QUILTER CHEVIOT

Quilter Cheviot Charity Knowledge Guide 1

Writing your statement of investment policy:

A guide for charities

SPECIALISTS IN INVESTMENT MANAGEMENT

Approver: Quilter Cheviot Limited, 16 April 2024

Introduction

As investment experts, we have a proud history of partnering with charities to help them better understand their investments.

Along with this knowledge guide **'Writing your statement of investment policy'**, we have also published guides on:

2. A glossary of investment terms and jargon
3. Defining a charity's ethical policy
4. Segregated and pooled mandates
5. Total return v standard rules for permanent endowments

You can find these guides on our website:
www.quiltercheviot.com/charities

We hope this knowledge guide helps you to make an informed choice for your charity.

If you would like to find out more about our specialist charity investment service, contact us today.

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What is a Statement of Investment Policy (SIP)?

A SIP is a document which holds both the trustees and the investment manager to account in ensuring that the charity's investments fit in line with the charity's strategy and aims. For charities appointing an investment manager under a discretionary* agreement there is a legal requirement for the charity to have a SIP in place.

The starting point for charities is the guidance given by the Charity Commission in CC14 which focuses on investment matters for charity trustees. Whilst this may seem to be a lengthy document it is invaluable in aiding charity trustees in understanding their responsibilities vis a vis the charity's investments.

Tip (CC14)
If trustees are able to 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 in adopting a particular investment policy.

Apart from a number of specific actions that trustees must take, below are some recommended actions for trustees from CC14:

1. Decide on the overall investment policy and investment objectives for the charity
2. Agree on the balance between risk and return that is right for their charity
3. Have regard to other factors that will influence the level of return (for example environmental, social and governance (ESG) issues)
4. Include a summary of the investment policy in the charity's annual report

Tip
The statement of investment policy (SIP) is a very good home for the 'must have' and 'should have' parts of CC14.

Legal requirement (CC14)
Where a charity has appointed an investment manager on a discretionary basis it is a legal requirement that an investment policy is in place.

*Trustees give authority to the investment manager to manage the charity's investments and transactions are undertaken without prior reference to the trustees. The investments are individually tailored to best match the charity's requirements by taking into account the investment objective, attitude to risk and any other relevant information.

Legal Requirement (CC14)

Trustees must:

- Know, and act within, their charity's powers to invest
- Exercise care and skill when making investment decisions
- Select investments that are right for the charity; taking into account of the need to diversify investments
- Take advice from someone experienced in investment matters unless they have good reason for not doing so
- Review investments from time to time
- Explain their investment policy (if they have one) in the trustees' annual report

It may seem like more bureaucracy however the SIP performs two important functions:

1

It should formally link the role of the charity's investments to its objectives and strategy.

2

It is an extension of the investment management agreement and therefore it provides written confirmation of the role and remit of the investment manager.

Linking the charity's investments to its objectives and strategy

For many charities, the investment portfolio is not the only resource or source of income; therefore the portfolio has to be viewed in the wider context of the charity's other assets (and liabilities) and plans for the future. Hence the SIP should reflect the charity's short, medium and longer term plans.

Short term: operating cash

Medium term: considering expenditure requirements for the next five years

Longer term: 5+ years timeframe

Tip

Define what you mean as short, medium and long term in the SIP. For some charities, long term may mean `in perpetuity'.

Written confirmation of the role and remit of the investment manager

Apart from being a legal requirement for charities that have appointed a discretionary investment manager, this is a useful piece of housekeeping for any charity. Having a document that details what is (and is not) permissible within a portfolio is helpful in ensuring that the charity's investment manager is keeping to the mandate, and also a helpful aid in reviewing the purpose of the portfolio on a regular basis. We define 'a regular basis' as annually.

Example

Three years ago XYZ Charity wrote its SIP setting out time frames for its portfolios:

Portfolio A: funds are likely to be required in three years (at time of writing)

Portfolio B: long term reserve set as a proportion of the charity's overall assets

The SIP has not been reviewed:

1. Are the funds from portfolio A required now?
2. Does the sum invested in portfolio B as a proportion of the charity's overall assets still seem sensible?

By referencing the SIP on an annual basis (this does not mean having to rewrite it annually) trustees are able to ensure that the charity's assets are distributed appropriately – for example are the long term reserves over or under-funded?

Responsibility for the investment policy and trustees' duty of care

Legal Requirement

The trustees are responsible for:

- writing the SIP (independent advice may be taken); and it may be useful to write the SIP in conjunction with the proposed investment manager
- setting out and reviewing the SIP on a regular basis
- deciding whether to delegate management of the charity's investments, if so, to whom and on what terms
- reviewing the appropriateness and performance of the investment managers regularly
- terminating appointments if appropriate

What should be included in the investment policy?

Below are some of CC14's recommendations and examples:

Scope of investment powers

Specific investment powers depend on the charity's constitution – please refer to the governing documents.

Unincorporated charities have a 'general power of investment'. This is an ability to invest in any asset that is specifically intended to maintain and increase its value and/or produce a financial return.

Incorporated charities' (i.e. charitable companies) investment powers are normally detailed in the articles of association and are similar to the general power of investment.

Responsibility for investment decisions

This has two facets: the role within the charity and the relationship with the investment manager.

Within the charity, has the responsibility for making decisions on investment issues been delegated to an investment sub-committee? If so, is the committee authorised to make decisions and execute these? Or are they referred back to the entire trustee board for a decision?

Is the investment manager responsible under a discretionary management agreement? This is when the trustees appoint an investment manager to make decisions on their behalf as to which investment to buy and sell (and when) in line with the charity's stated investment aims, risk profile and mandate.

Alternatively the trustees (this is less common) may have appointed the investment manager on an advisory basis where the investment manager provides advice, however, all changes have to be authorised by the trustees.

Or an 'execution only' basis whereby the trustees instruct the investment manager on which sales and purchases to make and advice is not given.

Investment objectives

What does the charity want from the investments?

- To grow the capital value of the portfolio
- To grow the capital value, as well as generate some degree of income from the portfolio
- To generate income from the portfolio

More specific objectives are useful including any income requirement (it is more useful to use a monetary value than a percentage yield as the starting value), and any reference to inflation. This is not the place to include references to performance; the objective for the portfolio is to meet the charity's requirements not to 'beat the All-Share':

Example

The example objective above of 'To grow the capital value, as well as generate some degree of income from the portfolio' would become specific to the charity and is fleshed out to ensure that there are clear objectives:

To grow the capital value in line with inflation as measured by UK consumer price inflation (CPI), as well as generate some degree of income from the portfolio, with an expected income of £X in year one (representing an initial yield of X%), which is anticipated to increase with CPI on an annual basis.

In this example, the charity wants to ensure that the capital of the portfolio maintains its purchasing power (inflation) and that the income grows in line with inflation over the longer term in order to ensure its spending power keeps pace as well.

Having a monetary number in year one is helpful as this creates a clear requirement, a yield moves in line with the portfolio value and therefore is a moving target.

Attitude to risk

Trustees must assess risk in the context of the charity and put aside their personal risk appetite. The charity's attitude to risk should (and is not limited to) include:

- Inflation
- Market (lack of diversification)
- Liquidity (how quickly can the investments be turned into cash)
- Volatility (movements in the portfolio's value)
- Currency

It is worth identifying the key risk to the charity in regards to its investments – it may be that a shortfall in expected income would be far more concerning than a fall in capital value.

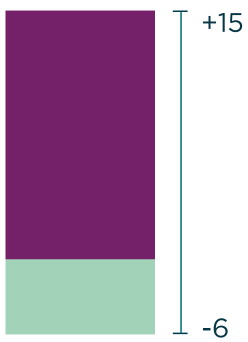
Understanding a charity's capacity for loss is an important part of assessing risk appetite. As shown in the example below the peak to trough measure is an indication of how an investment strategy we recommend for a given risk profile might fall in value during extreme market conditions, before recovering. It is based on a full investment cycle covering several years. A lower indicated level of risk means that an investment strategy that limits the fall in market value from peak to trough is likely to be more appropriate.

Example

A definition of medium risk; the focus is on expected returns – on the upside as well the downside

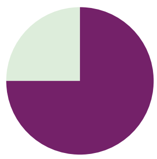
Medium

Estimated range of annualised return*



I/we have a medium tolerance for risk and can accept modest variation or disruption to capital value or current income in order to meet my/our longer-term objectives.

Typical equity weighing - up to 75%

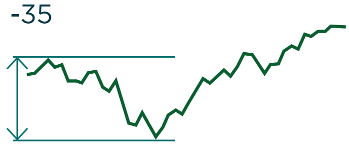


Suggested minimum investment period

5 years or more

Estimated peak to trough decline across investment period

-35



How much is available for investment, timing of returns and liquidity requirements

It is useful at this point to look at any expenditure plans the charity has and then match these to the funds that are available. For any funds classified as short term, cash and cash instruments are the most likely home; for medium term, consideration should be given to whether liability matching would be a useful exercise.

Basically this is about making sure that the charity's assets are working as effectively as they can and ensuring that they are sitting in the right place, this is not just about the investment 'right place'; if there are funds sitting in investments or cash that would be better deployed elsewhere then this is an opportunity to set parameters.

Example

Taking the example of XYZ Charity it had designated its portfolios as:

Portfolio A: these funds are likely to be required three years after the initial investment

Portfolio B: this is the long term reserve which was set as a proportion of the charity's overall assets

Instead of keeping the SIP locked away in a file and not reviewing it, the trustees have been reviewing this on an annual basis and in year two made the following decisions:

Portfolio A: successful fundraising meant that the funds in portfolio A were no longer required for the projects they had been earmarked for

Portfolio B: they had reviewed the long term reserve policy and determined that portfolio B provided a suitable 'rainy day' reserve and that funds need not be added to this from portfolio A

The Trustees decided to use the funds from portfolio A (at a suitable time) to invest in the fundraising effort as the they believe this will provide attractive returns.

Types of investment (this might include ethical considerations)

What assets are the trustees happy to invest in? If there are investments that they are not willing to hold within the portfolio then this should be stated here. For example, trustees may not wish to hold hedge funds, or they may state that if the investment manager wishes to hold in-house funds (i.e. those managed by their investment firm) then this should be agreed by the trustees in advance (or not at all).

It is worth including at this point a comment about the diversification required within the portfolio; i.e. that it should be diversified by asset class and by security. You may wish to include here a maximum permitted percentage size by security or issuer.

Additionally the trustees may wish to set minimum credit ratings for any bonds held in the portfolio.

Example

Within the bond exposure of the portfolio, investment in individual sub-investment grade bonds (i.e. those with a credit rating below BBB) should be limited to 25%; investment via funds may have exposure to sub-investment grade bonds but the combined exposure should not exceed 25% of the total bond weighting.

OR

Within the bond exposure of the portfolio investment in individual bonds should be restricted to those classified as investment grade i.e. with a credit rating above BBB; investment via funds may have exposure to sub-investment grade bonds but the combined exposure should not exceed 25% of the total bond weighting.

A summary of the charity's ethical policy should also be agreed here. It should be a clear policy going into clear detail; stating that the charity does not wish to invest in unethical investments is not helpful.

It should also be clear as to whether this applies solely to directly held investments or those held via a fund.

Example

The trustees have agreed that in line with the charitable objectives there should be no direct investment in companies which generate a significant proportion of their revenue from the production of tobacco or alcohol.

How the investments will be managed, plus the benchmarks and targets for performance comparison purposes

Management of the investments: the section on responsibility for investment decisions details the type of service the charity is receiving from the investment manager; alternatively you may wish to include that here. It might be expanded to include the number of managers employed by the charity and the remit for each of these.

Within this the trustees might agree with the investment manager specific ranges for different asset classes and the minimum and maximum percentages permitted in each asset class.

Example

Investment	Long term asset allocation and benchmark (%)	Ranges (%)	Benchmark indices
Fixed interest	**17.5**	**10-30**	
UK government bonds	12.0		iboxx £ UK Gilts
UK corporate bonds and overseas fixed interest	5.5		iboxx Sterling Corporates
Total equities	**70.0**	**50-75**	
UK equities	30.0		MSCI UK IMI
Overseas equities	40.0		MSCI AC World ex UK
Alternatives* (including property)	**10.0**	**0-20**	**50% Iboxx £ Gilt 1-5 years / 50% MSCI AC World Index (ACWI)**
Cash	**2.5**	**0-15**	**Bank of England Base Rate**

Source: Quilter Cheviot, June 2021

* We have determined to use a composite of 50% Iboxx £ Gilt 1-5 years and 50% MSCI AC World Index (ACWI) for this portion as we are allocating to alternatives which we believe have the characteristics of equity like returns and bond like volatility and therefore this most closely represents the attributes of the underlying vehicles

Benchmarks and targets

The charity should agree in conjunction with the investment manager suitable benchmarks to compare the portfolio's performance to. The point of a benchmark is to have a sensible comparator in order to judge the investment manager's performance whilst not losing sight of whether the portfolio is meeting the charity's investment objectives.

Occasionally charities may use a well-known index to compare portfolio performance, such as the MSCI AC Europe. This is only helpful if the portfolio is entirely invested in the wider UK equity market, otherwise it will prove a poor comparison.

Additionally the trustees may wish to refer to a peer group measure such as one of the ARC (Asset Risk Consultants) Charity Indices, as well as making sure that its long term growth objectives are met.

Tip

The charity may wish to have three benchmarks – this may seem excessive but remember it is the investment manager that is providing this information not the charity:

1. The market composite of indices which allows the trustees to measure how well the portfolio has performed versus the market. If the trustees have employed an active manager this allows them to judge whether there has been value added.
2. The peer group measure allows trustees to understand how well their charity portfolio has performed versus other charities providing a degree of comfort and a useful 'second opinion'
3. A long term benchmark reflecting the investment objective – if the portfolio is not delivering what is required of it what is the point of it?

Reporting requirements for the charity's investment managers

- **How often do the trustees wish to receive reports on the portfolio?**
- **What requirements does the charity have for administrative purposes?**
- **How often should the investment managers attend meetings?**
- **What should be included in the reporting?**

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Contact us

We hope you have found this guide helpful. If you would like to discuss writing your statement of investment policy further or would like to find out more about our specialist charity investment services, contact us today.

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QC00156 (05/2025)