

SOCIALLY RESPONSIBLE INVESTMENT BY CHARITIES¹

Robert Meakin²

Introduction

The aim of this article is to demonstrate that charity trustees must take into account socially responsible investment not only when investing charity funds but also when managing their charity's affairs generally.

What is Socially Responsible Investment?

An investment policy which combines ethical or moral goals with financial ones. Socially Responsible Investment can involve either positive or negative criteria. Negative criteria could involve a cancer research charity avoiding investments in tobacco, whereas positive criteria could involve an animal welfare charity deciding to invest in the Body Shop because none of its products involve animal experimentation. The decision about priorities is one for the trustees to resolve.

Why is Socially Responsible Investment Important Today?

Socially Responsible Investment can be a good investment

Five indices compiled by the Ethical Responsible Investment Research (EIRIS) under the Trustee Act 2000 achieved broadly similar returns to the FTSE All-Share Index between 1991 and 1998.³ So trustees, in fulfilling their duty to invest with such care and skill as is reasonable in the circumstances, having

¹ This paper first appeared in a European Association for Planned Giving "Give a Thought" booklet. For details contact www.plannedgiving.co.uk.

² Robert Meakin, Partner in the Charity and Education Group of Stone King, Solicitors, 39 Cloth Fair, London EC1A 7JQ. Tel: (020) 7796 1007 Fax: (020) 7796 1017.

³ *Financial Times*, 21st July, 1998.

regard to any special knowledge or experience that he or she holds himself out as having, and where he or she acts as a trustee in the course of a business or a profession any special knowledge or experience that is reasonable to expect of a person acting in the course of that kind of business or profession ('the duty of care')⁴ cannot ignore Socially Responsible Investment.

Consumer preference

Research shows that a large proportion of investors, if given the choice, would favour investments made taking into account ethical criteria. A survey of 300,000 people carried out for the Co-operative Wholesale Society in 1995 found that 60% would be prepared to boycott shops and products on ethical grounds. It is easy to see a link between this consumer preference and the potential for developing in the charity sector donor relationships by investing ethically in order to generate new funds and retain loyalty.

Socially directed investment

Following *Harries v Church Commissioners for England*⁵ ('the Bishop of Oxford's Case') it has been confirmed that charities can expend funds in furtherance of their objectives in ethical ventures rather than by way of investment. The Charity Commissioners have recently issued guidance on "charities and programme related investment" which should encourage the use of socially directed investment.⁶

Fund-raising

Socially Responsible Investments can be used as a fund-raising tool to encourage more people to give. For example donors could be told that until their donations are spent they will be invested in a socially responsible manner.

Endorsement of Socially Responsible Investment funds by charities

Charities have been known to endorse Socially Responsible Investment funds with their names and logos. The aim is to encourage people to invest in a way which will create pressure for change.

⁴ Trustee Act 2000, section 1. The duty set out in section 1 can be excluded. In which case it is submitted that the Trustees could be subject to the common law duty of the "ordinary prudent man" when investing for the benefit of people for whom the ordinary prudent man felt morally bound to provide. See *Re Whiteley* [1886] 33 ChD 347, per Lindley LJ at 355.

⁵ *Harries v Church Commissioners for England* [1992] WLR 1241.

⁶ Charities and Programme Related Investment (May 2001).

Reputation

A good example of socially responsible investment adversely affecting the reputation of a charity was the experience of the British Heart Foundation when it discovered that its employees' pension fund had invested in the tobacco industry. This was particularly embarrassing for a charity that campaigns against smoking.

Tax

Provision in the Finance Act 2000 to allow individuals and companies tax relief for gifts of listed shares and securities donated to charity when calculating their income or profits for tax purposes is expected to increase the scope for the development of socially responsible small investment. This could happen as a result of donors gifting their Socially Responsible Investment shares and securities to charities.

What is the General Legal Position in Relation to Charity Investment?

Power of investment

Trustees of charities will either have a general power of investment under the Trustee Act 2000⁷ or an express power under their governing instrument if the Trustee Act 2000 is restricted or excluded by that express power or by any enactment or any provision of subordinate legislation.⁸ Directors of charitable companies are not covered by the Trustee Act 2000⁹ and must therefore rely on express powers in their Memorandum of Association or the Trustee Investment Act 1961 as the case may be.

Exercising the power of investment

The rules prescribing the duties of charity trustees when exercising their power of investment have been developed through case law and the legal principles of equity. In general terms trustees must discharge the duty of care (set out above) and consider the suitability of investments and the need for diversification (see section 4 Trustee Act 2000). The Charity Commissioners have given guidance on

⁷ Trustee Act 2000, section 3.

⁸ Trustee Act 2000, section 6. It is highly unlikely that the Trustee Act 2000 will be restricted or excluded.

⁹ The Law Commission Report "Trustees' Powers and Duties" makes it clear that the Trustee Act 2000 is not intended to apply to directors of charitable companies.

what they regard as 'hazardous or speculative' investments which should normally be avoided by charity trustees (see CC14 'Investment of Charitable Funds'). Futures and interest rate swaps would, in the Charity Commissioners' view, be placed in this category, unless specific approval is obtained.

The Charity Commissioners advise in CC14 'Investment of Charitable Funds' that a sound investment policy must take into consideration:

- (a) the creation of sufficient income to enable the charity to carry out its purposes;
- (b) the maintenance, and, if possible, enhancement of the value of invested funds whilst they are retained.¹⁰

Trustee Act 2000

Following the enactment of the Trustee Act 2000 trustees have, subject to restriction or exclusion in their trust deed or by enactment or subordinate legislation, a general power of investment to the extent that they lack such a power. If anything, this will assist the growth of Socially Responsible Investment because it will open up the range of investments the trustees can invest in generally. Furthermore, the notes to the Trustee Bill set out in the Law Commission's report, 'Trustees' Powers and Duties (Law Com 260), mention that trustees will need to set out their Socially Responsible Investment policy in the required policy statement now included in the new Act itself. It is therefore contemplated that there will be a development of socially responsible investment.

The Duty of Charity Trustees in Relation to Socially Responsible Investment Considerations

Cowan v Scargill

In *Cowan v Scargill*¹¹ ('the Scargill Case') Sir Robert Megarry, Vice Chancellor, considered Socially Responsible Investment as it applied to the trustees of a pension fund. The question was whether it was legitimate for trustees to restrict funds to investments in the UK and prohibit investments in industries competing with the coal industry. He made the following observations:

¹⁰ For the common law expression of this recommended practice see *Harries v Church Commissioners for England* [1992] 1 WLR 1241.

¹¹ *Cowan v Scargill* [1984] 2 All ER 750.

Duties towards the beneficiaries paramount

The duty of trustees towards their beneficiaries is paramount. When the purpose of the trust is to provide financial benefits to the members, the best interests of the beneficiaries would normally be their best financial interests.

Trustees must put aside personal interests and views

In considering which investments to make, trustees must put on one side their own personal interests and views. In the Scottish case of *Martin v City of Edinburgh District Council*¹² Lord Murray added that if a trustee realised that he could not divest himself of his political or other beliefs then he should abstain from discussions or, in an extreme case, resign.

Trustees may have to act dishonourably

The trustees may have to act dishonourably (but not illegally) if the interests of the beneficiaries require it; for example, they may have a duty to 'gazump' when selling trust property in order to get the best possible price.¹³

Ethical tie-break

It is open to trustees to select some investments over others so long as the selection is not detrimental to the trust and is based on sound investment considerations and not perceived social and political programmes. This consideration is sometimes called the ethical tie-break, and with the development of the Socially Responsible Investment market and greater investment sensitivity to ethical issues it may well be the case that greater weight can be given to Socially Responsible Investment considerations today.

The Bishop of Oxford's case

The Scargill case must be read in conjunction with the leading charity case which is the Bishop of Oxford's case. Here the court was asked to consider whether it would be open to the Church Commissioners (as a charity) to avoid investments in armaments, gambling, alcohol, tobacco, newspapers and South African companies. Sir Donald Nicholls, Vice Chancellor, generally affirmed the Scargill judgment that it was the trustees' duty to carry out investment policy of the maximum return because this best secured the purposes of the charity. Therefore,

¹² *Martin v City of Edinburgh District Council* [1988] SLT 329.

¹³ Referring to *Buttle v Saunders* [1950] 2 All ER 193.

on the facts of this case the preferred investment policy could not be justified. He also commented, however, that there may be some instances where ethical considerations would override the need to get the best financial return.

Conflict with the objects of the charity

For example, cancer research charities and tobacco shares, trustees of alcoholic treatment charities and brewing shares, trustees of charities of the Society of Friends and shares in companies engaged in the production of armaments. It would be a legitimate investment decision to avoid these shares for such charities regardless of whether it would be to their financial detriment.

Hampering the charity's work

In some cases recipients of aid might be unwilling to be helped because they were conscious that the aid was financed from a dubious source. Another example would be if a charity's supporters were alienated by its investment policies. It must be said that it is difficult to imagine beneficiaries refusing aid because of its origins. In such cases the trustees need to balance the financial detriment to the charity by excluding investments as against the financial gains to be made by holding them. If they conclude that by making such investments the overall financial detriment will be greater they would be justified in excluding them.

Conflicting moral views of some beneficiaries or supporters

This would involve cases where although the investments of the charity are not in direct conflict with the objects the charity some beneficiaries or supporters consider that certain investments were inappropriate. For example, a religious charity holding investments in the arms industry. Trustees may accommodate such views so long as they are satisfied that such a course of action would not involve a risk of significant financial detriment. It should be noted that in many cases not all beneficiaries or supporters will necessarily hold the same view over moral issues. In the Bishop of Oxford's case Sir Donald Nicholls VC wryly observed that: 'to say that not all members of the Church of England eschew gambling, alcohol or tobacco would be an understatement'.

The charity has an express power of investment that allows for Socially Responsible Investment

If a charity has a power of investment which allows for a Socially Responsible Investment policy then this will be acceptable. This is at the moment quite rare and with the advent of the general power of investment in the Trustee Act and

modern drafting practice to include power of beneficial owners in governing instruments, perhaps unnecessary.

Socially directed investment

The Bishop of Oxford's case gave consideration to one socially directed investment which might be to the financial detriment of the charity. It was suggested that the land owned by the Church Commissioners in a village where local young people found housing impossible to afford, could be made available for low-cost housing at a price below open market value. The court rejected this view since the Church Commissioners were not a housing charity and did not have the necessary power to carry out the plan. Conversely, if the Church Commissioners had been a housing charity this would have been acceptable, irrespective of financial gain, as it would have been in direct furtherance of the charity's objects rather than a pure investment.

Socially Directed Investment Explored

To develop this further, if a charity has, for example, objects to relieve poverty by providing housing then the charity could, subject to having the necessary powers:

- (1) make grants;
- (2) make loans;
- (3) borrow funds to enable it to make grants and loans;
- (4) give guarantees to enable it to give in furtherance of the charitable purposes;
- (5) issue securities to enable it to borrow funds; or
- (6) make investments.

It would appear that the trustees could do all these things irrespective of financial gain so long as all these activities were in furtherance of the objects of the charity and could be ultimately justified, if necessary, as equally qualifying as a 'donation'.

Do trustees have a responsibility for funds once expended?

If an investment is made under investment powers then, subject to the exceptions outlined in this article, the trustees have a duty to secure the best financial return

that they can obtain. What is the position when funds are applied in furtherance of charitable objects?

If funds are applied in direct furtherance of a charity's charitable purposes rather than by way of investment then one school of thought is that once the funds have been spent the trustees have no further responsibility. The other school of thought is that there is a continuing responsibility to ensure that the funds are applied effectively. Situations where these views come into play involve funds which do not secure a good investment return and situations where funds are lost.

Less than a good return

In 1994 The Wellcome Trust sought to use some of its funds for venture capital. The Charity Commissioners raised a doubt as to whether the Wellcome Trust had the power to do this as they considered it would amount to a partnership which would constitute trading. The Charity Commission was concerned because this type of investment was more risky.

One of the arguments employed by The Wellcome Trust was that some of the venture capital might be invested in starter biotechnology companies which commercially exploit scientific research. This was consistent with The Wellcome Trust's objects to fund medical research and therefore investment return was not strictly speaking relevant. This argument was successful.

To develop the argument further, would investment by an environmental charity in companies and products which benefit the environment be consistent with its charitable objects? The Bishop of Oxford's case provides the answer yes, but this approach is underdeveloped in the UK as opposed to the USA.

In the USA the 'prudent man' rule for investing charity funds has been relaxed to allow charitable foundations to make below market rate investments and loans to organisations promoting the foundation's purposes.¹⁴ There has been a trend in the USA for some ethical fund managers to agree with their investors, including charitable foundations, that a small percentage of their fund is invested in social projects and the balance of the fund is invested ethically. The smaller investment in the social project may be on the basis that it is either riskier or perhaps below the market rate. This avoids the necessity in the UK for trustees to justify such investments as being capable of being classed as 'donations'. There is some evidence, though, that UK individual investors are becoming attracted to this more proactive way of Socially Responsible Investment. For example, Triodos

¹⁴ See "Social Investment and Other Financing Techniques for Voluntary Organisations" by Malcolm Lynch (CAF 1997).

Bank allows individual depositors to direct their savings and interest – if they wish – towards social projects. The Charity Commissioners have now issued guidelines on programme-related investments which should, as a result of raised awareness, lead to a growth in this type of charitable activity in the UK.

Funds lost

The argument that funds which have been lost were in any case within a charity's objects and therefore no different to an outright grant, has tended to be used as an argument of the last resort in Charity Commission investigation cases. Examples from practice include charity which entered into a housing development scheme to redevelop its main building to house vulnerable groups of people such as the poor, old and disabled. This project collapsed and the charity's building was foreclosed by the bank. The charity successfully argued, *inter alia*, that such expenditure was in direct furtherance of the charity's objects rather than being an investment.

Another example from practice involved a charity providing sporting activities which argued, when its trading company went into liquidation, that in effect its trading company carried out activities which could have been carried out by the charity itself. In other words, money pumped into the trading company by the charity was in direct furtherance of its objects rather than a pure investment. Again this argument was successful.

As a caveat it should be pointed out that these cases were all decided on their own particular facts.

Future Developments?

Fund-raising

'Decisions of the Charity Commissioners, Volume 1' refers to a case where a settlor donated shares in a public company to a charity. The settlor wished to restrict the trustees' power of disposal and provided for this in the trust deed. The settlor did not believe that a disposal of the shares would be in the charity's best interests because:

- (1) the shares had a good record; and
- (2) part of the success of the company was that it had a distinct management style which the settlor wished to preserve by holding the shares to protect it from a takeover; and

- (3) the company contributed to charity, was socially responsible and was involved in environmental projects.

The Charity Commissioners had no objection to this arrangement because the trustees were free to accept or decline the shares and even if the worst were to happen and the shares proved worthless, the charity would have enjoyed a substantial income from them. In this context investment performance is not particularly relevant because without the shares the charity would have had no such dividend income anyway.¹⁵

Applied to a fund-raising situation, a charity could appeal for funds on the basis that until they were applied for charitable purposes they would be invested in an ethical manner. When a gift is given to a charity, subject to particular condition; if the gift is structured properly, it is possible to create a special trust making the conditions attached to the gift compulsory (as in the case already referred to). In such a situation it would be arguable that the funds donated would be subject to their own trusts pertaining to Socially Responsible Investment which would override the trustees' duty to obtain the best investment return. Raising funds on this basis may be a novel way of attracting funds from donors.

New common investment funds

Mercury Asset Management has a Non-Tobacco Common Investment Fund for health related charities. Why not have a socially responsible common investment fund for environmental charities? Or have an ethical fund for charities generally with a good track record in charitable giving or community involvement, such as companies who are members of a group of companies and businesses who are committed to giving a percentage of their profits to charity called the One Per Cent Club?

Grant-Making Charities - Express Socially Responsible Investment clause

Lawyers advising charities being established or existing charities wishing to vary their powers of investment can consider putting an express Socially Responsible Investment clause in the governing instrument. In the case of grant-making

¹⁵ It would appear that the Charity Commissioners are starting to question these types of arrangements on the basis that there is an overriding duty to diversify under the Trustee Act 2000 which cannot be restricted or excluded by the trust instrument. But perhaps the better way of looking at these assets is not to view them as investments but as retained gifts. This is the way the Inland Revenue have approached the question of the pure donation of listed shares and securities which qualify individuals and companies for the tax relief provided by the Finance Act 2000 (mentioned above) but are not as "qualifying investments" (under Schedule 20 Income and Corporation Taxes Act 1988) for the purpose of the charity itself qualify for tax relief.

charities with general charitable purposes it is understood that the Charity Commissioners will not accept an express Socially Responsible Investment clause. This is because they consider that it would be difficult for a charity with general objects to satisfy the criteria set out in the Bishop of Oxford's case because it will always be the trustees' duty to maximise investment return to generate funds for its general charitable objects. But what if the trustees of a grant-making charity with general charitable purposes decided as a matter of policy to distribute grants to cancer charities? During the period of time when this was their declared policy it would surely be within their investment powers and entirely consistent with the Bishop of Oxford's case to avoid investing in tobacco companies?

Membership basis

The charity affinity credit card market has demonstrated that charities have a large and loyal membership base. It is conceivable that they could influence the way their members invest through educating them about issues which are also at the core of that particular charity's objects.

Advancing religious beliefs

Increasingly, religious charities are looking to invest funds in a socially responsible way. Curiously, it has been reported by some practitioners that the Charity Commissioners have objected to an Islamic charity having an express power in its constitution to invest in accordance with Islamic principles, including a prohibition on the charging of interest. This is strange because it would appear that the avoidance of usury would be entirely consistent with an Islamic charity's objects and therefore within the principles set out in the Bishop of Oxford's case, which allows for the avoidance of investments in conflict with a charity's objects.

On a positive note, investment opportunities are opening up for religious charities with pro-life principles. Banner Financial Services have launched a unit trust which will avoid investments that are connected with, amongst other things, abortion. The manager intends to pay 0.2% to LIFE, SPUC and two other anti-abortion campaign groups. Again it would appear that this is entirely consistent with the Bishop of Oxford's case and the Charity Commissioners do not seem to have objected to date.

Incidental political considerations

Although charities cannot, as a matter of law, have objects to promote or discourage political causes, they can carry out political activities which are ancillary to their objects, but nevertheless in furtherance of their charitable

objects (the Charity Commissioners have issued guidelines as set out in CC9 'Political Activities and Campaigning by Charities' (February 1997)). Subject to this, the combined effect of Socially Responsible Investment may offer a further way of influencing government policy in the UK and abroad. Economics and politics being, of course, inextricably linked.

Companies and product endorsement

There was a proposal (which was not adopted) in the 'Review of Charity Taxation Consultation Document' that a kite mark for companies with a good record for charitable giving should be given. It was thought that this could influence the way that charities and their supporters invest and lead to opportunities for charities to encourage socially responsible investment and at the same time generate funds. Evidence of this potential development is shown by the recent partnership between WWF-UK with NPI to launch an ethical fund for individual investors. WWF-UK is committed to working with companies which want to improve their environmental performance. A third of the management fees will go into WWF-UK's conservation work. The fund has targeted WWF-UK's 250,000 members initially. It will invest only in socially responsible companies such as Boots and Kingfisher and will exclude companies involved in animal testing, the arms trade, the tobacco trade, genetic engineering, nuclear power and pesticides. The fund is the first of its kind involving the use of a charity's brand name.

The potential for affiliation with companies is enormous when one takes into account the growth of corporate social responsibility. Companies are increasingly aware that, quite simply, it is good business to be seen to be socially responsible because investors and employees take issues such as the environment and involvement in the community seriously. To ignore such issues can lead to bad public relations and in turn decrease investment performance and adversely affect staff recruitment and retention. As a result social reporting is a fast growing feature of corporate governance. In recognition of this development the Department of Trade and Industry has consulted on the question of whether the duty of company directors to act in the best interest of shareholders should be widened to cover a duty to act in the best interests of the wider community and environment.¹⁶

Many companies seek advice from charities on how they can be more socially responsible. For example, Oxfam is advising several multinational mining and oil companies on issues of social responsibility because companies have noticed

¹⁶

"Modern Company Law for Competitive Economy".

that bad publicity on social and environmental issues can have an adverse effect on employee morale and even affect recruitment.

Conclusion

Today trustees in fulfilling their duty to invest wisely and to further their charity's objects effectively cannot ignore socially responsible investment.