



Law Commission Consultation on Social Investment by Charities - Charity Finance Group & National Council for Voluntary Organisations response

About us

The vision of the **Charity Finance Group (CFG)** is to inspire the development of a financially confident, dynamic and trustworthy charity sector. CFG works with finance managers to enable them to give the essential leadership on finance strategy and management that their charities need; promoting best practice in charity finance, driving up standards, campaigning for a better operating environment and ensuring every pound given to charity works harder. CFG has more than 2,200 members, and collectively our members are responsible for the management of over £19bn in charitable funds.

The National Council for Voluntary Organisations (NCVO) champions and strengthens the voluntary sector, with over 11,000 members, from the largest charities to the smallest community organisations. We make sure the voluntary sector can do what it does best.

Executive summary

- Social investment is a growing part of the funding landscape for voluntary organisations and has a role to play in supporting the financial sustainability of the sector.
- We believe that social investment should be one of the tools available to charities for achieving their objectives: charities should not feel compelled to make social investments as a consequence of the introduction of a new power.
- **We support the Law Commission’s proposal to introduce a new power to make social investments.**
- We believe that new guidance from the Charity Commission will be necessary to help trustees understand the new power and the complex social investment that is developing.
- We strongly agree with the Law Commission that the new power should apply to all organisations unless it has been expressly excluded or modified by the charity’s governing document.
- We believe that the new power should be accompanied by a list of factors that charity trustees should take into account, rather than an optional checklist.
- Any statutory checklist for social investments should be proportionate and not create unnecessary burdens for trustees when considering social investments.
- Social investments should only be made after careful consideration of the risks of the investment; evaluation of the mission benefit that will be accrued through the investment; how regularly the investment will be reviewed; the need to obtain advice; the impact of social investment on the rest of its investment portfolio and other activities such as grant making.
- Records of the consideration of these criteria will need to be kept by trustees, however, such record keeping should be proportionate to the size of the social investment being considered and the size of the charity.
- We believe that provided a mandatory statutory checklist, as outlined above, is put in place which trustees are obliged to consider the standard investment criteria.
- We support the Law Commission’s conclusion that existing law which enables the use of permanent endowments to make social investments that intend to retain the real, or actual, value of the endowment is satisfactory.
- We believe that additional guidance will be necessary to ensure that trustees of permanent endowments are confident in evaluating whether an investment is intended to retain the real or actual value of the endowment.
- Other barriers such as the tax eligibility of social investments, reporting requirements for charities and quantification of social impact of investments also need to be fully considered.

General remarks

Social investment is a growing part of the funding landscape for voluntary organisations and has a role to play in supporting the financial sustainability of the sector.

We welcome the Law Commission's review into the legal framework surrounding social investment by charities and believe that greater clarity will support charities in making decisions around social investment.

However, whilst clarity is important, we believe that social investment should be one of the tools available to charities for achieving their objectives: charities should not feel compelled to make social investments as a consequence of the introduction of a new power.

Social investment can be genuinely transformative in some cases, but is only likely to impact a small segment of our sector- it is not a panacea to be prescribed as a solution to the sector's funding challenges.

We have attended the Law Commission's pre-consultation meeting and post-consultation briefing as well as holding discussions with relevant stakeholders such as the Association of Charitable Foundations and Big Society Capital.

In our response we answer each of the questions posed by the Law Commission in turn, concluding with some views on other barriers to social investment.

1. We invite consultees' comments on whether the current law governing social investment by charities is satisfactory.

NCVO & CFG have not encountered charities that wish to undertake social investments feeling unable to do so because there is a lack of legal clarity. However, the Law Commission's consultation has highlighted that there are differences of opinion regarding the ability of charities to make social investment based on their existing charitable powers.

As a consequence, we believe that the law requires clarification to make explicit the ability of charities to make social investments. This would remove perceived barriers to social investment and reduce the need for costly or excessive legal advice for those charities where uncertainty predominates.

2. We invite consultees' comment on the Charity Commission's guidance in CCI4.

CCI4 covers the whole range of charitable investments and there is only short consideration of mixed-motive¹ investment in the guidance. Since the guidance was published, the social investment market has grown considerably more complex particularly

¹ The Charity Commission's concept of mixed motive investment appears closest to the definition of social investment considered by the Law Commission, although programme-related investment also falls within the definition, this would fall under a power to spend rather than any new power to make social investments.

with the introduction of products such as Social Impact Bonds² and Social Bond Funds³. Given this, guidance around social investment should be expanded to reflect these developments and the factors that trustees should consider when making social investments in this market.

Moreover, if a new power of social investment is introduced, it is essential that the Charity Commission produces new guidance on social investment to ensure that trustees understand their overall duty of care in managing their charity's resources, as well as fully understand this new power and duties entailed. This guidance should be produced in full consultation with the charity sector and relevant sector membership bodies.

3. We provisionally propose that a new statutory power should be created conferring on charity trustees the power to make social investment, meaning any use of funds from which a charity seeks to achieve both its charitable purposes and a financial benefit. Do consultees agree?

The Law Commission's consultation document highlighted that there are differing views on the permissibility of social investment.

Given the Law Commission's view that it is not possible in all cases to justify social investments under the power to invest, the power to spend or a combination of both powers, we support the proposal to create a new statutory power to enable charity trustees to make social investments. This will provide certainty that charities can make social investments, if they believe them to be an effective way to achieve their charitable objectives.

4. We provisionally propose that the new power should apply unless it has been expressly excluded or modified by the charity's governing document. Do consultees agree?

We strongly agree with the Law Commission that the new power should apply unless it has been expressly excluded or modified by the charity's governing document. This approach will reduce uncertainty and make the change simpler to administer.

5. We provisionally propose that the new power should be accompanied by a non-exhaustive list of factors that charity trustees may take into account. Do consultees agree?

We believe that the new power should be accompanied by a list of factors that charity trustees should take into account, rather than an optional checklist that is not included in legislation.

² <https://www.gov.uk/social-impact-bonds>

³ [http://www.threadneedle.co.uk/en/Intermediary/Funds/Funds-and-Prices/Prices-Data/OEICs/Retail-\(Net\)/Fixed-Income/UK-Social-Bond-Fund/](http://www.threadneedle.co.uk/en/Intermediary/Funds/Funds-and-Prices/Prices-Data/OEICs/Retail-(Net)/Fixed-Income/UK-Social-Bond-Fund/)

This will ensure that trustees have certainty about the factors they should take into account when considering social investments.

Moreover, we believe that it is important that similar legal duties are required between pure financial investments and social investment. This will ensure that the appropriate level of rigour and due diligence is undertaken when charity trustees consider social investments and prevent any temptation for regulatory arbitrage, where investments are classified as “social investments” to avoid more rigorous duties.

We believe that the list provided by the Law Commission is comprehensive whilst providing enough scope for charities to consider additional relevant factors as necessary, depending on the kind of social investment that they are making.

Guidance from the Charity Commission will need to support trustees in considering the risks of social investments, within the context of carefully managing their charity’s resources for the achievement of their charitable objectives.

6. We invite the views of consultees as to whether the following, or other, factors should be included in such a statutory checklist:

- (1) the anticipated overall benefit from the social investment;**
- (2) the duration of the social investment;**
- (3) the risks of the social investment falling or under-performing;**
- (4) how the performance of the social investment will be monitored;**
- (5) whether and how often the social investment will be reviewed**
- (6) whether the charity trustees should obtain advice from a suitable person on all, or any aspects of, the social investment and, if so, the substance of that advice;**
- (7) the relationship between the social investment and the charity’s overall investment portfolio (if any) and its spending or grant-making policies;**
- (8) any other relevant factors.**

Any statutory checklist for social investments should be proportionate and not create unnecessary burdens for trustees when considering social investments. However we believe that all the proposed factors outlined by the Law Commission should be included in a statutory checklist.

Social investments should only be made after careful consideration of the risks of the investment and evaluation of the mission benefit that will be accrued through the investment. Trustees should also be clear how they will evaluate the social investment and how regularly the investment will be reviewed.

We believe that trustees should consider whether they need to obtain advice when examining the case for making a social investment; a similar requirement is placed on trustees when making pure financial investments. Given the complex nature of the social

investment market, trustees should take into account the need to obtain advice to ensure that they make the best decision possible.

Trustees should also consider the impact that a social investment may have on the rest of its overall investment portfolio and its other activities, such as grant making. Social investments are not made in isolation and we believe it is sensible for trustees to take this into account when making a decision.

These factors are universal for all charities and all social investments. This checklist provides a proportionate framework for trustees making decisions on social investments.

Records of the consideration of these criteria will need to be kept by trustees, however, such record keeping should be proportionate to the size of the social investment being considered and the size of the charity. The Charity Commission when providing guidance on the operation of this new power and social investment should provide advice for trustees on how decisions on record keeping should be made.

7. We provisionally proposed that, when exercising the new statutory power to make social investments, charity trustees should not be required to comply with the duties under the Trustee Act 2000 to consider the standard investment criteria, to review investments periodically, and to consider obtaining advice. Do consultees agree?

We believe that provided a mandatory statutory checklist, as outlined above, is put in place which trustees are obliged to consider when making social investments that charity trustees should not be obliged to comply with duties under the Trustee Act 2000 – specifically to consider standard investment criteria.

Given the lack of comparability between social investments and the immature nature of the market which prevents the levels of diversification possible with pure financial investments, a duty to consider standard investment criteria may prevent charity trustees from making such investments if duties under the Trustee Act 2000 were retained.

Moreover, the checklist of factors that the Law Commission has outlined above asks for trustees to consider how regularly to review their investments and whether it is necessary to obtain advice.

However, guidance from the Charity Commission should assist trustees in developing policies on how regularly to review their social investments and developing a policy on obtaining advice on social investments.

8. We invite the views of consultees as to whether the requirements under the Trustee Act 2000 to consider the standard investment criteria, to review investments periodically, and to consider obtaining advice, should be excluded whenever trustees (in the technical legal sense) are making social investments.

As stated above, we believe that provided a mandatory statutory checklist, as outlined above, is put in place then excluded social investments from requirements under the Trustee Act 2000 is acceptable.

This would ensure that trustees are still required to consider the need to take advice and how regularly to review investments, whilst avoiding the need to compare social investments against the standard investment criteria, which as has been raised previously, we believe are not appropriate for the social investment market.

However, the removal of the duties under the Trustee Act 2000 makes it more important that a mandatory statutory framework is put in place to prevent a loophole being created for social investments.

9. We invite the views of consultees as to whether the current law concerning the use of permanent endowment to make social investment is satisfactory. If consultees consider the law to be unsatisfactory, we invite their views as to how the law should be reformed.

We support the Law Commission's conclusion that existing law which enables the use of permanent endowments to make social investments that intend to retain the real, or actual, value of the endowment is satisfactory.

However we also support the Law Commission's view that under current law, it is not possible for permanent endowments to make social investments that are not intended to retain the real or actual, value of the endowment.

In some cases, social investments are likely to generate lower returns than pure financial investments, and the proposal to introduce a new power of social investment is recognition of this. It is, therefore, important that trustees are required to consider social investments in the context of the charity's overall investment portfolio (including pure financial investments) and its spending or grant-making policies important.

Charitable trustees that wish to apply a total return investment policy to their permanent endowment are able to opt-in to this process under the Trusts (Capital and Income) Act 2013. Guidance from the Charity Commission on social investment for charity trustees of permanent endowments should remind trustees to consider the proportion of their capital that they wish to allocate for social investment and the potential that additional capital will need to be allocated to maintain the endowments value.

We agree with the Law Commission's view that there are sufficient existing procedures to enable a permanent endowment to change its governing documents to make social

investments which are not intended to generate income or retain the real or actual value of capital, and as a consequence the current law is satisfactory.

However, trustees of permanent foundations will need guidance on classifying whether an investment is intended to retain the real or actual value of the endowment – i.e. if it is too risky generate sufficient returns or see the return of capital invested. This guidance will need to include issues such as how to consider the risk of the investment, rates of inflation and interest rates. The Charity Commission should consider the need for this guidance as part of changes to CCI4.

10. Other barriers to social investment

Firstly, concerns have been raised over the course of this consultation that HMRC may refuse to recognise social investments as eligible for charitable reliefs because they are neither pure financial investments which are covered by existing legislation or grants. This could prove to be a considerable barrier for trustees when considering social investments and clarity from HMRC on the tax status of social investments is necessary.

Secondly, consideration needs to be given to the impact that the introduction of the power would have on reporting requirements for charities, in particular with regards to requirements under the new SORP. Good practice might dictate that charities clearly and quantitatively report to what extent their motivation for a mixed motive investment was on one, or another, end of the spectrum of motives. This report needs to be differentiated from the total risk attached to the investment, and the way this risk relates to the charity's portfolio of investments. If not treated separately and reported accurately there is a danger that a charity might underplay the risk involved because they can underwrite the risk by transferring the financial risk onto the social risk or vice versa.

Finally, the consultation recommends that there is no need to require the fastidious quantification of the anticipated impact of the social investment, to reflect the complexity of measuring and assessing social impact in certain sectors. This conclusion is one that we would endorse. Charities will be best placed (and sector bodies will encourage them) to decide on the best way of measuring and communicating impact assessments of their social investments. But we agree this does not need to be a regulatory requirement. The decision to quantify the anticipated social return on the investment needs to be made on a balance of considerations, namely: the administrative burden on doing so, the call for accountability on the charities part and the relevance of market developments on impact measurement to the charities activities.