Reserves and investments – key issues

Trustees Week, November 2017

CCLA

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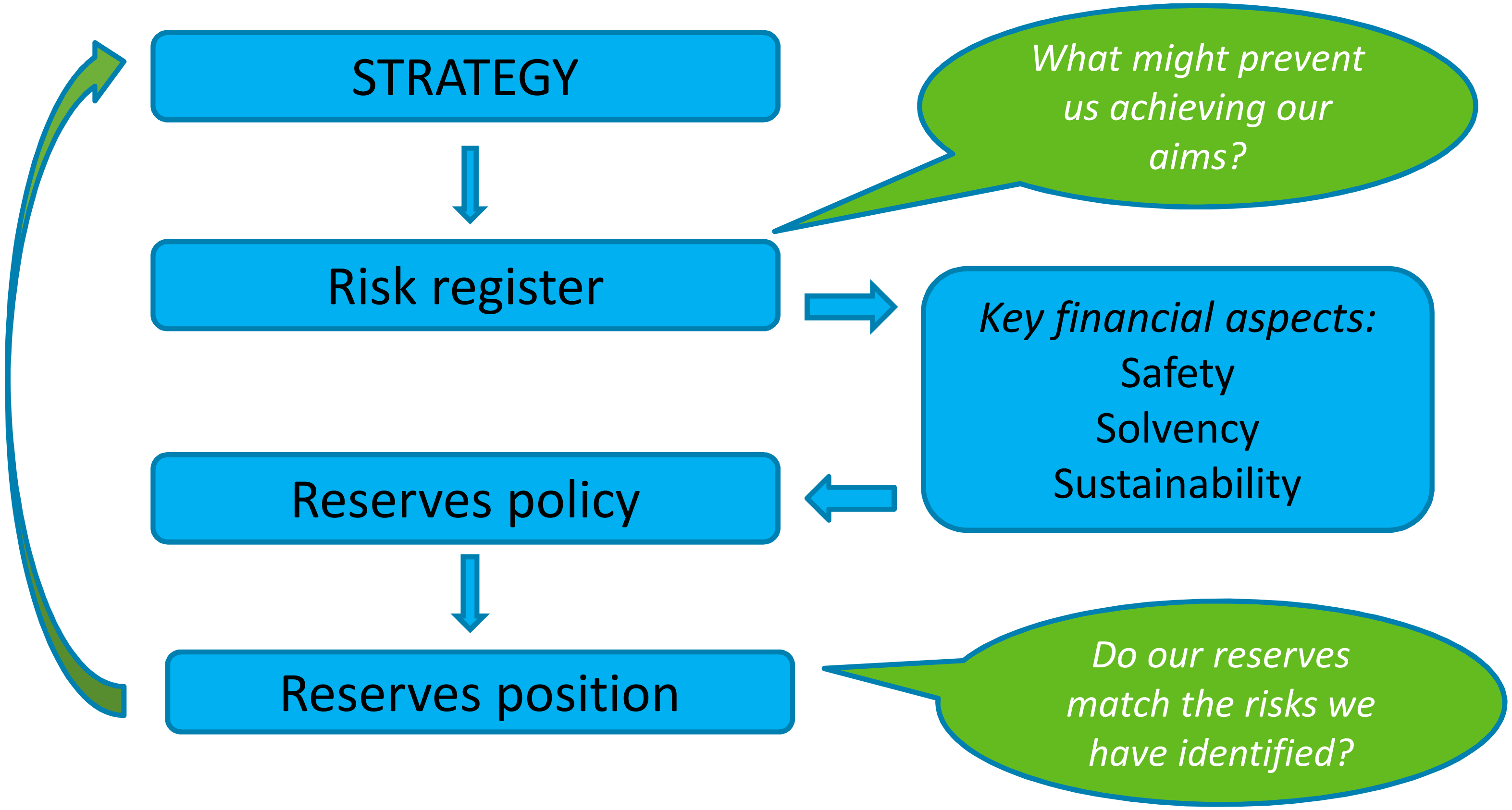
- 25 years in charity finance, 9 years at CCLA
- FCA, Chartered FCSI
- Trustee of three charities

- CCLA is a leading manager of investments and cash for charities
- Cost effective specialist funds and portfolios
- Mutually owned: commitment and stability

- The risks trustees sometimes miss – and what it can cost
- Towards a better understanding of risk priorities
- Practical solutions to address relevant risks

Understanding risk priorities enables best use of resources



‘A good reserves policy can help you show … how you are managing the charity’s money’
OSCR Charity Reserves Factsheet, May 2017

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	Safety	Solvency	Sustainability
Strategic risk question	Are the charity's assets secure?	Can we pay the bills on time?	What do we want to do, how will we fund it?
Risk in terms of cash and investments	Default risk	Valuation risk Liquidity risk	Inflation risk Income risk
Manifestation: what risk might look like	Bank failure	Asset mismatch – investments fall in value, and/or cash is locked in	Asset mismatch – poor returns damage spending power

Low probability, high impact

How safe is the charity's cash in the new bail-in regime?

- Banks are too important to fail
  - but they can be very expensive to save
  - 'why should tax payers pay while bond investors and depositors do not? No more bail-outs!'

- Post-financial crisis bail-in regime:
  - if the regulator identifies a financial institution as too weak a 'bail-in' is imposed without delay
  - equity holders are first in line but bond holders and depositors are exposed too
  - there is no pre-notice to those involved

- Depositors in some EU countries have already suffered
  - and the regime is now operational in the UK

- May need to review cash management policy
  - safety and liquidity are essential
  - take care with selection of institutions and deposit terms
  - keep within FSCS threshold (currently£85,000) if possible

- If that is not practical, consider managed cash funds
  - FSCS protection may not apply
  - but diversification and professional management of pooled funds can offer superior risk control
  - be aware of a fund's approach to risk. AAA is the highest security rating available

FOCUSING IN: RISK AND FINANCIAL RESOURCES (2)

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Potential conflict

Assets that best address short term risks leave us exposed to long term risks

HOW DO YOU PROTECT YOURSELF FROM LONG TERM RISK?

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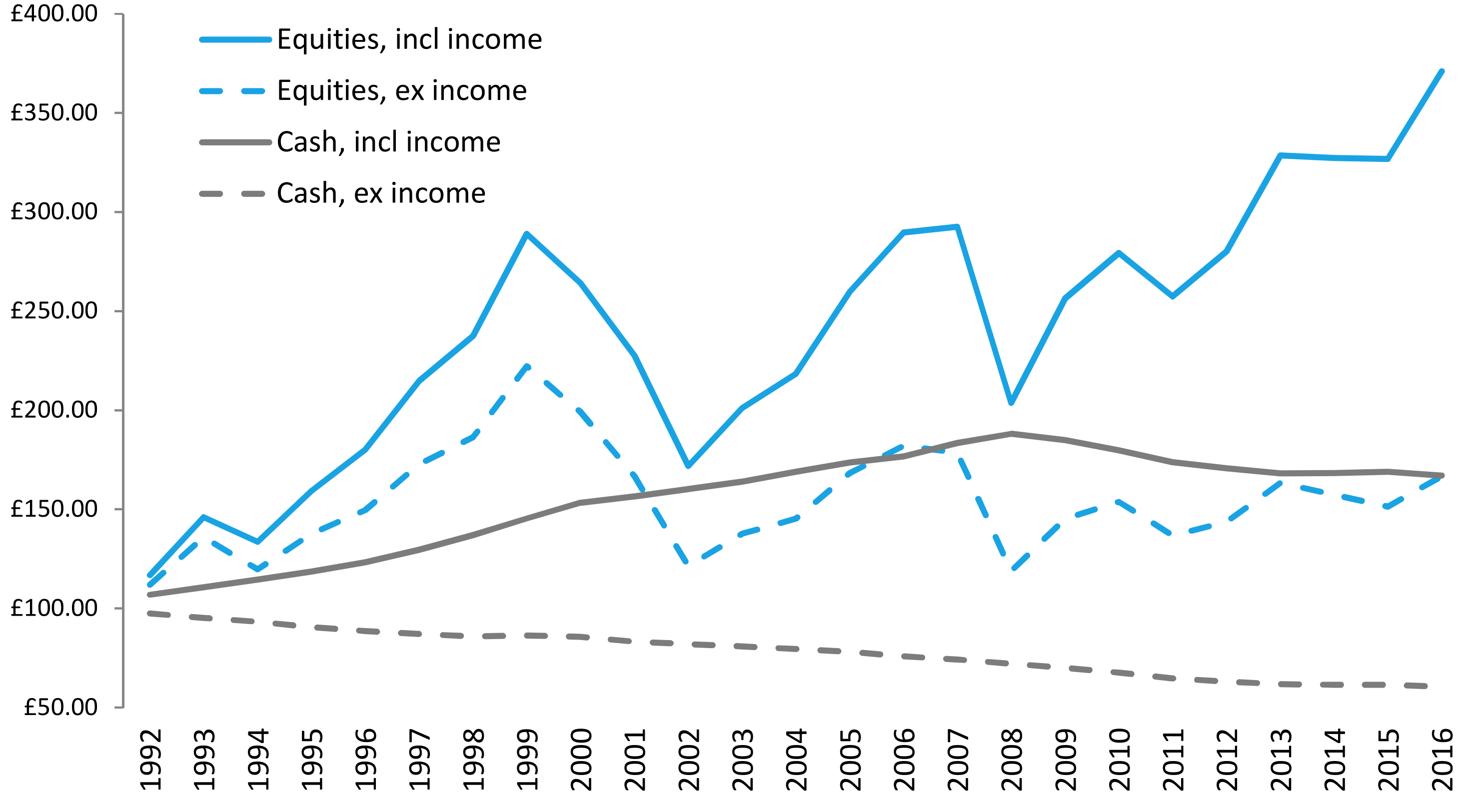
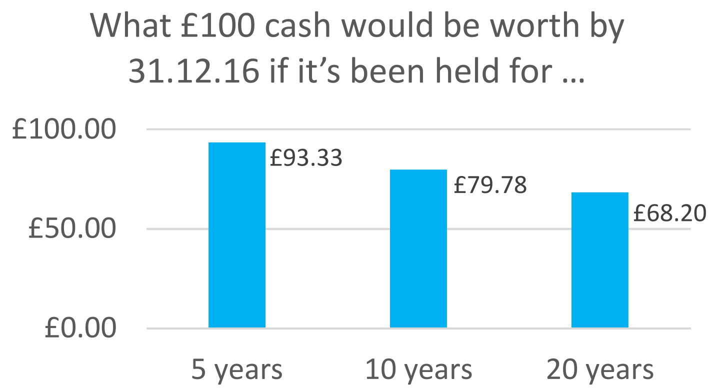
What £100 invested 25 years ago would be worth now IN REAL TERMS
– and how we got there



Source: Barclays Capital/ONS. Data as at 31 December 2016.

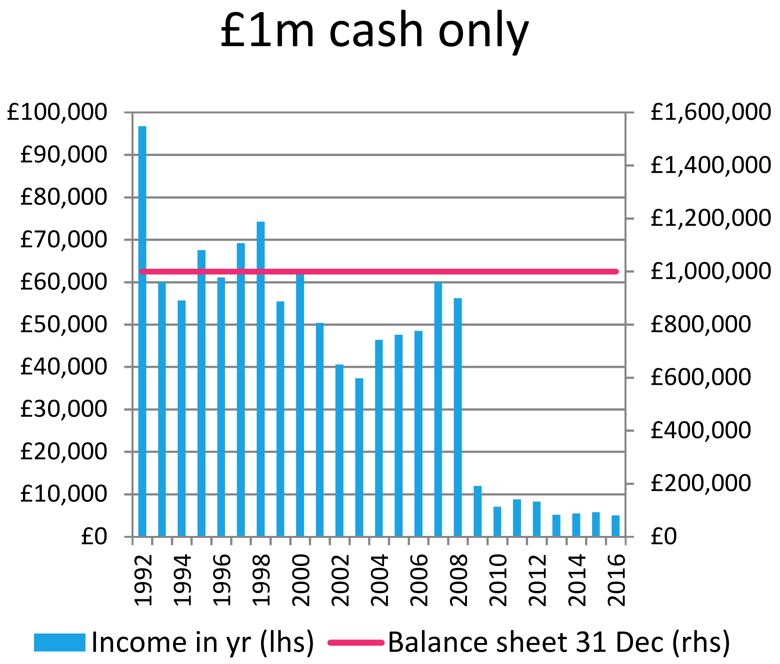
Priorities stem from what you are holding reserves for:

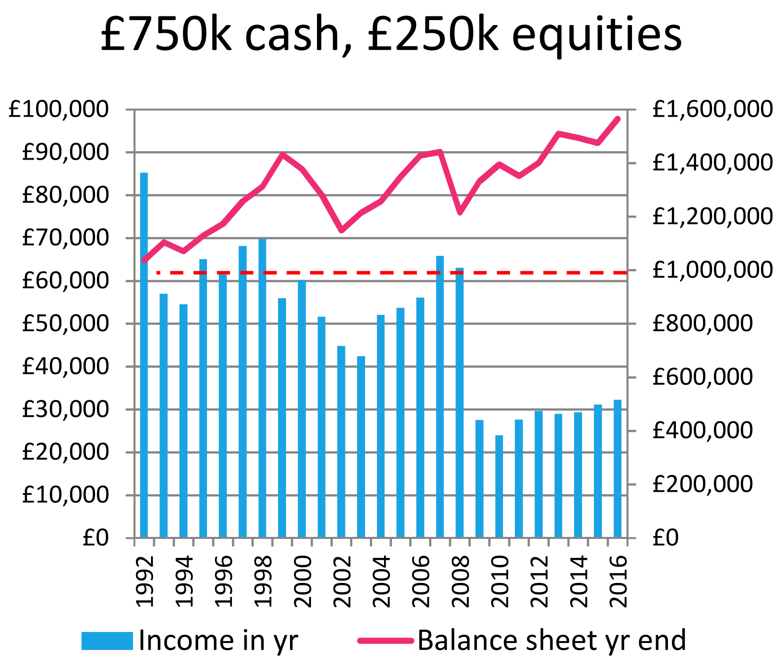
- Funds for expenditure?
  - security and liquidity are essential
  - cash is king; but not a good store of value!



- Long term reserves? If they're not likely to be spent, they should be working for the charity
  - generating income
  - growing in value to maintain spending power
  - requires assets with real economic exposure
    - equities, property, infrastructure

£1m since 1 Jan 1992: income returns and movement in capital value





Source: CCLA, Barclays as at 31.12.16. Based on nominal UK equity prices, equity income yield and average 3 month sterling LIBOR.

If cash balances are likely to persist, a modest allocation to real investments can make good sense

- Do you need an ethical investment policy?
- Who’s to say what is ethical?
- What effect will it have on our financial returns?

- Specific investment duties of ‘suitability’ and ‘diversification’
- General duty to act in your charity’s best interests
  - includes addressing risks (eg damage to charity’s reputation) of holding investments that conflict with mission
- Charity regulators: ‘Trustees of any charity can decide to invest ethically … investing in a way that reflects a charity’s values and ethos and does not run counter to its aims’
- May be required to comment in trustees’ report

- We all have ethics:
  'moral principles that govern behaviour or the conducting of an activity'

- Do we want / need to reflect the charity's values in its investment policy?
- If so, how?

- It's the organisation's values that count
  - not those of individual trustees
  - or other stakeholders

IF YOU HAVE AN ETHICAL POLICY, APPLY IT CONSISTENTLY

- Think issues first
  - based on your charitable purposes
- Then identify which investment sectors affected under which criteria
- Practicalities:
  - turnover thresholds?
  - manager research resource: UK or global?
  - third party funds?
  - engagement?
- Work with and learn from others

- Ethical restrictions will reduce your investable universe of funds or stocks

- In the short/medium term, likely to result in divergence (positive or negative) from experience of unscreened portfolios

- If implemented intelligently, a reasonable ethical policy should not adversely affect long term investment performance

PRACTICALITIES – HOW ACCESSIBLE IS LONG TERM INVESTMENT?

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- Governance
  - Investment policy to specify what the portfolio is for
  - Monitoring and reporting against those objectives
- Trustee investment duties
  - Suitability
    - Advice needed? Or use charity specialist funds
  - Diversification (between and within asset classes)
    - Easily achieved through pooled funds
- Reputational risk: ethical investment criteria?
    - Range of policies available through pooled funds

Suitable investment portfolios can be accessed flexibly and cost effectively through specialist pooled funds

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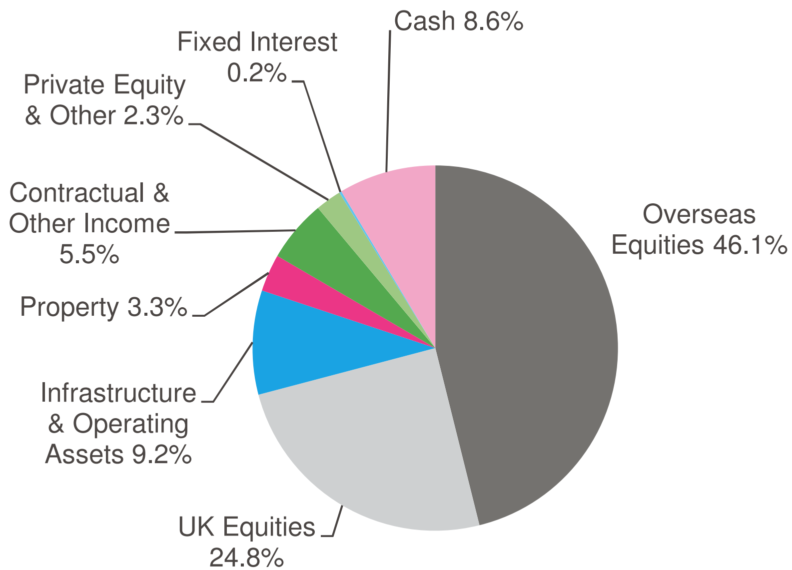
- Emphasis on real assets
  – seeking strong long term returns
- Highly diversified and well balanced spread of investments
  – controlling overall risk
- Underlying holdings selected individually to target objectives
  – risk and return
  – ethical screening
- Minimum initial investment £1,000
- Weekly dealing of Fund units
- Current income yield c.3.5%



Overseas Equity	%
North America	27.0
Europe ex UK	12.1
Japan	3.9
Asia Pacific ex Japan	3.1
	46.4

Source CCLA as at 30 June 2017

SUMMARY AND POSSIBLE ACTION POINTS FOR TRUSTEES

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- Addressing different risks requires different asset types
  - short term risks (cash) vs long term risks (real investments)
- If it has to be cash, keep it safe
  - risks are asymmetric
  - time to review cash management policy?
- Long term investment needn't be demanding or expensive
  - Well diversified, suitable portfolios are readily available in charity specialist pooled funds

Understanding risk priorities enables best use of resources

Questions and discussion

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