CHRISTIAN ETHICAL INVESTMENT GROUP

Ethical Investment: How Far May Charity Trustees Go?

Guidelines for Charity Trustee Investors

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Charity trustees, such as those who run the large number of relatively small local charitable trusts, or - in the case of the churches - those who are members of Parochial Church Councils (PCC's) or Diocesan Boards of Finance (DBF's), may sometimes find themselves with money to invest. This may be in the form of a legacy, perhaps, or funds accumulated over the years dedicated to particular purposes, such as the maintenance of the fabric of a building - perhaps an almshouse, or a church or chapel.

Technically, PCC's are 'excepted' charities and DBF's will be 'registered' charities. Charity law governs what they, and other charities, may do. What should the trustees of such bodies do with their money? Should they put it in the bank, or in a deposit account, or should they invest it in stocks and shares? They will naturally want a good return on their investment, but what other criteria are there to help them decide where to put the money for which they are responsible?

How far may charity trustees go in investing according to *ethical* criteria, and not just on the basis of *financial* considerations alone? They have a 'fiduciary duty', of course, to do the best they can for their beneficiaries, but to what extent should they use the money to further their *overall* objectives? Can they discriminate between investments on ethical grounds if this threatens to reduce their income, or must the money be invested simply to gain the best possible financial return?

These questions are growing in importance today. Charities have recently come under tighter legal regulation. Charity giving has become big business. The value of ethical investment funds has tripled in size (between mid-1994 and mid-1998) to around £2 billion. The ethical use of investment funds - by individuals and by groups - is now firmly on the agenda.

1. Source Documents

There are two main source documents setting out the various criteria which such trustees may use to help them make their decisions about these matters. They are:

1. The *Judgment* in the the Bishop of Oxford's case, *Harries and others V. Church Commissioners for England and another* ([1991] 1 WLR 1241, and [1993] 2 All ER 300), given in the Chancery Division on *25* October 1991, and

2. *Investment of Charitable Funds: Basic Principles,* booklet CC14, published by the Charity Commissioners (in a recent edition) in June 1996.

In his case *versus* the Church Commissioners, the Bishop of Oxford sought 'declarations that the commissioners were obliged to have regard to the object of promoting the Christian faith through the established Church of England and not to act in a manner which would be incompatible with that object when managing their assets' ([1993] 2 All ER 300f). Vice-Chancellor Nicholls, however, refused to make either of these declarations, having a fundamental difficulty with 'their ambiguity' (309h). The guidance given in his *Judgment* is not formally set out in, for example, numbered paragraphs, but is to be found within the general argument.

The Charity Commissioners' document offers the same general guidance, indicating that the interests of a charity are, in general, best served by seeking the best financial return. Their advice is given in three paragraphs in a section headed 'Ethical Investments'.

There is a discussion of the arguments set out in both these documents in *Charity Trustees and Investment Ethics: Guidelines for those making ethical investment decisions,* published by the Christian Ethical Investment Group in May 1996. There is also other Statute and Case Law that helps to clarify the details.

2. The Duties of Charity Trustees

The position is not, however, quite as simple or clear-cut as it may appear. There is more to it than 'financial criteria' alone. In the analysis below, the points made in the two source documents are set out separately and numbered for convenience and for ease of reference. The *Judgment* in the case brought by the Bishop of Oxford puts the position like this:

1. Charity trustees may hold property (i) for functional purposes in order to further the objectives of their charity (eg. owning 'hostels for the destitute', or 'office accommodation in which to carry out essential administrative work'), or (ii) 'for the purpose of generating money, whether from income or capital growth, with which to further the work of the trust. In other words, property held by trustees as an investment. Where property is so held, prima facie the purposes of the trust will be best served by seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence' ([1993] 2 All ER 304 c-d).

2. Where 'trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects their charity is seeking to achieve, they should not so invest', even if this 'would be likely to result in significant financial detriment' (304g).

3. When 'holdings of particular investments might hamper a charity's work either by making potential recipients of aid unwilling to be helped because of the source of the charity's money, or by alienating some of those who support the charity financially' the trustees 'will need to balance the difficulties they would encounter, or likely financial loss they would sustain, if they were to hold the investments, against the risk of financial detriment if those investments were excluded from their portfolio' (304j).

4. Trustees 'would be entitled, or even required, to take into account non-financial criteria' where 'the trust deed so provides' *(305a).*

5. Trustees 'cannot properly use assets held as an investment for other, viz non-investment, purposes' (305b).

6. The law does not require trustees 'to behave in a fashion which would bring them or their charity into disrepute (although their consciences must not be too tender...)' *(305c).*

7. Trustees 'must not use property held by them for investment purposes as a means for making moral statements at the expense of the charity of which they are trustees' (305d).

8. When 'those who support or benefit from a charity take widely different views on a particular type of investment', there is a 'real difficulty', but trustees 'may, if they wish, accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment' *(305e,g).*

9. When 'they are not so satisfied trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds an investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other.' *(305g).*

The Charity Comrnissioners' booklet *Investment of Charitable Funds: Basic Principles* puts forward broadly similar arguments, in this fashion:

1. Trustees should seek 'to obtain the best financial return from the charity's investments, consistently with

commercial prudence' (para.40).

2. Any decision 'to invest "ethically" by avoiding certain investments, or certain institutions, must be centred on the interests of the charity and not of the trustees' (para. 40).

3. 'Trustees may exclude investments on this ground only if it leaves them with a wide enough range of investments to produce an acceptable investment performance' (para. 40).

4. 'If trustees are satisfied that a particular range of investments would directly impede the furtherance of the objects of a charity or be of financial detriment then they may exclude that range. For example, investments may be excluded if they would result in a loss of financial support from subscribers' (para. 41).

5. Trustees 'should decline to invest in a particular company if it carries out activities which are directly contrary to the charity's purposes and, therefore, against its interests and those of its beneficiaries' (para. 42).

6. Trustees 'may not exclude, to the financial detriment of the charity, a particular range or class of investments in order to give effect to some moral or political belief held by the trustees but not directly related to the interests of the charity and its beneficiaries' (para. 42).

3. Interpreting the Principles

How can these principles be adequately interpreted? It is clear that there are no absolutely clear-cut guidelines, and that trustees will inevitably be faced with the need to decide between competing pressures, or priorities, in making practical decisions about their investments. There seem to be, however, the following ten main duties, grouped together under the general headings i. 'Fulfilling the Charity's Objectives', and ii. 'Applying Ethical Criteria':

i. Fulfilling the Charity's Objectives

Charities may have various types of assets - funds, cash, shares, property - and they can all be used to further their objectives. This may, for example, be (a) by owning or renting buildings in which to meet human need, or (b) office space from which to carry out their activities. It may be (c) by trading in such a way as to improve the conditions of the poor rather than to make a profit, or (d) by making loans to the poor in developing countries. In ways such as these, the charity's aims may be *directly* furthered or achieved. This is *(i) the duty to use the assets of the charity to further its objectives.*

Where investments are concerned, however, money should be invested to gain the best financial return for the good of the beneficiaries. This duty is laid down in the *Trustee Investments Act 1961* and is, in a sense, obvious. Charitable work to relieve human need in all its forms cannot be done unless it is adequately funded, and more money is always required. Where a pension fund is concerned, with its narrow objectives, the main interests of the members of the scheme will be clearly financial. This is (ii) *the duty to gain the best financial return for the beneficiaries.*

The objects of a charity may themselves, expressly or by implication, place restrictions on how money is to be invested. A charity's trust deed may itself forbid certain types of investment, or presume certain restrictions. Some activities actually conflict with, or hamper the achievement of the objectives of some charities. A cancer charity should not invest, for instance, in tobacco when it is known that tobacco causes cancer. A Christian charity could hardly invest, we might presume, in an organisation promoting an activity that was a denial of its basic beliefs, though this might, in practice, be difficult to identify with any certainty. On these grounds, certain investments may be positively avoided, or a decision made to sell certain shares. This is (iii) *the duty not to act in a way that conflicts with the objectives of the charity's trust deed.*

It would not be sensible to invest in an activity that (a) brought the trustees or the charity itself into disrepute, or was disreputable, (b) made the beneficiaries unwilling to accept the help offered and caused offence to a substantial number of them, or (c) alienated financial support or potential financial support. To do so would hamper the achievement of the charity's objectives. There is great scope for argument and debate, of course, in the attempt to judge whether investing, for instance, in arms production was wrong because it brought death to others, or right because it enabled adequate defence against aggression. The fact that controversy might arise would not, in itself, cause publicity that might damage the charity. This is, however, *(iv) the duty not to bring the charity into disrepute, offend its beneficiaries, or alienate its supporters.*

Trustees are under an obligation to seek professional advice in making their investment decisions and, in all these cases, carefully-balanced judgements cannot be avoided. There would be no point in having trustees if they were only allowed to 'rubber-stamp' the advice of others. In making their investment decisions, however, trustees should think of the overall aims of the charity, and not of their own personal views, or even the views of a majority of their supporters. This is *(v) the duty to act prudently.*

ii. Applying Ethical Considerations

Because trustees have the duty to further the aims of their charity, they cannot properly use their money for some ulterior purpose, to make a social, moral or political point which is not directly related to their objectives (though they may do so to accommodate the views of those who object to certain investments if no financial risk is involved). This applies both to a positive choice in favour of, or a negative choice against, any particular investment, if this is their motivation. Taking funds dedicated to one purpose and using them for another would be a breach of trust. This is *(vi) the duty to use their funds for the purposes for which they have been given, and not to use them for unrelated social, moral or political purposes.*

In general terms, restrictions on ethical grounds (avoiding certain investments) may be adopted, provided this does not reduce the scope of investment opportunity so that 'significant financial detriment' is incurred. There must be a wide enough range of investments to produce an acceptable investment performance. Diversification, investing in a wide range of activities, is well-known to be sensible. This is *(vii) the duty to spread the risk across a variety of types of investment.*

In evaluating some of these matters in his paper *Ethical Investment - A Legal Overview,* the Bishop of Oxford's lawyer, Andrew Phillips, has deduced that 'significant financial detriment' might follow from a particular investment if the staff, or the volunteers on which the charity depended, 'would be seriously alienated and/or demotivated' or where the trustees 'might also be demotivated and might resign', as a result. In assessing this, a 'balancing act by the trustees' would be required, 'seeking to exclude too subjective a consideration of the same' (p.3).

Care would need to be taken in identifying such a situation. If other equally suitable trustees or staff were willing to take the place of any who resigned, the charity might not suffer significant dislocation, or serious demotivation, in its internal functioning, or attract unfavourable publicity, by making that investment. Financial detriment might not then occur. This is *(viii) the duty to put the interests of the charity before those of the individual staff volunteers or trustees, though not in such a way as to demotivate them if they could not be replaced by others without damaging the well-being of the charity.*

Further cases where ethical criteria should be applied, Phillips points out, will arise where a donor attached a condition to his or her gift 'in terms of what it must be used for and what it can be invested in in the interim', or where a charity 'solicits donations on the basis that they will be invested ethically (that word being defined)' (p.3).

In such cases, the money donated would have to be invested in accordance with the terms on which the gift was requested, or given. To use the money otherwise would be a breach of the trusts on which the money was accepted. This is *(ix) the duty to abide by any restrictions specified by the charity in seeking, or by the donors in making, donations.*

In his paper, Phillips concludes that a charity with 'no particular ethical bias in its constitution or objects' and with a large portfolio might 'place part of the same (albeit a very small part, say 1%) in what might be called ethical investments of an unconventional kind (particularly perhaps because of limited marketability)' (p.4).

Again, care would be needed in working out the implications of this. A company with an ethical policy that seemed to offer short-term risks but the possibility of good long-term gains might be acceptable, and might become more so as public attitudes to ethical considerations developed. There would also be financial grounds for avoiding businesses run in what seemed to be an unethical way. In any case, an ethical investment should be preferred to an unethical one where both seemed equally good, and ethical criteria could be used as a 'tie-breaker' to decide between two companies that seemed equally financially attractive. Applying ethical criteria in a positive way in deciding where to place an investment would coincide with exercising financial prudence, as well *as* being attractive to some potential investors. This is, then, (x) *the duty to use ethical criteria where financial prudence requires it, or allows it, or as a means of deciding between different investments of equal financial merit*

4. Guidelines for Trustee Investors

In conclusion, how might all this he summarised? If the above interpretations are consistent with the words and the implications of the source documents quoted, how might this advice be concisely summarised as a simple guide for other charity trustee investors? There may sometimes be conflict between these duties, but they can be summarised as a set of guidelines - do's and don'ts - as follows:

Ten Guidelines for Trustee Investors

1. Do use your assets and invest your money to further the objectives of your charity.
2. Do invest on financial criteria in order to gain the maximum return for your beneficiaries.
3. Do not invest in activities that conflict with the objectives of your trust deed.
4. Do not use your assets or invest your money in activities that might:
    a. bring you or your charity into disrepute,
    b. offend your beneficiaries, or
    c. stop people giving you money,

   and so hamper the achievement of your objectives.
5. Do invest prudently.
6. Do not invest your money to make a social, moral or political point unrelated to your objectives.
7. Do spread the risk across a variety of investments.
8. Do not act in such a way that your staff, volunteers or trustees, are seriously demotivated.
9. Do use your money for the purposes for which it was given.
10. Do use ethical criteria where prudence requires or allows it.

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