we will look to create practical solutions to managing your charity's asset allocation at an appropriate level of detail - highly bespoke strategies are unlikely to be appropriate if future spending and income are uncertain, but a "cashflow matching" strategy may be appropriate where future finances are more certain.

A starting point might be to consider splitting future expenditure into short- and long-term requirements so that short-term requirements are broadly funded by defensive, liquid assets such as cash and short-term bonds, while longer-term commitments are funded by growth-seeking assets which are expected to produce higher returns in the longer term but with greater volatility. This split will very much depend upon your income expectations, expenditure requirements and the timeframe over which these can be planned, as well as the overriding acceptable level of risk.

## Investment platforms

Once an asset allocation strategy has been agreed, you must then decide how they should invest in these assets.

### Private wealth managers

For historic reasons, many charities invest via private wealth managers who may also provide advice to the charity's trustees on asset allocation, or even be delegated responsibility to manage the allocation.

Rather than managing investments directly, many private wealth manager just act as brokers, providing access to a wide range of investment funds and investment managers. However, the fees charged are generally higher than those that institutional investors might expect to pay to access the same investments directly with the investment manager. The higher fees also cover the cost of administering the account, which are often set up with individual investors as their target market and consequently have features which may not be necessary for a charity.

The fees will often also include an allowance for guidance that the manager might provide on asset allocation, fund selection and performance monitoring, although trustees should consider whether this set-up offers a sufficiently independent analysis of performance. A common feature of private wealth manager portfolios is that they often include a large number of holdings. This can make performance monitoring burdensome, particularly if the charity does not have expertise in this area or sufficient time to dedicate to understanding the factors which have affected performance

### Direct investment with managers

An alternative approach to using private wealth managers is for charities to invest directly with investment managers, normally with guidance from an investment advisor.

For large charities, setting up a segregated portfolio with an investment manager may be an option. With a segregated portfolio, the charity can instruct the manager to invest according to their own individual strategy and requirements. They may also ask the manager to make tactical decisions on their behalf. However, this set-up only becomes economical on a relatively large scale and so many charities will find they are better off investing through pooled investment funds.

Pooled investment funds are so-called because investors' money is bundled with others' in order to create a larger fund which will benefit from economies of scale and be cheaper to run. The strategy of the fund is determined by the investment manager and they will specify in which asset classes the fund will be permitted to invest and what the target performance is, normally relative to a given benchmark.

As investment advisors, we specialise in providing advice on manager selection, allocation between funds and managers, and also monitoring the performance of the managers and the charity's investment strategy. Our work is primarily focussed on investment in pooled funds.



# Considerations when investing

## Environmental, social and governance factors (ESG)

Your charity may choose to restrict its investments to companies which demonstrate environmental and social awareness, and who implement governance controls to monitor and correct problems in these areas. Strong governance can also be associated with better structured, more efficient, and consequently more profitable, companies and institutions. However, imposing strict “ethical” investment requirements can restrict the opportunity set of investments available to an investor, and in turn reduce available returns.

## Taxation of charities’ investments

Charities are generally subject to favourable treatment in respect of some taxes, including possible exemptions from income tax, stamp duty and capital gains tax. In contrast to other investors, charities and charitable investors are therefore permitted to invest in Common Investment Funds or CIFs. CIFs are usually set up as charities in their own right and consequently can offer returns without many of these taxes deducted. This therefore reduces the administration cost and time spent reclaiming taxes from which charities are exempt.

That said, there is a limited range of CIFs on the market and it will often be more important to choose a fund which satisfies the charity’s objectives from the wider range of investment funds available to institutional investors, rather than confining any search to just CIFs, despite their benefits.

## Active or passive management

Another consideration is whether to invest in actively-managed or passively-managed funds. Active managers will use their skill and judgement to select stocks, industries, economic regions, or even asset classes for a multi-asset fund, which they believe will outperform their target benchmark. The benchmark will normally be an investment index in the market in which they invest, for example the FTSE All-Share Index for a fund investing in UK equities.

The research and management which goes into selecting stocks and managing the portfolio will of course come at a cost, and active managers will therefore charge management fees, and possibly performance fees, which will generally be based upon the asset class in which they invest, their style of management, the amount of research they perform and, of course, the fees charged by their competitors. It is important to take these into account when analysing past and expected future performance against benchmark and on comparing funds.

In contrast to the aims of actively-managed funds, passively-managed funds aim to closely track their benchmark. This can be achieved through various methods depending upon the benchmark tracked. The fees charged for passively-managed funds will generally be much lower than active manager fees and there is also likely to be a reduction in the monitoring burden for the charity’s trustees.

As a charity’s investment strategy becomes more complicated, the governance budget to monitor and analyse the strategy will increase, and management fees would also be expected to increase with complexity.

## Selecting managers

Once the asset classes, the allocation between them, and the form of management have been decided, the charity will need to select a specific manager or managers. A common structure for doing this is to draw up a long list of eligible managers which is then reduced to a shortlist based upon stated, objective criteria. The shortlisted managers would then be invited to present to your charity’s investment committee and answer their questions before a final decision is made.

Barnett Waddingham specialises in advising charities on appropriate investment managers to consider, drawing up shortlists, and organising manager selection exercises.

## Monitoring strategy and manager performance

Barnett Waddingham provide a full monitoring service for charities’ investments. As well as monitoring the performance of the investment managers, we also monitor how the charity’s investments are performing against the adopted strategy. This enables the charity to determine whether their manager are performing as expected and whether the objectives they have set remain appropriate.

## Barnett Waddingham’s services

- Assistance with objective setting;
- Asset allocation planning including the split between growth and protection assets and allocations between asset classes;
- Advice on governance issues (e.g. ethical policy, voting rights and so on);
- Preparation of a Statement of Investment Principles;
- Setting benchmarks for investment performance measurement;
- Manager selection;
- Fee negotiation with investment managers (whether existing or new);
- Ongoing performance measurement and analysis of investment manager reports, or attending trustee meetings.

## For further information

Please contact your Barnett Waddingham Consultant if you would like to discuss any of the above topics in more detail. Alternatively, please email:

**[CharityInvestment@Barnett-Waddingham.co.uk](mailto:CharityInvestment@Barnett-Waddingham.co.uk)**

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