QUILTER CHEVIOT CHARITY KNOWLEDGE GUIDE 4

SEGREGATED AND POOLED MANDATES

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

INTRODUCTION

At Quilter Cheviot, we have a long history of working with charities and helping them to understand their investments. As investment experts, we are proud of our work and hold regular investment sessions and education seminars on a range of finance topics.

Along with this Knowledge Guide on pooled and segregated mandates, we have also published Guides on:

- Writing your statement of investment policy
- Defining a charity's ethical policy
- A glossary of investment terms and jargon

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

In this guide, we look at segregated and pooled mandates, examining what each offers charity investors and common considerations when investing in either vehicle. Charity investors often find advantages to both structures; the important thing is to choose an investment that is suited to your charity's objectives.

We hope this Knowledge Guide helps you to make an informed choice for your charity. If you would like to talk through your investments, we are always happy to do so.

WHAT IS A POOLED MANDATE?

A pooled mandate is simply an investment vehicle that allows investors to pool their assets and invest together. Investors in pooled vehicles tend to benefit from economies of scale and are able to diversify their investments more easily.

You may have come across several different types of pooled investments already. The common types include:

- OEICS (open-ended investment companies)
- Unit trusts
- Investment trusts

Unit trusts and OEICs are essentially the same type of pooled vehicle, though there are slight differences in their price structures. An investment trust is slightly different, because it is listed on the stock exchange and can use debt to invest in assets. The share price of an investment trust can therefore move independently of its underlying investments, and its returns may be higher or lower than the returns of its underlying assets.

Charity investors may also be familiar with:

- CIFs (Charity Investment Funds)
- CAIFs (Charity Authorised Investment Funds – these are the successors to CIFs)

Only charities that qualify for UK tax relief are able to invest in CIFs and CAIFs. Investing in a CAIF allows charities to avoid paying VAT on investment management fees.

WHAT IS A SEGREGATED MANDATE?

Segregated mandates are investment portfolios which are constructed to the charity's own investment guidelines. They allow the charity to have greater control over its investments as the trustees are able to set the investment mandate. This may be a significant advantage for charities with a specific ethical policy, or for those with other particular requirements.

Some of the key differences between CAIFs, CIFs and segregated mandates are outlined in the table below.

Table 1: Know your CAIF from your CIF from your segregated mandate

	CIF	CAIF	Segregated mandate
Regulated by	Charity Commission	Charity Commission and the Financial Conduct Authority	The Financial Conduct Authority
Do I need to be a charity that qualifies for UK tax relief?	Yes	Yes	No
Ability for ethical restrictions?	There may be ethical restrictions in a CIF but the charity has to accept the policy as it is	There may be ethical restrictions in a CAIF but the charity has to accept the policy as it is	A charity can integrate its own ethical considerations into the investment mandate
VAT exemption	No	Yes	No
Ability to return capital appreciations as income?	No	Yes	Yes

Source: Quilter Cheviot, March 2019

Did you know?

The saving for charities by excluding VAT on investment management fees is estimated at around £13m per annum, based on existing assets under management for CIFs of £13.2bn.[1]

1 https://www.cazenovecapital.com/uk/charities/insights/charity-investment/farewell-to-cifs/

THE MAIN DIFFERENCES BETWEEN SEGREGATED MANDATES AND POOLED VEHICLES

Charity investors will typically want to consider four aspects when thinking about whether to invest in a segregated mandate or a pooled vehicle:

- administration
- cost
- diversification
- transparency

We believe that there are attractions across both types of vehicles, regardless of size. As a general rule, however, we would recommend that charity investors with assets under £2m invest through a pooled vehicle. The range and diversity of pooled vehicles on offer means that large charities can be equally well served by a pooled vehicle though, regardless of their investment or ethical criteria.

ADMINISTRATION

The choice of a segregated fund over a pooled vehicle (or vice versa) has important implications for the time needed to administer investments.

Segregated mandates typically place a greater onus on charities in terms of administration. You, or your auditor, will be responsible for the reconciliation of dividends (i.e. making sure that you know what is coming in and being paid out), keeping contract notes, and generally ensuring you know how much you are getting from your investment and how it is being managed. If you do employ an auditor, you should factor in the extra cost of an auditor's fees.

COSTS

Cost is clearly an important consideration for any investor. We would always recommend comparing your options directly, but costs will typically be lower for a pooled fund like a CAIF than a segregated mandate. There are several reasons for this:

- CAIFs tend to have a higher allocation to individual company shares and a lower allocation to collective investments. This means that you should benefit from a lower overall cost of investment, through a reduction in fees paid to the managers of collective vehicles.
- A segregated mandate needs to pay for services like accountancy and custodianship. These costs are shared by investors in pooled vehicles, rather than being borne by one investor alone in a segregated mandate.
- Investment houses are also likely to charge a lower fee for a fund, as there are cost benefits to them running one fund with several investors in it. This reduction can amount to as much as 0.1% for a charity with around £1m to invest.

Table 2: A guide to costs

Cost	What is it?
Annual management charge	This pays for the expertise in running the fund, including research of investments, running the portfolio, and other support needed
Underlying fund charges	Including custody and custody transaction fees, audit fees, and regulatory fees
Dealing costs	Costs incurred when buying and selling a holding in your portfolio
Currency costs	The cost incurred for switching between currencies
VAT	VAT at 20% is applied on the fees for segregated funds and certain pooled vehicles. CAIFs are exempt from VAT on investment management fees

Source: Quilter Cheviot, March 2019

Cost can also have an impact on investment performance. Data from Teknometry, a company providing investment analysis services for asset managers, shows larger investment funds typically tend to outperform over the long term. As they are larger, they can afford to charge lower costs and thus have a lower hurdle when it comes to outperforming their competitors and benchmarks.

You can see this by comparing the weighted average performance of UK charity portfolios to the simple average. The weighted average takes account of the size of the portfolio, with larger portfolios making a larger contribution to overall performance than smaller portfolios.

As an example, if we take the annualised returns from Teknometry for one, three and five years to the end of December 2018, the difference (shown below in dark blue) between the average and weighted average returns shows that larger portfolios have outperformed over these periods.

Chart 1: Larger investment funds typically outperform over the long term

Source: Teknometry 2019

Regardless of the differences between segregated and pooled investments, the important thing is to always compare performance after fees have been taken into account. There is no iron law saying that high cost investment managers will underperform, but lower fees do make it easier to outperform.

DIVERSIFICATION

Diversification is an important part of successful investing, with it often being referred to as the only free lunch. For smaller charity investors, pooled funds offer a more efficient way to diversify their holdings.

While segregated mandates can include third party funds to boost diversification, this can result in higher costs. You effectively end up paying the manager of the pooled fund and the manager of the segregated mandate. You should also be careful not to over-diversify – a portfolio with ten pooled vehicles could contain as many as 1,000 holdings, and sometimes substantially more. A segregated mandate will typically buy investments directly, thus giving you much more concentrated stock selection.

A pooled vehicle is typically a better option for small investors who need to diversify. Because you pool your money with other investors, you can use your collective size to access more asset classes – particularly overseas ones – and ensure you are not over-exposed to any one investment risk.

Table 3: How different asset classes perform each year

Percentage Change

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Oil (£) 56.2%	Gilts 12.8%	Oil (£) 85.99%	Gold 29.35%	N America equity 32.3%	UK REITs 30.9%	N America equity 28.3%	UK REITs 24.2%	Japan equity 15.92%	Oil (£) 80.77%	AsiaPac equity 23.4%	N America equity 0.78%
EM equity 37.4%	Gold 3.12%	EM equity 59.4%	Oil (£) 23.16%	Oil (£) 16.19%	Euro equity 17.4%	Japan equity 24.8%	N America equity 19.59%	UK REITs 9.7%	EM equity 35.4%	EM equity 21.1%	Gilts 0.6%
AsiaPac equity 34.9%	Japan equity -5.57%	AsiaPac equity 54.6%	EM equity 22.9%	Gilts 15.6%	AsiaPac equity 17.2%	Euro equity 24.0%	Gilts 13.9%	Euro equity 5.5%	N America equity 34.11%	Euro equity 16.9%	Gold -1.7%
Gold 31.78%	N America equity -13.34%	UK equity 30.1%	AsiaPac equity 22.1%	Gold 11.07%	EM equity 13.4%	UK equity 21.3%	AsiaPac equity 9.5%	N America equity 5.35%	AsiaPac equity 28.7%	Japan equity 13.19%	Japan equity -7.07%
Euro equity 16.4%	UK REITs -22.5%	Gold 27.12%	N America equity 19.07%	UK equity -3.5%	UK equity 12.3%	UK REITs 19.4%	EM equity 4.3%	UK equity 1.0%	Japan equity 21.35%	UK equity 13.1%	EM equity -7.6%
N America equity 5.62%	Euro equity -25.9%	Euro equity 21.8%	Japan equity 18.38%	UK REITs -9.1%	N America equity 10.72%	AsiaPac equity 1.7%	Japan equity 1.75%	Gilts 0.6%	Euro equity 21.2%	UK REITs 12.9%	AsiaPac equity -8.8%
UK equity 5.3%	UK equity -29.9%	Japan equity 18.38%	UK equity 14.5%	Japan equity -14.79%	Gold 5.58%	Oil (£) -1.7%	UK equity 1.4%	AsiaPac equity -3.9%	UK equity 16.8%	Gold 12.61%	Euro equity -9.1%
Gilts 5.3%	AsiaPac equity -33.0%	N America equity 14.84%	Gilts 7.2%	AsiaPac equity -14.8%	Japan equity 4.9%	Gilts -3.9%	Euro equity -1.4%	EM equity -9.7%	Gilts 10.1%	N America equity 11.27%	UK equity -9.5%
Japan equity -3.16%	EM equity -35.2%	UK REITs 2.2%	UK REITs 7.0%	Euro equity -15.0%	Gilts 2.7%	EM equity -4.1%	Gold -1.78%	Gold -10.45%	Gold 8.95%	Oil (£) 10.4%	UK REITs -13.7%
UK REITs -5.5%	Oil (£) -45.21%	Gilts -1.2%	Euro equity 6.6%	EM equity -17.6%	Oil (£) -1.38%	Gold -27.34%	Oil (£) -47.24%	Oil (£) -29.62%	UK REITs -7.4%	Gilts 1.8%	Oil (£) -19.52%

Source: Thomson Reuters 2019

TRANSPARENCY

In recent years, there has been an increasing focus on transparency so that investors understand what they are invested in. Segregated mandates have typically offered more transparency in the past, but pooled vehicles are quickly catching up. Our Quilter Cheviot Global Income & Growth Fund for Charities ("the Fund"), for example, lists all of its holdings on a monthly basis. Charities who invest with us also have a designated investment manager, whom they can contact directly if they have any questions.

However, pooled vehicles still fall relatively short on transparency – particularly those offered by large institutional asset managers. Many still try to provide a 'one size fits all' approach to minimise costs. At a minimum, a pooled vehicle should provide the following on a monthly basis:

- Current fund price and performance over one, three, five and ten years (or since inception)
- Top ten holdings
- Sector allocation
- Country allocation
- Fund costs

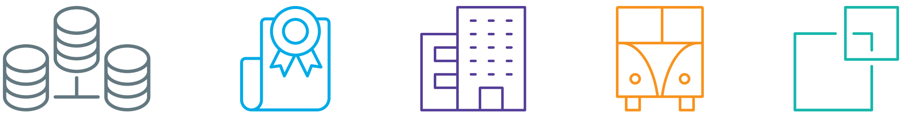
Pooled mandates may also provide other forms of reporting, including monthly written commentaries, quarterly webinars on performance, and wider marketing and events activity.

THE QUILTER CHEVIOT GLOBAL INCOME & GROWTH FUND FOR CHARITIES

Quilter Cheviot offer both pooled vehicles and segregated mandates. For charities with assets of under £2m, we would generally suggest that a pooled vehicle would be a more suitable structure for investments. There are no hard and fast rules, however, and it is up to each charity to decide what they prefer. Charities with assets of more than £2m can be equally well served by a pooled vehicle, and investment managers offer a wide range of portfolios designed to meet different investor needs and ethical requirements.

The Quilter Cheviot Global Income & Growth Fund for Charities ('the Fund') is our pooled vehicle for charities. The Fund aims to deliver a net annualised return of 3.5% above the UK Consumer Prices Index over the medium term. Out of this return, the Fund aims to provide a minimum income yield of 3% per annum.

Within the Fund we invest in a mix of direct equities (UK, US and Europe primarily) and bonds, as well as funds to gain exposure to specialist areas such as property, infrastructure and emerging markets. We will not invest in companies whose primary business is producing or manufacturing tobacco; and as a company we do not invest in businesses which make controversial weapons. Please visit www.quiltercheviot.com to see our controversial weapons policy.



If you would like more information on the Quilter Cheviot Global Income & Growth Fund for Charities, visit our website, contact us on 020 7150 4000 or email marketing@quiltercheviot.com.

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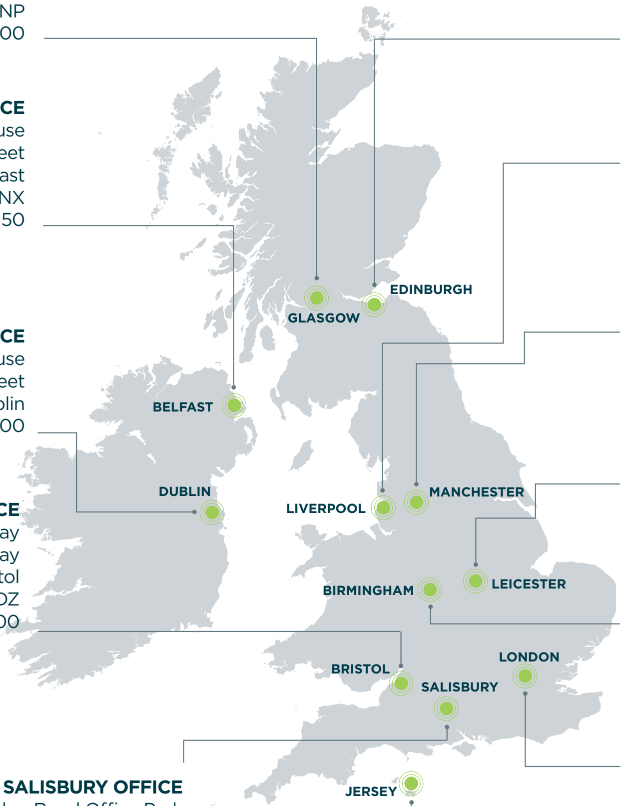

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QCB052 (04/2019)

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