Yorkshire Funders – Reviewing your Investment Policy

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Training delivered by:

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Webinar overview

The session will cover the essentials of investment policy reviews, including balancing mission with risk and returns, aligning your investment policy with your investment portfolio and the practical steps trustees can take as well as general insights and advice on monitoring.

Session Summary

A good starting point is to consider what matters to your charity – triggers for review include if something has changed? (e.g. increased demand)

Some of the things that may change over time include; regular commitments, multi-year funding, evolving to larger capital projects, increasing importance of environment and social factors.

Once you are clear about the factors at play, it's important to build your knowledge. There can be a range of experience around investments amongst trustees – building knowledge could be via finance director, organisation of charity, webinars or training.

The ideal is to strike the right balance between short- and long-term needs, whilst ensuring financial resilience. (taking professional advice where appropriate)

An investment policy review should discuss the current financial position and review investments and past performance in the context of future plans, ensuring a wide range of factors have been considered.

The investment management role is to deliver the plans of the trustees, not develop the strategy. The trustees set the framework and parameters – the investment manager interprets and delivers them.

Trustees need to understand the risks associated with difference asset classes and understand the liquidity of each and the variability of returns of each asset class.

Cash really isn't a place to invest – it's to be used for liquidity and funding, as over time, cash will be eroded by inflation.

Historically, diversification of investment has offered the best prospect of achieving above inflation returns over time. Mixed-asset investments are still relatively liquid and can be accessed fairly quickly if required.

Practical Steps for Trustees

1) Start with a summary of where you are - objectives and targets & where do you want to be? (be aware that any target will not be hit every year but is to be considered as an average). Clarity around investments is important
2) Any restrictions

3) Parameters and appetite to risk – including asset classes, base currency, restrictions & credit quality (=any restriction on which organisations are acceptable to have investments with). Having enough knowledge of asset classes to know whether you are comfortable with them or not is important as a trustee.
4) Liquidity requirements
5) Time – linking investment strategy to funding strategy
6) Performance measurement – be clear about who is responsible for what
7) Reporting and monitoring – timeline for portfolio review

Q&A

If we commit to funding a charity a set amount over multiple years, do we have to have that money available rather than tied up?

If you know you need capital within three years, be wary of investing in the stock market. Some trustees have a split – a growth fund (no need to access for 5,10 or 15 years) & sub fund ("waterfall") e.g. government bonds to link and match liabilities - or hold in cash.

Re: Inflation-linked return target, how challenging is too challenging? Historically, we used CPI+4% and met it easily but is this realistically achievable now?

Around 10 years ago, this was easy. However, as we've been through a period of significant inflation, achieving CPI+X% in recent years has meant having to take considerable risk to achieve it, given inflation at one point topped 11%. In the current climate, this might be worth reevaluating. CPI+4% is a stretch year in year out – this would currently require returns of 8%+.

Looking at spend down strategy, is there anything additional trustees should be aware of when looking at the spend down process?

Split of investments – managing outflow expectations ensuring enough of a buffer. Making sure income from investments is enough for the longer term – fixed income investment e.g. government bonds

What are your thoughts on managing in the long term and trustee duties regarding surplus. Over the last 15 years, our portfolios have significantly outperformed inflation. If we have an investment portfolio where the objective is to maintain for distribution but we're outstripping this and sitting on an increasing surplus, is there anything else to consider?

This situation is not unusual. If you've benefitted from strong stock markets over time, you will have had a lot of benefit in there. Sometimes, trustees don't have enough confidence to distribute more money. As a team, consider whether you want to distribute more as you have sufficient to accommodate. Understanding what you have and where it's come from is key. The challenge is a strategic discussion around where you're going with your endowment and whether you want to adjust your distributions. It's not an investment decision.

Do we need to think about this within trustee duties – are there other things we should be considering from a moral standpoint?

This question comes back to the main duties of trustees – ensuring your charity is carrying out its purpose for public benefit is the number one priority of most charities. Sharing knowledge and learning amongst peers rather than just in the room can be useful – what are others doing, best practice – to reflect into your organisation as appropriate. Now is a good time for reflection – what are others doing and how can we use our asset to help?

If you have a short time frame and have cash you need to go out in next couple of years, it is probably advisable to keep in bonds, bank or Flagstone (platform that allows you to spread the risk of holding cash).

If your asset is a permanent endowment, there can be restrictions - sometimes you can only distribute income. Sometimes request for proposal documents will specify an amount that must be retained. This is always charity specific. Sometimes charitable trusts are established so that capital can't be eroded – this pushes you towards a particular investment style. Investment managers need to take this into account, and you should take advice.

Large, endowed funds are now exploring more social investments, sacrificing some return. What are the considerations here?

Social impact investments are different to standard investments – it's a growth area but you are generally taking a much higher level of risk – how does this work if not direct (3rd party) projects? How do you measure? You need to know what you're looking at - some people are managing this by splitting asset classes.

(Shared in comments – The Impact Investing Hub is a useful resource for learning and seminars)

Measuring Success

Framework for assessing returns – focus on the average returns and track on an annual basis to see what sort of return you are generating – look at capital return and income vs target in investment policy and take a medium-term view (3-5 years)

Benchmarks are a composite – keeping things simple (using inflation) is their preferred measure. You can find indices for charities to benchmark against peer group but note that you aren't necessarily comparing like with like.

Some charities prefer to split funds between managers. A management review is a big and important job – it's important to take time to devote to this.

Your investment manager should be accessible, prepared to give insights and explanations and speak to you in plain English. Ask questions around risks, diversifications and opportunities.

Is there a point (in terms of size) where having two investment managers makes sense?

This depends on individual attitudes – if your organisation is big enough to have an investment committee, you probably have capacity to have more than one investment manager. There's a potential benefit – but if you are sub £1million, I'd question why you'd have two although it's hard to draw the line. Complexity of organisation would be a factor. Would normally have £10m+ and strategies might be very different for each investment manager according to expertise/style for spread of risk – but try to avoid duplicating the same type of manager.

Final Questions

If we are concentrating on socially responsible investments or ESG funds, are there long-term numbers for penalty we are paying vs a fully diversified portfolio?

What is interesting is how that mandate is delivered depending on your instructions – you don't need to compromise necessarily on investment returns – it depends how prescriptive you are.

If you have a long time horizon, this shouldn't be an issue. Our approach is to apply consideration to those ESG factors to and decide which are the areas we won't invest. Be aware that some areas could be accused of greenwashing and the FCA are taking action to ensure claims can be backed up. If you are proactively selecting green assets, they will have different pressures on them at different times.

ESG has morphed into the modern-day "socially responsible investment". However in any individual investment (generally mutual funds) it's not black and white – you can start off saying you want to be socially responsible e.g. renewable energy – but this could also be an oil producer.

It's much easier if you aren't using a fund – you can be more specific re things you do and don't want to have exposure to with direct investment.

Be sure to set your own parameters around ESG stocks – what do you mean? – do you want to exclude some things or encourage better behaviour? (e.g. encouraging an airline to use more efficient fuels). Break down the E, S & G – Environment (= climate change etc), S = local benefit, D&I, G = governance (protecting company and shareholders having right policies.)

You don't have to sacrifice return if an investment manager is doing their role fully.