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CHARITY COMMISSION
FOR ENGLAND AND WALES

Guidance

Charities and investment matters: Legal underpinning

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Contents

This publication is available at https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-legal-underpinning

1. Preliminary statement

This document is intended to be a summary of the Charity Commission's view of the law underpinning its publication "Investing charity money: guidance for trustees" (https://www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees) ('the guidance') and necessarily uses more technical language.

This analysis is not intended to be a comprehensive legal digest, but a useful reference point for trustees, their advisers and the public. It is intended to reflect the law and practice at July 2023. It is not binding in law. It should be borne in mind that it offers a general analysis of the law but whether the analysis is appropriate in a particular case will depend on all the facts of that case, noting that the law of trusts often develops incrementally case by case. The Commission also notes the importance of not treating obiter comments in cases as statute, and where possible identifying the binding ratio of cases or the underlying principle.

In some places this document quotes from judicial decisions which use language specific to one gender. These are direct quotations from historical case reports, and the relevant principles apply without reference to gender.

The Commission will take the same approach as the courts and the Tribunal in applying the law.

2. Introduction

This legal underpinning of the guidance is concerned with the duties and obligations of trustees of charities. The position described is based on the law relating to trust law except where otherwise indicated. As such parts of this guidance do not directly apply to directors of charitable companies. However, as directors of a charitable company are also acting in a fiduciary manner in furthering charitable purposes, they have similar responsibilities. They are within the description of 'charity trustees' as defined in section 177 of the Charities Act 2011.

What is an investment?

In the guidance, the Commission uses the term 'investment' to include any outlay of funds in something which it is hoped will lead to a financial return.

This definition covers a wide range of strategies used by charities in employing their funds.

There is no statutory definition of investment although there is authority in case law for what is meant by the term. In Harries v Church Commissioners [1992] 1 WLR 1241 (Harries) the Vice-Chancellor Sir Donald Nicholls referred to “property held by the trustees for the purpose of generating money, whether income or capital growth, with which to further the work of the trust”. He characterised this as “property held by the trustees as an investment”.

The meaning given to ‘investment’ at common law is generally limited to financial investments e.g. “property held by the trustees for the purpose of generating money, whether income or capital growth, with which to further the work of the trust”. However, in a New Zealand case Culverden Retirement Village v Registrar of Companies [1997] 1 NZLR 257, 261 the Privy Council said:

“……..one of the everyday meanings of investment is the laying out of money in the acquisition of property in the hope of return. The return may come in the form of capital or income or both. It may be in cash, or it may be in kind such as the provision of services.”

In that case, buying a town house in a retirement village on terms that the purchaser will occupy it, with necessary services provided, for so long as they wish and that they then get back all or a large part of their outlay was properly regarded as an investment. In particular, the court stated:

“The return from their outlay is to be found in the totality of these benefits, not just the financial payment at the end.”

The starting point for trustees in all of these ‘investment’ strategies is the duty of trustees to exercise their powers in the best interests of the charity. In the case of financial investments this will usually involve seeking the maximum return consistent with commercial prudence.

Charity trustees’ powers of investment

Charity trustees must exercise all of their powers to further the purposes of their charity, and this includes powers of investment. In Harries, in the context of trustees’ powers of investment, Sir Donald Nicholls V-C said:

“It is axiomatic that charity trustees, in common with all other trustees, are concerned to further the purposes of the trust of which they have accepted the office of trustee. That is their duty. To enable them the better to discharge that duty, trustees have powers vested in them. Those powers must be exercised for the purpose for which they have been given: to further the purposes of the trust."

In many cases this will involve charity trustees investing in order to maximise the financial return to the charity, so that the resulting funds are available for the charity's purposes; but there will be some cases where factors other than investment performance are also relevant to trustee decision-making. These include cases where potential investments may conflict with the purposes which the charity is established to achieve, or cases where making particular investments may risk damage to the reputation of the charity among donors, beneficiaries or others.

In Butler-Sloss and ors v Charity Commission and anor [2022] Ch 371 (Butler-Sloss), the trustees of two unincorporated charitable trusts sought the approval of the Court to the adoption of investment policy statements aiming to ensure that their investments were aligned with the goals of the Paris Agreement on climate change, as well as certain other declarations relating to the relevant law. In giving judgment, Michael Green J set out the following summary of the law in relation to charity trustees' decision-making when exercising their powers of financial investment:

"(1) Trustees' powers of investment derive from the trust deeds or governing instruments (if any) and the Trustee Act 2000.

(2) Charity trustees' primary and overarching duty is to further the purposes of the trust. The power to invest must therefore be exercised to further the charitable purposes.

(3) That is normally achieved by maximising the financial returns on the investments that are made; the standard investment criteria set out in s.4 of the Trustee Act 2000 requires trustees to consider the suitability of the investment and the need for diversification; applying those criteria and taking appropriate advice is so as to produce the best financial return at an appropriate level of risk for the benefit of the charity and its purposes.

(4) Social investments or impact or programme-related investments are made using separate powers than the pure power of investment.

(5) Where specific investments are prohibited from being made by the trustees under the trust deed or governing instrument, they cannot be made.

(6) But where trustees are of the reasonable view that particular investments or classes of investments potentially conflict with the charitable purposes, the trustees have a discretion as to whether to exclude such investments and they should exercise that discretion by reasonably balancing all relevant factors including, in particular, the likelihood and seriousness of the potential conflict and the likelihood and seriousness of any potential financial effect from the exclusion of such investments.

(7) In considering the financial effect of making or excluding certain investments, the trustees can take into account the risk of losing support from donors and damage to the reputation of the charity generally and in particular among its beneficiaries.

(8) However, trustees need to be careful in relation to making decisions as to investments on purely moral grounds, recognising that among the charity's supporters and beneficiaries there may be differing legitimate moral views on certain issues.

(9) Essentially, trustees are required to act honestly, reasonably (with all due care and skill) and responsibly in formulating an appropriate investment policy for the charity that is in the best interests of the charity and its purposes. Where there are difficult decisions to be made involving potential conflicts or reputational damage, the trustees need to exercise good judgment by balancing all relevant factors in particular the extent of the potential conflict against the risk of financial detriment.

(10) If that balancing exercise is properly done and a reasonable and proportionate investment policy is thereby adopted, the trustees have complied with their legal duties in such respect and cannot be criticised, even if the court or other trustees might have come to a different conclusion."

Butler-Sloss is now the leading case in this area, and this judgment is central to the basis for the Commission's guidance on investment by trustees.

In setting out requirements including to act reasonably, to balance all relevant factors, and to act honestly, responsibly and with all due care and skill, the statement set out above places trustee decision-making regarding financial investments in the same context as trustee decision-making generally. Although the judgment was given specifically in the context of trustees of unincorporated charities, the Commission considers that the same duties are likely to apply to charity trustees of all charities whatever their legal form, by virtue of their fiduciary position in relation to their charities.

The summary above refers to the Trustee Act 2000 as one of the sources of trustees' powers to invest. That Act applies to trustees in the strict sense, such as those who were party to the Butler-Sloss proceedings, who are trustees of unincorporated charities. The powers of the trustees of incorporated charities, including companies, charitable incorporated organisations and other corporate bodies, will derive from the separate legal frameworks which apply to them.

The Commission's separate guidance on trustees' duties and on decision-making by trustees reflect many of the principles set out in the above summary from that case as they apply to trustee decisions generally, and the investment guidance applies these in the context of investment.

3. Financial investment

Maximum financial return

In Harries, the Vice-Chancellor was clear that where property is held as an investment, “prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, consistent with commercial prudence”. In Butler-Sloss, Michael Green J said that the furthering of a charity’s purposes by use of financial investment powers “is normally achieved by maximising the financial returns on the investments that are made”.

The power to invest in the Trustee Act 2000 is likewise concerned with investment made for the purpose of achieving a financial return. It is also the case that funds held as permanent endowment on a trust for investment are, subject to any specific provisions in the governing document, held for the purpose of securing a financial return which can be applied in furtherance of the charity’s purposes. The funds cannot, in the absence of specific provisions to that effect, be used in a way which would erode the capital of the fund.

Distinction between investment and trading

There is a distinction between an investment and a trading venture although on occasion it may be difficult to make. Generation of an income may be a feature of both an investment and a trading venture. The two may be treated differently with regard to taxation so it is important to be clear whether a particular outlay of funds is on an investment rather than a trading venture.

Investment powers

Many charities have express powers of investment set out in their governing documents. In any event, the Trustee Act 2000 confers a general power of investment on trustees of unincorporated charities. This is stated to be that a trustee “may make any kind of investment that he could make if he were absolutely entitled to the assets of the trust”. Charity trustees have to exercise their powers in the interests of the charity. What this means with regard to investment powers is explored later in this section.

This is a very wide power, but only true “investments” are within its scope. It is also necessary for trustees to bear in mind the tax issues and the distinction between activities which are investment and those which are trading. Carrying out transactions that cannot properly be regarded as ‘investments’ cannot be justified as an exercise of an investment power. Uses of funds to further a charity’s purposes directly are not made in the exercise of financial investment powers.

The general power of investment conferred by the Trustee Act 2000 does not permit trustees to make an investment in land other than in loans secured on land. However, section 8 of the Trustee Act gives trustees the power to acquire freehold or leasehold land in the United Kingdom as an investment.

The courts have always permitted express powers of investment to either restrict the general trustee powers of investment or to widen them although express powers of investment are strictly construed by the courts.

Although the court strictly construes express powers of investment, it does not have a duty to put an unduly restricted construction on an investment clause.

Under section 99 of the Charities Act 2011 the powers of investment of a charity include power to participate in common investment funds and common deposit funds unless the power is excluded by a provision in its governing document specifically referring to common investment funds or common deposit funds

Common investment funds

Common investment schemes are collective investment funds established by a scheme made by the Commission (or the court) under sections 96-97 of the Charities Act 2011 in which only charities established in England and Wales and those established in Scotland and Northern Ireland can invest. They are deemed to be charities. More information can be found in the guidance Common Investment Funds and Common Deposit Funds: a basic guide to their regulation (https://www.gov.uk/government/publications/common-investment-funds-and-common-deposit-funds/common-investment-funds-and-common-deposit-funds-a-basic-guide-to-their-regulation).

Many Common Investment Funds are structured as Charitable Authorised Investment Funds (CAIFs), which are authorised by the Financial Conduct Authority.

Common deposit funds (CDFs) are deposit-taking schemes set up by schemes made by the commission under section 100 of the Charities Act 2011. They are deemed by law to be charities themselves. They are therefore eligible for registration as charities in their own right. More information can be found in the guidance linked above.

Borrowing to invest

Usually, borrowing money in order to invest it will not be a prudent use of the funds in question as the return on them will not necessarily cover the costs of borrowing. However, there is also an issue as to whether this is covered by the power to invest.

Even where it is in the charity's interests to borrow and invest, it will only be able to do so if there is a specific power to borrow in order to invest. In In re Suenson-Taylor's Settlement Trusts [1974] 1 WLR 1280 Foster J considered a proposal by trustees to use their borrowing powers to raise funds for the purpose of investment. Their investment power appeared to be very wide, namely:

"The trustees shall have the same unrestricted power of investment of moneys requiring investment under the trusts hereof as they would have if they were a sole absolute and beneficial owner of the trust fund."

The Court considered that 'moneys requiring investment' referred to the capital of the trust fund and that borrowed funds were not part of the trust fund and so not within the power of investment. This is not to say that it is not possible to have express powers to borrow and invest borrowed funds only that express powers of trustees will be strictly construed.

Where borrowing in order to invest is permitted, it will be necessary for the trustees to ensure they are acting in accordance with their duties in the interests of the charity.

This does not prevent charities from investing in entities which themselves borrow to make investments, provided that the charity's decision to do so complies in other respects with its legal duties.

Trustees' duties (exercising a power of investment)

The general power of investment conferred by section 3 of the Trustee Act 2000 does not of course affect the duty of a trustee in exercising the power of investment "to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide" (per Lindley L.J. in In re Whiteley (1886) 33 Ch.D. 347, 355).

In Learoyd v Whiteley (1887) 12 App. Cas 727, 733 Lord Watson said:

"Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard."

In In re Godfrey (1883) 23 Ch.D. 483, 493 Bacon V-C said:

"No doubt it is the duty of a trustee, in administering the trusts of a will, to deal with property intrusted into his care exactly as any prudent man would deal with his own property.

But the words in which the rule is expressed must not be strained beyond their meaning. Prudent businessmen in their dealings incur risk. That may and must happen in almost all human affairs."

For private trust cases, balancing the interests of the tenant for life and those entitled in remainder was an important aspect of the trustees' investment duties. In JW v Morgan Trust Co of the Bahamas Ltd (2001-2) I.T.E.L.R. 541 the Supreme Court (Bahamas) held that trustees were expected to consider total return on trust assets as the yardstick for their investment performance without prejudicing the position of a life tenant or a remainderman. Trustees have to strike a fair balance between fixed interest securities, favouring the life tenant, and stocks and shares which, with their potential for capital growth, favoured the remainderman interested in capital where there is a low dividend policy.

In charity law this equates in the case of permanent endowment to considering the furtherance of the charitable purpose both now and in the future. With regard to charities without permanent endowment, there is not necessarily such a balancing process. The main criteria is the furtherance of the charity's purposes whether this is best served by investing for a financial return to be applied for the purposes or applying the capital directly in furtherance of the purposes.

In Cowan v Scargill [1985] Ch 270 Sir Robert Megarry V-C quoted with approval the words of Sir James Wigram V-C in Balls v Strutt (1841) 1 Hare 146, 149:

"It is a principle in this court, that a trustee shall not be permitted to use the powers which the trust may confer upon him at law, except for the legitimate purposes of his trust;………"

Megarry V-C went on to say:

"Powers must be exercised fairly and honestly for the purposes for which they are given and not so as to accomplish any ulterior purpose, whether for the benefit of the trustees or otherwise…."

In Trustees of the British Museum v H.M. Attorney-General [1984] 1 WLR 418 Sir Robert Megarry V-C set out five matters as being among those to be considered by the court when considering conferring investment powers:

"The court is likely to give great weight to the width and efficacy of any provisions for advice and control."

"Where the powers are of great width…..there is much to be said for some scheme of fractional division, confining part of the fund to relatively safe investments, and allowing the other part to be used for investments in which the greater risks will be offset by substantial prospects of a greater return."

"What the court has to judge is the combined effect of width, division, advice and control, which all interact, together with the standing of the trustees."

"The size of the fund in question may be very material. A fund that is very large may well justify a latitude of investment that would be denied to a more modest fund; for the spread of investments possible for a larger fund may justify the greater risks that wider powers will permit to be taken."

"The object of the trust may be very material. In the present case, the desirability of having an increase of capital value which will make possible the purchase of desirable acquisitions for the museum despite soaring prices does something to justify the greater risks whereby capital appreciation may be obtained."

The degree of control envisaged mirrors the approach taken in the Trustee Investment Act 1961 which was in force at that time. However, even though the general power of investment is broad, a governing document may still impose a more restrictive approach.

The Trustee Act 2000 imposes specific duties on trustees with regard to the exercise of their investment powers. In particular, under section 4 the trustees must review the charity's investments from time to time and, having regard to the standard investment criteria, vary them if appropriate. These criteria are:

(a) the suitability to the trust of investments of the same kind as any particular investment proposed to be made or retained and of that particular investment as an investment of that kind

(b) the need for diversification of investments of the trust, in so far as is appropriate to the circumstances of the trust

In addition, under section 5(1), “before exercising any power of investment………. a trustee must (unless the exception applies) obtain and consider proper advice about the way in which, having regard to the standard investment criteria, the power should be exercised”. Proper advice is “the advice of a person who is reasonably believed by the trustee to be qualified to give it by his ability in and practical experience of financial and other matters relating to the proposed investment” (section 5(4)). The exception is “that a trustee need not obtain such advice if he reasonably concludes that in all the circumstances it is unnecessary or inappropriate to do so” (section 5(3)).

The duty of care under section 1 of the Trustee Act is also applicable to any exercise of the power of investment or when carrying out the duties to consider the standard investment criteria or to take advice. The duty of care is to ‘exercise such care and skill as is reasonable in the circumstances, having regard in particular:

(a) to any special knowledge or experience that he has or holds himself out as having

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession’.

It has long been the case that a higher duty of care applies to those who for profit hold themselves out as having special knowledge. Brightman J in Bartlett v Barclays Bank Trustee Co. Ltd [1980] Ch 515 said:

“…..I am of opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management.”

Trustees in making their investment decisions will be subject to the duty to avoid conflicts of interest (see [Conflicts of interest: a guide for trustees (https://www.gov.uk/government/publications/conflicts-of-interest-a-guide-for-charity-trustees-cc29)](https://www.gov.uk/government/publications/conflicts-of-interest-a-guide-for-charity-trustees-cc29)). In addition, they should be careful not to take into account factors that are not relevant to the decision in question nor to fail to take into account an aspect that is relevant.

Conflicts between objects and investments

As noted above, Butler-Sloss is now the leading case in relation to the law on investment decision-making by charity trustees. In that case the Court specifically considered the possibility of proposed investments conflicting directly with the objects of a charity.

The Court heard argument as to the implications of the dictum of Sir Donald Nicholls V-C in Harries that "if […] trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects [which their] charity is seeking to achieve, they should not so invest" (emphasis added). Michael Green J held what the Vice Chancellor meant in Harries is that the "use of the word "should" means something slightly less than "must" and does not preclude consideration of other important factors. It is just that a direct conflict is likely to be the most significant factor and should be avoided if possible." The Commission considers that in his analysis Michael Green J was not seeking to identify a binding principle of law as to the degree of importance of avoiding a direct conflict in every case, but at most providing general guidance which should be read alongside the summary and statements of principle at [78] of the judgment – that trustees will need to have regard to all relevant factors, including potential direct conflicts between investments and objects, and exercise their discretion appropriately.

As with all other types of decision, investment decisions require charity trustees to comply with their general duties and exercise their powers in furtherance of the purposes of their charity.

4. Social Investment

What is social investment?

Sections 292A to 292C Charities Act 2011 provide for a statutory power for charities to make social investments.

In the legislation, a 'social investment' means a 'relevant act' of a charity which is carried out "with a view to both directly furthering the charity's purposes and achieving a financial return for the charity".

A 'relevant act' means one of two things:

- an application or use of funds or other property by the charity; or
- taking on a commitment in relation to a liability of another person which puts the charity's funds or other property at risk of being applied or used,

such as a guarantee

In this context, an application or use of funds or other property achieves a ‘financial return’ if its outcome is better for the charity in financial terms than expending the whole of the funds or other property. However, the concept of ‘financial return’ differs slightly when taking on a commitment in relation to a liability of another person.

Whether or not a social investment is being made is determined by the motivation of the charity – if the reasons for applying funds in a particular way include both directly furthering the charity’s purposes and making a financial return then the proposed action will be a social investment. The definition is wide and may include some actions which would not ordinarily be thought of as investments.

In view of this, charities should consider which (if any) activities of their charity fall within the definition of ‘social investment’. This is because trustees have specific legal duties which apply when making social investment decisions and they should be able to show that they have made these decisions in good faith.

The statutory power does not change the fact that a charity must act in furtherance of its own charitable purposes.

Most charities have power to make social investments. This power is set out in legislation, meaning that, in many cases, the law gives this power to charities without the trustees needing to change anything.

It is important to note that the statutory power can be restricted by a charity’s governing document, so it will still be necessary to check a charity’s governing document before making any investment to ensure that the charity has the necessary power. If trustees are in any doubt about their charity’s powers then they should take specialist legal advice.

The statutory power does not apply to charities established by, or whose purposes and functions are set out in, legislation, or charities established by Royal Charter. These charities will need to continue to rely on their existing constitutional powers, which will not be affected by this new legislation.

Section 292C Charities Act 2011 imposes specific duties on trustees when making decisions about social investments. These duties apply in place of statutory duties which relate specifically to financial investments. Before exercising any power to make social investments, whether this is the statutory power or another power, such as one found in the charity’s governing document, trustees must:

- consider whether in all the circumstances any advice about the proposed social investment ought to be obtained

- obtain and consider any advice which they conclude ought to be obtained; and
- satisfy themselves that it is in the interests of the charity to make the social investment, having regard to the benefit they expect it to achieve for the charity, by directly furthering the charity's purposes and achieving a financial return

Trustees must also review their charity's social investments from time to time. There is no specific period of time after which a review should be carried out, and the appropriate amount of time will vary depending on the circumstances applying to a particular charity. This should be decided by the trustees in each case.

When reviewing social investments, trustees must:

- consider whether any advice about the social investments (or any particular social investment) ought to be obtained; and
- obtain and consider any advice they conclude ought to be obtained

These duties apply whenever trustees do anything which meets the definition of social investment, whether or not they are using the statutory power. This means that trustees must always consider whether or not a particular action might constitute the making of a social investment, and comply with the duties if they decide that it does.

In a situation where the specific statutory duties of trustees under ss4 and 5 Trustee Act 2000 would apply in relation to social investments, s292C(6) Charities Act 2011 disapplies the Trustee Act 2000 duties in favour of the statutory social investment duties.

Permanent endowment and social investments

The statutory power only allows a social investment to be made using assets which are held as permanent endowment, or the giving of a guarantee which would put permanent endowment assets at risk, where the trustees of a charity expect that the making of the social investment will not contravene any restriction with respect to expenditure that applies to the permanent endowment in question.

This means that social investments with an anticipated negative financial return (where the trustees expect to receive back less than the initial investment) or uncertain financial return cannot generally be made using permanent endowment.

However, charities that have resolved to invest on a total return basis can resolve to make social investments with a negative or uncertain financial return. Any losses must be expected to be offset by gains elsewhere in the total return investment portfolio. Trustees must follow the rules in the Charities (Total Return) Regulations 2013 (as amended) to adopt a power to make social investments of this type.

Trustees of charities with permanent endowment who want to make social investments with a positive financial return will still need to ensure that they understand the restrictions which apply to permanent endowment expenditure before making social investment decisions regarding it. Trustees may need to seek professional advice on this subject.

Where the trustees conclude that they expect that restrictions will not be contravened, this expectation should be reasonable, and should be determined based on a consideration of all of the available evidence, including professional advice if required.

Guarantees

The definition of an act which can be a social investment includes the taking on of a commitment in relation to the liability of another person. In this document, for ease of reference, we have referred to this type of commitment as a 'guarantee', although there are other types of such commitments. A person who gives a guarantee (in other words, agrees to take on a commitment) is referred to as a 'guarantor'. There are a range of situations in which this type of commitment might be taken on.

The giving of guarantees needs to be approached with caution. Giving a guarantee means agreeing to be responsible for paying costs or liabilities which would otherwise be paid by someone else. An example would be agreeing to pay a tenant's rent to a landlord if the tenant does not pay it, or agreeing to repay a loan to a bank if the borrower does not keep up their repayments. Depending on the terms of the guarantee, the costs which a guarantor might be required to pay may be unpredictable. For example, a guarantee given to a landlord might include the guarantor being required to compensate the landlord for breaches of the tenancy agreement by the tenant.

If a charity is asked to give a guarantee, the trustees will need to consider carefully whether they have the power to give it. The power to make social investments includes a power to give guarantees if they meet the definition.

It is important to remember that, in order for a guarantee to be a social investment, it must be made both with a view to directly furthering the charity's purposes and achieving a financial return.

The legislation says that a guarantee is regarded as ‘achieving a financial return’ if it is not called upon, or if it is called upon without resulting in the expenditure of the whole of the funds or other property put at risk. This means that, in order for a guarantee to be a social investment it does not need to result in any money coming back to the charity (whereas other forms of social investment do).

Where a charity has the power to give a guarantee as a social investment, it is important to remember that part of the reason for giving the guarantee must be directly furthering the charity’s purposes. That means that the giving of the guarantee itself must be intended to further the purposes of the charity. For example, a homelessness charity might give a guarantee to a landlord in respect of a tenant’s payment of rent on the basis that, in the absence of that guarantee, the tenant would be unable to find accommodation.

Private benefit

Any private benefit arising from an investment by a charity, for example to the proprietors of the company in which the investment is made or to other investors, would need to be legitimately incidental to the furtherance of the charity’s purposes. Any private benefit must be a necessary part of a course of action which is determined by the trustees to be an efficient and effective way of furthering the charity’s purposes or it must necessarily result from such a course of action.

5. Other issues relating to the trustees’ power to make financial investments

Liability for breach of trustees’ duties

If trustees act in breach of their investment duties, they may be liable to the charity for any loss. In Nestle v National Westminster Bank plc [1993] 1 WLR 1260 trustees misunderstood their power of investment and did not invest in the full range of investments that they might have. However, no loss to the trust was proved so there was nothing for which they were liable.

The court takes a different approach to trustees depending on whether they are lay trustees who are unremunerated or trustees who are remunerated and in that position because of special skill and knowledge. In the first case the court is more likely to accept that trustees should be excused from being liable for any loss to the charity provided they have acted honestly and in good faith.

As Brightman J indicated in Bartlett v Barclays Bank Trust Co. Ltd:

“The distinction is between a prudent degree of risk on the one hand and hazard on the other. Nor must the court be astute to fix liability upon a trustee who has committed no more than an error of judgment, from which no businessman, however prudent, can expect to be immune.”

Brightman LJ then cited Lopes LJ in In re Chapman [1896] 2 Ch 763, 778:

“A trustee who is honest and reasonably competent is not to be held responsible for a mere error of judgment when the question which he has to consider is whether a security of a class authorized, but depreciated in value, should be retained or realized, provided he acts with reasonable care, prudence, and circumspection.”

In the case of Stanway v A-G and others 5 April 2000 Chancery Division No. HC0000852 the Vice-Chancellor, Sir Richard Scott, found in the circumstances of a case involving trustees who had acted honestly and without reward that an action “should not be brought against them, or any of them, unless it can be seen to be a good action – not just a possible action, not even just an action more likely to succeed than to fail, but an action which looks pretty copper bottomed.”

Of course, each case depends on its facts and trustees do need to ensure that they comply with their duties as trustees. However, an honest and reasonably competent trustee is unlikely to be held liable for any loss.

Holding financial investments

Who can hold investments for an unincorporated charity?

Unincorporated charities do not have their own legal identity, and therefore the charity trustees will have to hold the investments in their own names or appoint one or more people or a corporate body to hold investments on behalf of the charity.

Who can hold investments for an incorporated charity?

Charities which are companies or charitable incorporated organisations are corporate bodies and therefore have a legal identity. As a result, they can hold investments in their own name. They may decide that this is not the best option for them and opt to delegate the holding function to a nominee.

Can trustees appoint nominees and custodians?

A nominee is a person appointed to hold assets in their name on behalf of the charity.

A custodian is defined in section 17(2) of the Trustee Act 2000 as someone who undertakes the safe custody of the assets or any documents or records concerning the assets.

Under section 16 of the Trustee Act 2000 trustees may appoint a person to act as nominee of such assets as they decide except that they cannot do so in respect of settled land. The assets can be vested in the nominee. Such an appointment must be in writing or evidenced in writing.

Under section 17 of the Trustee Act 2000 trustees may appoint a person to act as custodian in relation to such assets as they may decide.

Accordingly, it is possible for a charity to have a nominee and a custodian in respect of the same assets. However, where a charity has a custodian trustee it cannot appoint either a nominee or a custodian. It can also not appoint a nominee or custodian in respect of any assets vested in the Official Custodian.

Under the Trustee Act 2000 the term ‘custodian trustee’ has the same meaning as in the Public Trustee Act 1906. However, that act does not define ‘custodian trustee’ as such. Section 4 states that the Public Trustee may be appointed as a custodian trustee and sets out the powers they will have. It also states that this will apply to any banking or insurance company, or other body corporate entitled by rules made under this Act to act as custodian trustee’.

So, it would appear that where the term appears in the Trustee Act 2000 it refers to a situation where the Public Trustee or a corporate body is the custodian trustee.

The term ‘custodian trustees’ is sometimes used for persons appointed under a governing document to hold property on behalf of the managing trustees. As with the situation set out in section 4 of the 1906 Act, usually they are required to deal with the property in any way they are instructed to do by the managing trustees. However, as section 4 does not expressly govern such a situation, they will only have the powers conferred by the governing document. This is indistinguishable from the position of holding trustees.

Total return

Some types of investment return are allocated to income (the trust for application) and some to capital (the trust for investment). A total return approach to investment is where both the income return and any capital uplift are amalgamated as the total return.

Charities without permanent endowment do not have restrictions on spending their capital and they can spend the total return on furthering their purposes as well as the underlying capital. Permanently endowed charities can usually only spend the income from their capital on furthering their purposes. If they wish to take a total return approach to investment, this has to be appropriately authorised. Although this can be by an order or scheme of the Commission, the Total Return Regulations 2013 (as amended) provide a power for trustees to resolve to adopt a total return approach to investment. The Commission has separately issued guidance on this topic for charities, Total return investment for permanently endowed charities (https://www.gov.uk/government/publications/total-return-investment-for-permanently-endowed-charities) .

6. Other issues relating to the trustees' power to make financial investments and to their power to make social investments

Gifts of shares

Donors to charities may give donations by way of shares, sometimes in a family company in which the founder of the charity has a significant interest. The duty in respect of such shares is for the trustees to decide whether it is in the interests of the charity to hold and retain the shares. In some cases this may take the form of a social investment, such as where retaining a shareholding is motivated in part by its directly furthering the purposes of the charity.

In the case of shares held as financial investments, the standard investment criteria will apply so that the trustees have to review the holding of the shares from time to time and, having regard to the investment criteria, to vary them if appropriate. Accordingly, the trustees will have to have regard to suitability and the need for diversification. Having said this, where there is a gift of shares, other factors may also require consideration such as the likelihood of the donor making further donations to the charity and whether the advantages of this outweigh any risks involved in continuing to hold the shares.

Sometimes donors impose a condition on a gift that the trustees cannot sell the shares without the agreement of the donor. The Commission takes the view that this power of veto by the donor is a fiduciary power which has to be exercised in the interests of the charity's purposes and not in the donor's interests. In any event, the trustees' duties will still be to review the investments. If they consider they need to diversify but the donor refuses consent, the trustees may wish to apply to the commission to vary the governing document of the charity.

Where a gift of shares results in the charity owning a majority shareholding the responsibilities of the trustees are to manage that in the interests of the charity. Similar considerations arise to those described in the section on trading companies established by a charity for income generation purposes.

Trading Companies

Many charities have trading companies. This may be for the purpose of income generation or for the purpose of conducting activities which further the purposes of the charity, or both. Any provision of funds for such a trading company can be justified as either a proper exercise of the general power of investment, as a means of directly furthering the purposes of the charity, as a way of mitigating risk to the charity's assets, or a combination of these factors. In the case of justification as a financial investment, if the return from the trading company does not justify the investment in it, then the charity trustees need to attend to this.

The duty of trustees with regard to a company in which they are the sole or majority shareholder were set out in In re Lucking's Will Trusts [1968] 1 WLR 866, 874 where Cross J said:

"Now what steps, if any, does a reasonably prudent man who finds himself a majority shareholder in a private company take with regard to the management of the company's affairs? He does not, I think, content himself with such information as to the management of the company's affairs as he is entitled to as shareholder, but ensures that he is represented on the board. He may be prepared to run the business himself as managing director or, at least, to become a non-executive director while having the business managed by someone else. Alternatively, he may find someone who will act as his nominee on the board and report to him from time to time as to the company's affairs. In the same way, as it seems to me, trustees holding a controlling interest ought to ensure so far as they can that they have such information as to the progress of the company's affairs as directors would have. If they sit back and allow the company to be run by the minority shareholder and receive no more information than shareholders are entitled to, they do so at their risk, if things go wrong."

Directors of non-charitable companies may commit their companies to ventures which would be too speculative for trustees to undertake directly. However, the creation of a wholly or majority owned company by trustees does not discharge the trustees from responsibility for the decisions of the company. The Garfield Weston Foundation Regulatory Case Report in 2010 is an example of the Commission applying the principle that trustees of a charity that owns a controlling interest in a company have a duty to the charity to exercise that control so as to safeguard the interests of the charity. In Bartlett v Barclays Bank Trustee Co. Ltd Brightman J said "The bank, as trustee, was bound to act in relation to the shares and to the controlling position which they conferred, in the same manner as a prudent man of business. The prudent man of business will act in such manner as is necessary to safeguard his investment. He will do this in two ways. If facts come to his knowledge which tell him that the company's affairs are not being conducted as they should be, or which put him on inquiry, he will take appropriate action. Appropriate action will no doubt consist in the first instance of inquiry of and consultation with the directors, and in the last but most unlikely resort, the convening of a general meeting to replace one or more directors. What the prudent man of business will not do is to content himself with the receipt of such information on the affairs of the company as a shareholder ordinarily receives at annual general meetings. Since he has the power to do so, he will go further and see that he has sufficient information to enable him to make a responsible decision from time to time either to let matters proceed as they are proceeding, or to intervene if he is dissatisfied."

Sometimes charities set up companies (whether charitable or not) for the purpose of furthering their purposes rather than for the purpose of income generation. The reason for doing this may be to protect the main charity from any liabilities arising from a particular activity of the charity. However, it must still be borne in mind that the trustees will still have responsibility for the activities of the company so that setting up a company to do things the trustees themselves did not have the power to do is not likely to succeed except where the funding of the company is justified as a financial investment.

In Abbey Malvern Wells Ltd v Ministry of Local Government and Planning [1951] Ch 728 Danckwerts J said

"Therefore, while the company theoretically has the power to apply its property and assets for the purpose of making profits and devoting the resulting profit to the distribution of dividends among the members, when I proceed to inquire who are the persons who regulate the operations of the company, I find that they are not free persons unrestricted in their operations, but are the trustees of the trust deed, who may only act in accordance with the provisions of that deed, may only use the property of the company in a particular way, and must not make use of the assets of the company for the purpose of a profit-making concern."

Delegation of investment management

The Trustee Act 2000 gives trustees certain powers to delegate management of their investments. These powers are in addition to any powers of delegation that are stated in a charity's governing document.

The powers for trustees to appoint agents in section 11 of the Trustee Act 2000 include appointing an agent to carry out 'any function relating to the investment of assets subjects to the trusts (including, in the case of land held as an investment, managing the land and creating or disposing of an interest in the land'.

Under section 13(1) of the Trustee Act 2000 a person who is authorised under section 11 to exercise the general power of investment is subject to the duty to have regard to the standard investment criteria when exercising any power of investment. Such a person is also subject to the duty to review the investments of the trust from time to time and consider whether, having regard to the standard investment criteria, the investments should be varied.

Under section 14 the trustees may authorise a person to exercise such a function on such terms as to remuneration and other matters as they may determine. With regard to terms which

- permits the agent to appoint a substitute
- restricts the liability of the agent or his substitute to the trustees or any beneficiary
- permits the agent to act in circumstances capable of giving rise to a conflict of interest the trustees may not authorise a person to exercise such a function as their agent

unless it is reasonably necessary for them to do so.

Section 15 sets out limitations on the appointment of an investment manager. There has to be an agreement in or evidenced by writing. The trustees must have prepared a policy statement giving guidance as to how the function should be exercised. The agreement must include a term that the agent will secure compliance with the policy statement (which must also be in writing or evidenced by writing). The trustees must formulate any guidance given in the policy statement with a view to ensuring the functions will be exercised in the best interests of the trust.

The previous provisions relate to the delegation of the financial investment of assets. It does not authorise the delegation of programme related investment. The delegable functions set out in section 11(3) of the Trustee Act 2000 are:

” (a) any function consisting of carrying out a decision that the trustees have taken

(b) any function relating to the investment of assets subject to the trust (including, in the case of land held as an investment, managing the land and creating or disposing of an interest in the land)

(c) any function relating to the raising of funds for the trust otherwise than by means of profits of a trade which is an integral part of carrying out the trust’s charitable purpose

(d) any other function prescribed by an order made by the Secretary of State.”

Under section 25 of the Trustee Act 1925 a trustee may, by power of attorney, delegate the execution or exercise of all of any of the trusts, powers and discretions vested in him or her as trustee either alone or jointly with others. The section sets out the form the deed should take and various matters regarding it.