



A TOTAL RETURN APPROACH TO INVESTMENT FOR ENDOWED CHARITABLE TRUSTS

Response from ICAS to the Charity Commission

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Introduction

The Charities Committee of ICAS welcomes the opportunity to comment on the Charity Commission's draft regulations on a total return approach to investment for endowed charitable trusts.

Our CA qualification is internationally recognised and respected. We are a professional body with over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public and charity sectors.

Our Charter requires ICAS committees to act primarily in the public interest and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key points

We welcome the proposed regulations which will simplify the adoption of a total return approach, which has previously required the formal consent of the Charity Commission:

- The proposed regulations will permit charity trustees of endowed charitable trusts to take a more flexible approach to their investment strategy and to optimise their overall investment return.
- While an endowment's 'unapplied total return' (i.e. investment returns which have not been used for charitable purposes) must still be identified separately in the charity's books and records, the new regulations helpfully acknowledge the potential for this to be a negative amount.
- We believe that the proposal in the draft regulations to enable charity trustees to cease applying a total return approach without the prior consent of the Charity Commission will be very helpful. This will enable the trustees to change the approach at a time best suited to the circumstances of the charity.
- The proposal to permit charity trustees to allocate up to 10% of their capital to income, subject to this being recouped over an appropriate period of time on a pound for pound basis, will contribute to a charity's ability to further its purposes now and in the future.

Any enquiries should be addressed to Christine Scott, Assistant Director, Charities and Pensions, at cscott@icas.org.uk.

Detailed comments

Question 1

The Act allows trustees to adopt a total return approach to investment by their own resolution rather than applying for our authority. Do you think that there are any circumstances in which trustees should have to obtain our consent to adopt this approach?

Response

The only circumstances in which trustees should be required to seek Charity Commission consent would be where it appears that the trust for investment on the total return basis would be significantly less than the value of the original gift.

Question 2

We are not proposing to impose a limit on the amount of unapplied total return that can be allocated to income and spent on a charity's aims. Do you think there would be advantages or disadvantages in setting such a limit?

Response

Regulation 6(2) requires that "trustees shall only exercise their powers in such a way as not to prejudice the ability of the charity to further the purposes of the charity now and in the future as designated by its trusts". We consider that this clearly sets out the duties and responsibilities of trustees, in particular the need to balance risk and return when making investment decisions, making it unnecessary to further define the amount of unapplied total return that can be allocated to income.

Question 3

We are suggesting that our regulations will give trustees a power to allocate some of their charity's capital to be allocated to the trust for application (income). What are your views on this proposal?

Response

We agree with this proposal. However, we recommend that where possible, that trustees seek the consent of the donor of the gift before exercising this power.

Question 4

With regard to question 3, we are proposing that there should be an upper limit on the release of capital - we suggest an upper limit of 10%. We think this will give trustees a greater ability to react to changing financial market conditions if they need to without allowing the capital fund to be expended. Do you think an ability to allocate a proportion of capital to the trust for application (income) will be useful for trustees of permanently endowed trusts? If so, do you think a cap of 10% is reasonable – if not, what would be a better figure?

Response

We consider that the ability to allocate a proportion of capital to the trust for application will be useful, especially where a major project is under consideration in furtherance of the charity's objects. A figure of 10% appears reasonable in so far as it represents only a figure below which prior Charity Commission consent is not required. The trustees should still be able to seek the consent of the Charity Commission for a higher percentage.

Question 5

Trustees will only be able to release such capital funds for application as income if they put into place reasonable arrangements for their repayment. This is in line with our current policies on capital replacement. Do you think that this is the right approach to the replacement of any capital funds used? Do you think that there should be any other safeguards for capital funds?

Response

We agree that trustees should only be able to release capital funds for application as income where reasonable arrangements are put in place for their repayment. We further agree that such recoument should be on a pound for pound basis.

Where capital funds are to be released to finance the purchase or improvement of an asset, we consider that, in order to protect the capital fund, the trustees should be empowered to give the capital fund security over the asset, (which could be waived with the donor's consent). Where capital funds are to be released for other purposes, not related to fixed assets, then the trustees should consider which other assets could be provided as security. Professional advice should be sought in either of these circumstances. By this means, the integrity of the fund will be protected in a winding-up or merger situation.

Question 6

Do you think that there are any other safeguards that need to be included in regulations we are making and why do you think they need to be included?

Response

We set our views on safeguards, with reasons stated, in our responses to questions 1, 3 and 5.

Question 7

Do you think that specific duties need to be imposed (and set out in our regulations) on trustees taking a total return approach to investment over and above those which already apply to trustees of permanent endowment who do not take a total return approach?

Response

We do not believe that additional duties should be placed on trustees taking a total return approach.

Question 8

Part III of the draft regulations makes provision for the revocation of a resolution to adopt a total return approach to investment and return to the standard rules for investing permanent endowment.

Sections 8 (1) – (4) set out actions that the trustees shall take:

- (a) where there is a negative total return
- (b) in allocating unapplied total return between the trust for investment and the trust for application

Do you think our approach is a pragmatic way of protecting/restoring the value of a charity's permanent endowment on return to the standard rules for investment? Do you think there are any better/other ways of doing it?

Response

We agree that provision needs to be made for trustees (a) to revoke a resolution to adopt total return, and (b) to make a provision to repay to the endowment fund an amount equivalent to the negative total return.

Trustees are more likely to consider revoking their resolution when financial markets have fallen to the extent that unapplied total return is negative and no further income can be applied until this situation is rectified. By reverting to the standard rules for endowments, they will be able to continue to draw on such income as is earned by the capital fund.

The capital fund will increase in value as and when financial markets recover. For example, since 2008 when markets fell by over 30%, there have been improvements (apart from in 2011) and markets now stand close to where they were at December 2007.

Accordingly, we consider that the regulations for repayment need be more flexible and to recognise that a recovery in financial markets may permit the trustees to adjust their provision in the light of circumstances after the revocation is made. In effect, all or part of the negative total return could be eliminated by market improvements.

In other circumstances, (where unapplied total return is not negative), we note that the maximum amount of unapplied total return that can be allocated to the trust for investment is to be determined by a relevant percentage (CPI or RPI). These indices may well not be indicative of the performance of financial markets and the result could be a bias towards income or capital. We therefore recommend that the Charity Commission undertakes further research to establish an appropriate measure.