

The meaning of social investment in the Charities (Protection and Social Investment) Act 2016

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Charities have (or will very shortly have) a new statutory power to make social investments introduced by the Charities (Protection and Social Investment) Act 2016 (the Act). At the time of writing this article the date when the new legislation will be brought into force was unknown, but it is expected imminently. The new power is designed to remove doubts as to whether charity trustees can use their investment assets to make social investments.

The statutory definition of social investment is broad and requires an assessment of whether a charity invests with a view to both directly furthering the charity's purposes, and achieving a financial return. This article explores this definition and the parameters of this power for charity trustees.

Directly furthering a charity's purposes

An investment must 'directly further the charity's purposes'. The Explanatory Notes to the Act confirm that the word 'directly' does not preclude the achievement of the charity's objects by a third party, provided there is a 'sufficiently close causal connection' between the investment and the furtherance of a charity's purposes. In the absence of any legal clarification, trustees may decide to undertake a similar thought process when assessing any form of charitable activity – i.e. does this investment directly further the charity's objects rather than the financial return providing funds to a charity to apply furthering its objects.

In view of the need for a causal connection between the objects and the investment, it is perhaps questionable whether the new power enables the purchase of pre-existing social investments, e.g. shares in a social enterprise held by another investor. Where a pre-existing investment is purchased, the link between buying the shares from another investor and furthering the charity's objects is not clear, as the money to purchase the investment will be paid to the other investor, rather than to the social enterprise to support its work. While the Explanatory Notes don't tackle this point head on, they refer to an example of buying shares in a medical research company being potentially charitable because of the work done by that medical research charity. However, in this example, it is not clear whether the purchase is of shares held by another investor or a new issue of shares.



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Achieving a financial return

A social investment must be undertaken with a view to achieving a financial return. This requirement can be broken into three parts:

1. Whether an act by a charity is a 'relevant act'
2. What a financial return means
3. What assurances may be necessary to confirm that an investment is undertaken with a view to achieving a financial return.

These are considered in turn below.

Whether an act by a charity is a 'relevant act'

The legislation clarifies that a social investment is capable of involving: (a) an application or use of funds or other property; or (b) taking on a commitment in relation to a liability of another person (such as a guarantee) that puts the charity's funds or other property at risk of being applied or used. This broad definition means that an investment needn't be in cash and that it can include circumstances where no assets of a charity are applied at all, but a guarantee is given.

What a financial return means in relation to the investment

The meaning of 'financial return' depends on whether the investment involves applying charity assets or giving a commitment.

In investment terms, a financial return usually means that the initial capital invested is preserved and there

is some capital appreciation and/or income earned so that the total return is greater than the sum invested. The concept of financial return with a social investment differs because financial return means both a positive and negative return. Consequently the total returned to the charity investor can be less than the sum invested. This flexibility allows trustees to place weight on the charitable return expected and weigh this benefit against the expected financial returns to assess whether or not an investment is in a charity's best interests.

If the form of investment is applying funds (or other property), a financial return is where the financial outcome (ignoring whatever the charitable outcome may be) is better than expending the whole of the funds or other property. Consequently, so long as it is reasonably expected that there will be some form of return (even where this is less than the initial investment), then the test is satisfied.

Where the investment involves giving a guarantee or other commitment, the definition of financial return is satisfied provided that either the guarantee or commitment will not be called upon; or where, if it is called upon, this would not result in the entire amount guaranteed or committed being spent.

What assurances trustees might need to be satisfied that an investment is being undertaken with a view to achieving a financial return

The statutory power does not require generation of a financial return, given the nature of investment is that



the return is often uncertain at the outset. Instead, the obligation on the charity is that the investment is carried out with a view to achieving a financial return, as defined in the legislation.

We expect charities making social investments should have a reasonable expectation of making some financial return. Where an investment is very high risk and there is the potential for no financial return on the investment, the trustees should consider carefully whether there is sufficient expectation of a return being made, if they are relying on the statutory power.

The availability of the power

The power is (or will be) available to both incorporated and unincorporated charities, unless there is a provision in their constitutions excluding the use of the power, and excluding charities established by Royal Charter or as statutory corporations. This excludes most universities, national museums and a number of high profile charities from relying on the new power. It is not entirely clear why these charities are excluded, but trustees of these charities wishing to make social investments will have to consider what other powers may be available to them.

Charities holding permanent endowment must ensure that any investment (whether involving the application of funds or giving a commitment) does not use permanent endowment property, unless trustees are satisfied that the restrictions on expending it are not contravened by the investment.

Trustees' duties when making social investments (whether or not using the statutory power)

The general duties of charity trustees apply to the making of social investments and consequently the overriding duty of charity trustees will be to exercise the power in the way they consider to be in the charity's best interests, taking into account all relevant considerations.

The legislation introduces a list of steps that charity trustees must follow before making social investments, which apply irrespective of whether or not the statutory power to make the investment is being utilised. This requires that before a social investment is made, the trustees have:

1. Considered whether to obtain advice
2. Obtained and considered any such advice
3. Satisfied themselves that the investment is in the charity's interests, having regard to the benefit they expect it to achieve for the charity by furthering the charity's purposes and achieving a financial return.

The social investments of a charity must also be reviewed from time to time by the trustees, with

thought given to whether there is any need to obtain advice on the investments.

Use of the new power

There remain a number of issues around use of the power.

First, there is a concern as to how HMRC may treat social investments for tax purposes. It must be hoped that HMRC will clarify their approach to social investment to provide reassurance to charity trustees.

Secondly, there are concerns as to how trustees satisfy themselves that there is public benefit in the charitable element of a social investment, and that any private benefits are incidental, ancillary or subsidiary to furthering the charity's purposes. This analysis is fact-specific, and because there is little law in this area, it can be difficult for trustees to carry out this balancing exercise, particularly where the charitable return is not on its own sufficient to justify the investment. It is hoped that when the Charity Commission review and revise their investment guidance CC14: *Charities and Investment Matters: A guide for trustees* then this may offer some commentary on assessing private benefit when making social investments.

Next steps

The Act received Royal Assent in the middle of March and should shortly be available to trustees once regulations are made to bring the operative provisions of the Act into force.

Charities wishing to make use of the statutory power should check that the proposed investment falls within the definition in the Act. Furthermore, all trustees making social investments, irrespective of whether they use the statutory power, must ensure that they have complied with the particular duties that are described in the legislation.

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