# charitytimes

# Trustee Guide 2018

</CHARITY DIGITAL CODE>

edentree investment management

icsa The Governance Institute

the good exchange

Reach Volunteering

pwc

SARASIN & PARTNERS

## Contents:


27 **Young trustees**
Eleanor Urben looks at the benefits of recruiting young trustees, plus how to attract and keep them on board.

28 **Trustee eligibility**
Appointing trustees who aren't eligible for trusteeship can have serious consequences. Louise Thomson explains how to mitigate the risks.

29 **Annual reports**
Daniel Chan looks at the key criteria needed for an open, transparent and engaging annual report.

30 **Technology and giving**
Ed Gairdner looks at how charities can use technology to drive greater collaboration to advance place and theme-based giving.

31 **The Digital Code of Practice**
New guidance is available to help charities embrace digital. Zoe Amar explains what it will look like and how it can help trustees.

32 **Fraud awareness**
Fraud is a growing concern for all charities and trustees need to remain aware to avoid losing out, says Mia Campbell.

33 **Ethical investing**
On which side of the ethical fence do Facebook, Apple, Amazon, Netflix and Google-Alphabet sit? Caroline Jarvis Gee explores.

34 **Managing risk**
Understanding investment risks and planning ahead is crucial for mitigating any unnecessary problems, says Robert Boddington.

# Bring on board some youthful diversity

*Charity Commission research found trustees are not representative of the communities they serve, thus it is essential to bring a bit of youth to the table.*

The average age of a charity trustee is 61[i] . Yet diversity improves governance and organisation success[ii]. Given that 85% of people under 35 would consider becoming a trustee it is clear that charities should be exploring ways to recruit young people.

**What are the benefits of young trustees?**

- Contributing a different perspective and fresh insights to board discussions and a healthy challenge to established assumptions and ways of doing things.
- Enthusiasm for learning the role – they are often keen to develop their existing skills whilst helping a charitable cause. This enthusiasm means that they will be more likely to bring energy, creativity and new ideas.
- If your beneficiaries include young people, young trustees can provide useful insight and perspectives on beneficiary needs and experience, and increase the board's credibility in the eyes of this group.
- Benefits the charity sector as a whole as it helps to engage younger people with sector, developing the next generation of potential charity leaders and supporters.

**How to attract them and keep them**

Ensure that your advert and role description are written in a way that attracts young people and does not include criteria which excludes them. Consider testing out recruitment materials on young people first. Signal your openness and recruit via multiple channels, beyond your usual networks.

One of the biggest obstacles young trustees face is lack of flexibility with their time, because they are likely to be in employment or education. Be open to adapt to the needs of your trustees by giving plenty of notice prior to board meetings and scheduling meetings for a time which all trustees can make.

It is also important to offer young trustees a good induction process to ensure that they feel supported and valued whilst gaining a deeper understanding of their role.

An existing trustee could take on the role of a mentor to provide for a young trustee. Recruiting more than one young trustee at a time can help them feel less alone. Resources, such as The Young Charity Trustees Guide can also be useful.

Depending on their background and experience, you might need to consider other ways of ensuring that your young trustee can participate on an equal footing with other trustees. Consider how you can make your board papers more accessible, and your meetings engaging. All trustees will benefit from this. Giving young trustees a specific role or focus area that they can take the lead on can be a good way to empower them.

**Inspiration**

Chantal Chang, young trustee, Leap Confonting Conflict: "The other trustees are keen to hear what I have to say because I'm aware of the challenges for young people and can provide insight into how our work really affects them."

Vicky Smith, young trustee, Focus Birmingham: "I wanted to expand my understanding of leadership at a governance level in practice. And it's a cause I feel really passionate about. It was a perfect fit because the charity was looking for someone with marketing and fundraising skills and I have significant relevant experience."

***Written by Eleanor Urben, Trusteeworks Manager at Reach Volunteering***

---

i https://www.gov.uk/government/publications/taken-on-trust-awareness-and-effectiveness-of-charity-trustees-in-england-and-wales

ii https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters

iii https://www.cafonline.org/docs/default-source/about-us-publications/youngtrusteesreport_1682a_web_080915.pdf?sfvrsn=8

# How to ensure trustee eligibility

*Appointing trustees who aren't eligible for trusteeship can have serious consequences on both the individual and the board. Here's how to avoid unnecessary recruitment risks.*

Inherent in building and maintaining an effective board is having robust systems for recruitment, appointment and induction of trustees, backed up by ongoing support and development. It is essential that the right people are recruited to the board, not just in terms of skills, attributes and competences, but also in ensuring an individual meets the legal and constitutional eligibility criteria.

**Check what your governing document says**

Generally, a charity's governing document will provide details as to who can and cannot be a charity trustee. The common criteria for trustee disqualification include:

- ceasing to be a member (where the charity operates a membership structure);
- being unable to manage their own affairs;
- non-attendance of trustee meetings – normally a set figure or a timeframe;
- being convicted of an offence; and
- bringing the charity into disrepute or not acting in its best interests.

All prospective, and existing, trustees should be aware of criteria specific to their charity and ensure that they meet the requirements before appointment and whilst in position.

**Legal considerations**

The Charities (Protection and Social Investment) Act 2016 introduced new limits on who can be a trustee and, as of 1 August 2018, extended the regime to cover senior managers. The full list of criteria that would disqualify an individual from becoming a trustee are noted below. Those that came into force on 1 August 2018 are shown in italics.

- Being under age (over 16 years to be a director of a charitable company limited by guarantee or a charitable incorporated organisation, or over 18 years for trusts and unincorporated associations)
- *Being on the sex offenders register*
- An unspent conviction for an offence involving deception or dishonesty; *terrorist offences; money laundering; bribery; misconduct in public office, perjury, or perverting the course of justice; contravention of certain Charity Commission preventative orders; or attempting, aiding or abetting the above offences*
- *Contempt of court*
- *Designated individuals under specific anti-terrorist legislation*
- *Found guilty in the High Court of disobeying a Charity Commission order or direction*
- Removed from trusteeship, or as an officer, agent, or employee of a charity by the Charity Commission or High Court for misconduct or mismanagement; a position of management or control of a charity in Scotland for mismanagement or misconduct; being a director under the Company Director Disqualification Act 1986, including Company Directors Disqualification (Northern Ireland) Order 2002; directorship due to being an undischarged bankrupt; or directorship because of an ongoing composition or arrangement with creditors.

Charity Commission orders can also disqualify individuals from being trustees. In addition, for charities claiming Gift Aid, HMRC requires trustees and managers to meet the 'fit and proper persons test'.

**Waivers**

In certain situations a charity can approach the Commission for a waiver if an individual does not meet the eligibility criteria but the charity believes they can make a valuable contribution to the charity.

**Potential penalties**

Ultimately, trustees should be aware that it is an offence to act when disqualified. If a disqualified person is appointed, the appointment will be invalid. If problems arise and it emerges that existing trustees failed to follow Charity Commission guidance, the Commission may consider the trustees to have acted improperly.

Trustee recruitment is an ongoing challenge for many charities. Getting the basics right as to who can and cannot be a trustee is a fundamental part of embedding good governance within any organisation.

***Written by Louise Thomson, Head of Policy (NFP) at ICSA: The Governance Institute***

icsa

The Governance Institute

# What does the perfect annual report look like?

*Annual reports can be lengthy and time-consuming for trustee boards, but transparent reporting is essential for engaging with donors.*

There is no one size fits all 'perfect' annual report, and nor should there be given the diversity of the charity sector. However, there is a lot that charities can do to move beyond a minimum compliance lens in their reporting. Here are five areas that charities should consider as they take the journey towards authentic, engaging and impactful storytelling.

**Openness around context**

No charity operates in a vacuum and reporting should explain where the charity fits in the broader landscape and the societal need it is responding to.

The charity's purpose and strategy should be clearly set out, with a view to the medium to longer term. It is important that reporting brings the values of the charity to the fore through being open about its response to key sector issues, including fundraising, data protection, safeguarding and senior management remuneration, where appropriate.

**Openness in how you prioritise**

In an environment where funding is scarce, reporting needs to be clear about how and why key decisions are made and how resources are prioritised.

Reporting should consider how the needs of different stakeholders have been taken into account, such as funders, staff and volunteers, as well as beneficiaries and wider society. This should be aligned with clear explanations of the risks and uncertainties as well as opportunities for the charity, including how it is responding to a constantly changing external environment.

**Openness around governance**

The 'tone at the top' is important, often first communicated through a statement by the chair and chief executive. It is useful to explain the charity's governance structure, including any committees and the relationship between the trustees and senior management team.

It can also be helpful to comment on how the board of trustees is made up, including how, together, the trustees bring a diversity of background, skills, experience and thought to effectively meet charitable objectives.

However, people reporting should go beyond the trustees

and a comprehensive report will demonstrate how equality, diversity and inclusion across the charity is achieved.

**Openness in how you manage and measure performance**

The charity should be clear about its definition of success and how impact is measured. This means explicitly setting out performance, often alongside a comparison with the previous year and current targets, as well as against any longer-term ambitions. This should correlate with the charity's financial review, covering how, as well as how much, has been raised and spent and clarity on financial sustainability.

Great case studies will engage hearts and minds, but the charity should also be open about the challenges which have prevented it from being even more impactful, and how it has responded to them.

**Openness in how you communicate**

At their core, an annual report should embody the purpose and values of the charity. All aspects of reporting should be aligned and communicated with 'one voice', for example, by using an overarching theme. The charity should abide by the principles of open, balanced and authentic reporting, which will engage readers and make reporting stand out from the rest.

So, while there may not be one 'perfect' annual report, by embracing openness and investing in telling a clear, concise, consistent and compelling story, charities can demonstrate their value and build public trust.

***Written by Daniel Chan, Senior Manager at PwC. Chan is also a trustee and honorary treasurer for charity UK Youth***

# Using technology to drive greater collaboration to advance place and theme-based giving

*Technology-led collaborative philanthropy could do to the charity sector what streaming has done to the music industry and comparison websites have done for finding insurance.*

Pressure on the third sector has forced charitable causes to make ever more speculative applications to grant-makers for funds to try and close the gaps in their budgets. The applicant is predominantly responsible for seeking out and requesting funding from multiple grant-givers (in the hope that their request will meet the requisite eligibility criteria) and the grant-giver reacts to applications received rather than proactively finding and assessing all eligible charitable causes. Ineligibility was identified by the Directory of Social Change (DSC) back in 2010 when their research[i] found 36% of the almost one million applications made to the top 2,500 UK-based grant-making trusts were ineligible, equating to about 7 years of wasted effort (if each application took only 10 minutes to complete – feedback from our users is that it typically takes between one hour and one day to complete a funding application).

**So why has nothing changed since then and what can be done about it?**

Two areas spring to mind: The well-known reduction in local authority and central government and the reticence of many established funding organisations to move away from their existing funder-centric processes and to embrace new technologies.

The Good Exchange recommends establishing 'Collaborative Funding Programmes' - networks of grant-makers, philanthropists, businesses and public donors who work 'together' to tackle a known geographical/theme-based issue (or both) while maintaining autonomy over their own funds and grant making and disbursement processes. Underpinned by digital technology, these programmes identify the most relevant charitable organisations needing funding (facilitated by a shared application process) by matching charitable causes to individual grant-makers' funding criteria within the chosen programme. The programme provides an amalgam of funding budgets and collaborative funding opportunities giving grant-makers transparency of who else is matched to the same charitable causes. In addition, it accelerates problem and root cause resolution as well as addressing point-in-time needs. Technology-driven Collaborative Funding Programmes drives a greater collective impact in a community by proactively matching grant-makers to all charitable causes that meet their grant-giving criteria, enabling match funding grants to be awarded to incentivise public donations and other grants whilst delivering real-time clarity on total fundraising activity.

**What are the benefits to the charitable sector?**

- Drive targeted grant funding and fundraising activity towards areas of greatest need through collective support of areas of common interest such as place or issue-based problems (e.g. homelessness in Wales, knife crime in London or child poverty in the North East)
- Incentivise fundraising charitable organisations through match-funding grants to proactively drive their own fundraising activities and increase levels of self-sufficiency
- Equal access to grants for charitable organisations regardless of size, skills and resources
- Encourage collaboration and deliver transparency across the sector to help close the funding gap
- Deliver open access to real-time funding and fundraising data giving complete insight into need at the time of giving
- Measure and monitor the true social impact of funding on a cause, geography and/or campaign
- Cut the administrative burden across the entire charitable sector

Through a step-by-step journey, technology-led collaborative philanthropy will do for the charitable sector what streaming has done for the music industry and comparison websites for finding insurance. It's the only way for grant-makers, donors and fundraisers to ensure their money and resources go to those that need it most, have a measurable impact on social problems and build community engagement.

***Written by Ed Gairdner, COO at The Good Exchange***

[i] https://www.dsc.org.uk/wp-content/uploads/2015/09/IneligibleApplicationsfinal.pdf

# How The Charity Digital Code of Practice can help trustees

*The Charity Digital Code of Practice is set to help charities of all shapes and sizes embrace digital. But what will is cover and how will it help?*

Back in September 2015 I joined the board of a new charity. I'd sat on two separate charity boards before over a seven year period, and had unofficially been 'the trustee who knows about digital' on one of them. I was really excited about my new appointment and even more so when the chair asked me to help the rest of the board get up to speed with digital, and to understand the opportunities and risks it offered to the organisation.

**Why digital guidance was needed**

My day job is running a social enterprise and digital agency, which helps charities lead digital change more effectively, so I was pretty confident about helping my charity. However I was sure that there must be resources out there to help skill charity boards up with digital and most importantly to support them in understanding where they were at and what good practice looks like.

I Googled. Nothing. But fast forward a few years and the challenge of getting support for boards and digital remains.

I work daily with executive teams and boards who all want to understand why they should go digital, the key areas they should focus on, and where their gaps are. Meanwhile, a number of worrying reports including Lloyds Business Digital Index and *The Charity Digital Skills Report* showed that charities are falling behind with digital and urgency was growing to help them move forward.

What could help boards understand where they are but how they could either start using digital or getting more from it?

**What is The Charity Digital Code of Practice?**

Working alongside the Charity Commission, Office for Civil Society, the Association of Chief Executives of Voluntary Organisations (ACEVO), The Small Charities Coalition, and the National Council for Voluntary Organisations (NCVO), we've developed a framework to help trustees and their executive teams use digital to help their charities achieve their vision and mission. The framework will help your charity increase its impact, develop skills and be more sustainable.

The Code has been tested on more than forty charities, all at different stages of digital maturity and of varying sizes and causes. It's also been out to consultation across the sector. We've had more than 170 responses and plenty of positive feedback, as well as lots of helpful comments on what we can improve.

We'll be launching the final version of the Code at *http://charitydigitalcode.org* on 15 November during Trustees Week.

**How will it help small charities?**

Digital shouldn't just be for large organisations with big budgets. We've purposefully included best practice for small charities in the Code. Much of it is designed to be followed with no or limited resources. We are delighted to have worked alongside Small Charities Coalition in this endeavour.

**How will it affect charities?**

We don't want the Code to be a huge and onerous burden for the sector, and we've crafted it to highlight the opportunity that digital offers. It is not a regulatory requirement and focuses on principles and best practice.

That said, the Code is ambitious and shows the breadth of areas that need consideration in digital. We will be releasing more guidance on the expectations of charities when we launch the final version of the Code on 15 November.

Take a look at *http://charitydigitalcode.org*.

***Written by Zoe Amar, director of marketing and digital consultancy, Zoe Amar Digital. Zoe also sat on the Charity Times Awards judging panel and tweets from @zoeamar***

</CHARITY
DIGITAL
CODE>

# Taking a stand against fraud

*Fraud is a growing concern for all charities and trustees need to remain aware to avoid losing out*

Fraud is a significant and growing threat to the voluntary sector and is an issue that trustees cannot afford to ignore. But keeping up-to-date on the latest fraud threats and remedies can be a real challenge for trustee boards.

However help is at hand with this month's Charity Fraud Awareness Week taking place 22-26 October. Over five consecutive days the sector will be coming together to share experiences, knowledge and best practice in tackling fraud and financial crime.

The week is jointly led by the Fraud Advisory Panel and Charity Commission in partnership with more than 40 other charities, regulators, professional bodies and other not-for-profit stakeholders in an collective effort to make the sector a more unattractive target to fraudsters.

**What's available?**

A suite of posters, e-learning resources and practical helpsheets will address common risks such as the insider threat, cybercrime, bank fraud, grant and donation fraud and highlight the importance of getting to know your staff, volunteers, grant-holders and donors better. There is also a set of ten questions that every trustee board should ask about fraud. On the last day trustees will be able to put their questions to a panel of sector experts in a free live lunchtime webinar.

Twelve free places are also being offered to charity staff on an Accredited Counter Fraud Specialist course, starting in January 2019.

**The importance of tackling charity fraud**

With fraud and cybercrime are now so widespread (taken together they are the most commonly reported crimes in the UK) it is inevitable that every charity will be touched by fraud during its lifetime. Now, it is a case of when, not if.

As custodians of a diverse, vibrant and important sector charity leaders have a crucial role to fulfil in keeping their charity's funds, people and data safe. From a governance perspective the key question is this: do you have the right people, doing the right things, at the right time, and in the right parts of the organisation? This is why it is so important for trustees to set the tone at the top and to understand and manage their fraud risks properly.

Trustees are encouraged to use the week as a focal point for their own activities to educate and share best practice with one another. We are stronger when we work together to keep #CharityFraudOut.

**10 questions every trustee board should ask about fraud**

Do we:

1. Know about our responsibility to protect funds?
2. Have a fraud, bribery and corruption policy?
3. Understand our financial systems and the data we hold?
4. Have regular and frank conversations about fraud?
5. Take appropriate steps to know our staff, donors and partners?
6. Regularly review and test our financial safeguards?
7. Promote fraud awareness and understanding?
8. Encourage staff and volunteers to raise concerns?
9. Have a plan to respond to fraud?
10. Know who to tell if a fraud is discovered?

**How to get involved**

- Download and use the free campaign materials
- Join the conversation at #CharityFraudOut
- Organise some activities to make your staff and volunteers more fraud aware
- Watch, listen and share the short e-learning resources
- Read, enact and share the practical helpsheets

For more information please visit: https://www.fraudadvisorypanel.org/charity-fraud/get-involved/ or call 020 7920 8637.

***Written by Mia Campbell, Head of the Fraud Advisory Panel***

# The FAANGs: an ethical question

*Facebook, Apple, Amazon, Netflix and Google-Alphabet have experienced incredible growth in recent years, but on which side of the ethical fence do they sit? And what should charities consider before investing in them?*

Since the Global Financial Crisis, the world has enjoyed one of the longest bull markets in history fuelled in part by the incredible growth stories of the 'FAANGs' (Facebook, Apple, Amazon, Netflix and Google-Alphabet). Concurrently, charities have become increasingly sophisticated in how they seek to promote positive business practices in order to align their investment policies with their mission through Socially Responsible Investing (SRI). Many ask: on which side of our ethical fence do these technology giants fall?

Twenty years ago, if someone mentioned FAANGs it would conjure images of Halloween costume teeth, not today's technology behemoths – two of which (Apple and Amazon) were the first $1trillion companies in terms of market cap. Equally, in the traditional sense, poor SRI conjures industrial images of smouldering smoke stacks and heaving landfills. While it is easy to imagine those cheap plastic teeth clogging the local landfill from 1 November how might the FAANGs be ethically questionable overall?

For starters, SRI is not just about saving the environment; it is also about companies behaving and operating responsibly. This includes preserving the health and wellbeing of staff, the community in which it operates, and its users. With these in mind, what are some of the concerns that may affect charities' decisions to invest?

In the case of Facebook, praised for democratising communication and connecting the world through its availability in 100+ languages, some question the social media giant's contribution to mental health issues (user addiction and cyber bullying, for example) and privacy concerns over data mining and misuse. The company has failed to produce stronger environmental, social and governance (ESG) policies around these concerns and their overall business ethics appear weak. Many charities who want portfolios screened for code of conduct and avoidance of harm would question if investing in Facebook is something they would 'like.'

Equally, Apple, best known for cutting edge handheld technology and its loyal user following, have attempted to make inroads against accusations of negative environmental impact, largely due to obsolescence (your ancient swirl dial iPod is in a landfill somewhere!), by developing stronger policies around recycling and the sourcing of conflict minerals. However it still has questionable practices around supply chain, especially in its Chinese manufacturing plants where there have been accusations of excessive working hours, child labour, health risks and unpaid wages. Such headlines would undoubtedly give a child abuse or workers' rights charity pause for thought.

Amazon rounds out the big three. The company is infamous for poor labour relations and inadequate working conditions, and its aggressive tax avoidance recently raised the Archbishop of Canterbury's ire; he denigrated these failures as an abuse on the benefits system which must then support workers who do not receive a living wage. For those charities fighting to end working poverty and promote the ethical treatment of staff as well as health and well-being in the workplace investing in Amazon could represent a significant divergence from mission.

Ultimately the substantial financial growth in the FAANGs, and the good works that this growth can fund, is incentive enough for many investors to reconsider their shortcomings. Additionally, some charities who invest take the view that it is better to influence from the inside whereas disinvestment does not encourage change. Both arguments have merit. However, as charities increasingly recognise the financial disincentives caused by reputational damage and unaligned investment policies, one must ask where is the tipping point?

EdenTree Investment Management has a thirty year legacy of helping charities to invest responsibly. We routinely research, analyse and write on sustainable investment themes. Our range of 'Amity' funds hold over 250 different company stocks (each of which is responsible and screened for sustainability). An ethically sound company that is unlikely to be a good long-term investment will fail our process, as would a financially strong company that had questionable ethical practices.

***Written by Caroline Jarvis Gee, Charity Business Development Manager at EdenTree***

# Managing risk within charity portfolios

*Risk is unavoidable for charities, but understanding what they are, planning ahead and appointing the appropriate people to manage them are all key for mitigating unnecessary problems.*

Risk is a little word for a very big subject. Investors potentially face several types of risk – ***counterparty risk, reputational risk, income risk and investment risk.***

**Counterparty risk** is the risk of failure of the bank, fund manager or stockbroker managing your investments, who may also hold your securities and cash balances. Regulators and auditors closely supervise the financial services sector and there are several layers of investor protection in place. For example, custodians ring-fence their clients' assets from their own assets providing protection in the event of a custodian failing.

Nevertheless, disasters do occur and so it is prudent to appoint a firm of the highest quality, standing and credit-worthiness to manage your charity's investments.

**Reputational risk** is the risk of making an investment in a company whose activities are contrary to your charity's objectives or mission, causing discontent amongst your supporters, which may ultimately restrict the ability to raise funds in the future.

To mitigate this risk, many charities adopt a disciplined and sensitive approach to environmental, social and corporate governance (ESG) risks putting in place exclusionary negative screens to ensure that the investments are appropriate and sensitive. This approach is straightforward, transparent and ensures investments align with the Charity's ethical beliefs.

**Income risk** is the risk that the portfolio fails to generate the expected level of income, which results in a shortfall in cash flow and impacts operations or the ability to make grants.

Many charities now adopt a total return policy to income generation, which helps to mitigate the income risk, and under controlled circumstances charity law now permits charities with permanently endowed capital to do the same. However, whether you adopt a total return approach or not, diversification remains the key.

A portfolio should have multiple income streams, some that are fixed (fixed interest) to provide security and some which are variable (dividends and rents) that can grow to provide protection against inflation. Not only should equities be diversified across different companies, so should corporate bonds and property investments. Finally, the demise of the Icelandic banking system was a good reminder not to get complacent with cash deposits.

**Investment risk** at its simplest level is the risk of losing money. However, on the basis that a prudently managed portfolio of investments is well diversified across asset classes and within asset classes then a more conventional measure of investment risk is the volatility of investment returns.

History shows that some asset classes are much more volatile than others. A cash deposit provides broadly the same return every month, so the volatility of returns is low and reliable and hence we consider the asset class to be low risk. At the other end of the spectrum, equity returns even in normal market conditions can vary by 10% each month. Consequently, the volatility of returns is high and less reliable so more risky. If you have time on your side and are able to wait for prices to recover before selling then you could argue that equities are no more risky, but without sufficient time you might become a forced seller at what turns out to be the wrong time, which makes them more risky.

Why do investors hold volatile risky assets? Because over a very long period of time investors have been well rewarded with higher returns for taking the additional risk. For example over the last 100 or so years UK equities have on average returned over 4% per annum more than government bonds and nearly 5% more than cash. That said, at times one has had to endure unpleasant equity bear markets during which you had to hold your nerve and retain faith that things would recover.

The key then is to ensure that the amount of risk taken in pursuit of higher returns is appropriate for your charity.

A charity will typically have many different demands on its reserves. Some of the reserves might need to be spent relatively soon and some might form part of the charity's genuinely long-term reserves. The investment requirements of each are very different, but whether the reserves have a short, medium or long-term time horizon, the key is to ensure that you never become a 'forced-seller' of assets as this will invariably be at the point of maximum stress.

Constructing a policy that incorporates the different demands on the reserves can be daunting. To make the task more manageable, one needs to break down reserves into distinct 'pots' of money. Subsequently one can identify the investment risks for each pot and then mitigate the risks with an appropriate strategy.

The following table breaks down reserves into three pots;

# Trustee Guide

| | Short term reserves | Medium term reserves | Long term reserves |
|---|---|---|---|
| **Time frame** | 0 – 18m | 18m – 5yrs | 5yrs + |
| **Investment objective** | To improve on the returns from cash | A return that at least matches inflation | To maintain the real value whilst providing sufficient income |
| **Greatest risk** | The impact of <u>any</u> volatility | The impact of <u>some</u> volatility | The impact of <u>inflation</u> |
| **Asset allocation** | Cash, certificates of deposit & short dated government bonds | Predominantly fixed interest with some risk assets | Predominantly equities & property with some defensive assets |

those that are genuinely long-term and which can be invested for in excess of 5 years, those that are short term and that might be spent within the next 18 months, and medium-term reserves which fall between the two. In each case, we identify the investment time frame, objectives, greatest investment risk and appropriate asset class exposure.

**Short-term reserves** – the greatest risk for reserves that might need to be spent within the next 18 months is any form of volatility. Consequently, only low risk investments are appropriate; cash deposits, fixed term deposits or short dated government bonds. Despite these asset classes falling into the low risk category, they should still adhere to the fundamental rule of being well diversified.

**Medium-term reserves** – the longer investment time horizon means that one needs to be mindful of the impact of inflation, as even 2% inflation over five years can have a meaningful impact on the real (after inflation) value of the capital. This will require a higher level of investment risk and although bonds will likely form the core of the strategy, they are likely to be supplemented with equities and corporate bonds to provide some protection against inflation.

**Long-term reserves** – a long term investor is typically seeking a flow of income to spend today whilst maintaining the value of the reserves in real terms. History shows that a long-term investor's biggest risk is inflation, so to mitigate this the long term pot will be predominantly invested in real assets (equities and property) and supplemented with uncorrelated asset classes to reduce volatility; bonds, alternative assets and cash.

**Conclusion** – all investment involves risk, with the principal risks being counterparty risk and investment risk. The key is to identify the risks and then put in place a strategy to mitigate them.

Counterparty risk is mitigated through the appointment of a firm of the highest quality, standing and credit-worthiness. Investment risk is mitigated through a thorough understanding of the investment requirements, the identification of the greatest risks and finally the creation of a strategy to mitigate those risks.

***Written by Robert Boddington, Partner at Sarasin & Partners***