INVESTMENT

Choose change?

Charities are required to review their investments and managers, but there are plenty of grey areas around when and how they should do it

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After setting an investment policy, choosing the managers that will run a charity's money is one of the most important financial decisions many trustee boards can make. Investment management is a competitive space, and a charity with considerable investable assets will find no shortage of suitors prepared to peddle their wares before the board.

Reviewing the performance of investments and the firms employed to manage them can be a major undertaking. Boards risk wasting considerable time and resource if they are too quick to change manager, and potential banana skins abound from the questions put to prospective managers to the number who get placed on a shortlist to present to the board.

The Charity Commission's guidance for trustees on making investment decisions sets out that, first, a charity needs to be clear about what it wants to do, how it intends to do it and what the timescale for delivery will be. These considerations will govern the organisation's investment objective.

"The investment policy statement is absolutely key," says Nicola Barber, partner and head of charities at James Hambro and Partners, "It's an outline of everything; your time horizons, the scope of the investment powers, the attitude to risk, the amount of money that's available, whether you want an ethical policy, and who can take decisions."

This policy will form part of any future investment management agreement, making it an important influence on whether the manager is able to deliver on trustee's expectations.

Investment is a notoriously esoteric field, arguably much more than it needs to be. In any case, trustees will be best served by ensuring investment objectives and policies are set out as clearly and simply as possible.

This will serve to ensure there is a minimum of confusion or room for varying interpretations later, greatly assisting in judging managers' performance.

Charles Mesquita, senior director of charities at Stanhope Consulting and experienced trustee, says investment policies should be precise, but also written in terms understandable by those without a financial background.

"The best test of an investment policy is to give it to a new trustee, ask them to read it, then come back and tell you what their interpretation of that policy is and if there's anything they don't understand."

When to review?

Once a charity has set out its objectives and policies clearly, and brought on managers to carry them out, the role then becomes one of monitoring and review.

But there are no hard and fast rules on the frequency of monitoring required, in particular when it comes to the performance of investment managers.

The Charity Commission says trustees must keep their portfolio under "regular review". This scrutiny must cover the performance of investments, and the service provided by investment managers.

And there is no clear consensus on how often managers should be reviewed, or how deep a review should go.

Newton Investment Management's charity investment survey 2015 found 90 per cent of charities had reviewed their arrangements in the past five years.

Of the 94 charities surveyed, with total assets of £20.7 billion and a median portfolio of £41 million, 49 per cent had changed manager following their last review.

But the task of carrying out a full review, and in particular testing the market for alternatives, is an onerous one and should not be undertaken for its own sake.

There is also agreement on the types of circumstances that should trigger a review. James Brennan is head of charity business development at investment manager Rathbones, and a trustee of a charity. He says a significant personnel change at an investment manager is one red flag, as is a major change in process.

"If we appoint a manager on the basis of their investment style, we would be concerned if they decided to change tack and effectively abandon their core philosophy."

Brennan says reviewing managers around every three years is generally good practice - striking a balance between prudence, reasonable use of resources, and judging managers over a reasonable time period.

But things needn't change at the investment manager to trigger a review. Being prepared to respond to market forces plays an important part.

Neil Davies, associate at consultancy Barnett Waddingham, warns against trustees "reviewing a manager because they think they ought to". A period of low returns may be more to do with what a charity is asking its manager to do rather than any issue with the

manager's performance.

However, if there is a significant change in the market that may require managers to do different things in order to meet investment objectives. A charity's existing provider or providers may be able to do this, but the organisation may also need to look elsewhere.

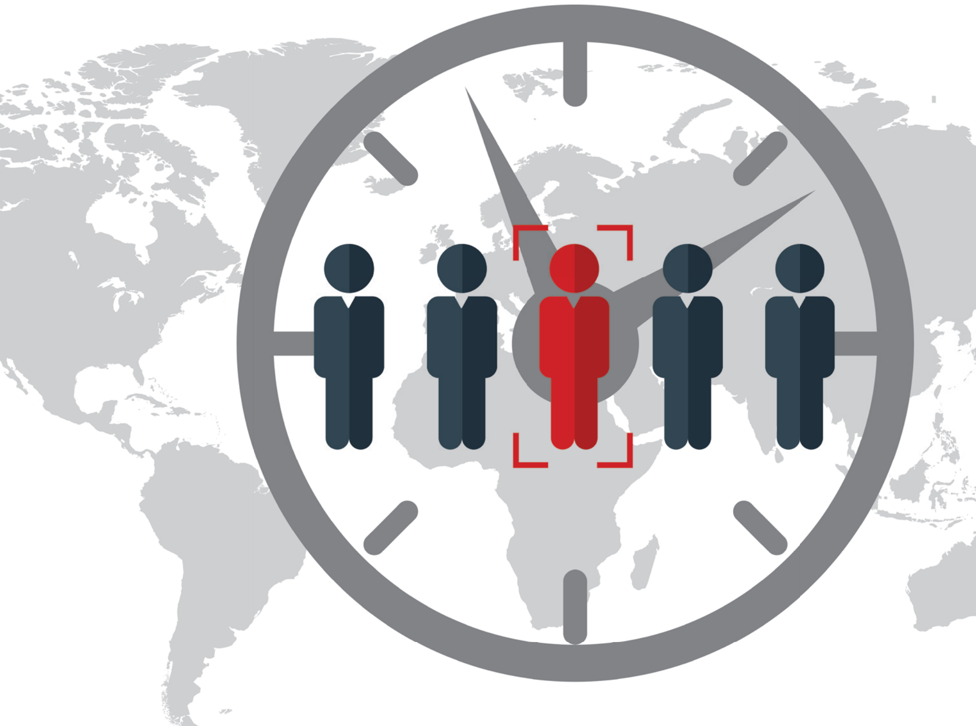
"Some trustees like to think that they're getting the best manager in every single asset class. But actually the most important decision you can make is which asset classes are you in? And are you in them at the right time? That's what's going to earn you money," Davies says

Mesquita points to studies that suggest the strategic allocation produces 90 per cent of a portfolio's return, so it is crucial to get the policy right.

To change or not to change?

Often any issues in the service arrangement can be solved with a conversation and greater understanding between the trustees and the manager, without having to go through the process of a full review.

Taking a closer look at the current arrangements does not automatically mean seeking out alternatives.



Indeed, Barber was involved with the management of a foundation's assets for 15 years, and the organisation reviewed its management arrangements three times over that period.

"As a matter of due diligence and good practice they always went through a review every five years. One of the things it does do is focus the existing manager not to become complacent and to ensure their fees are always competitive."

But a meaningful search is costly and time consuming, and Mesquita says the process can take three months from start to finish. Trustees need to ask whether this is the best use of their time, he says.

"We would sit down as a trustee board and formally ask whether our manager is doing a good job. 'Yes' - great. Are they doing it at a reasonable price? 'Yes'. Then we move on. Is there anything we should be changing within the investment objective? Has anything changed within the organisation?"

Stanhope Capital's consulting business is often hired to carry out 'drains up' reviews on managers, Mesquita says, but starts from the position that the charity wants to retain its manager.

"More often than not their concerns are around reporting, or service, or just that they don't feel loved any longer. And it could be a communication issue between trustees and the investment manager."

Brennan says that a review of a charity's strategy could involve asking the investment manager to deliver a different service, but this does not necessarily require a change in manager.

"Just because you review doesn't mean you change. It's quite a lengthy process reviewing managers so if your manager is delivering, as long as you've looked at the numbers, you're happy with the team, you're happy with the performance, you're happy with the administration and are receiving ongoing investment advice - why change?"

Beauty parade

A range of other issues emerge should trustees choose to explore their options for change. And the process can be made more complicated by taking on too much in the pursuit of being thorough.

If the review proceeds to a 'beauty parade' of managers, best practice suggests a shortlist should be just that: short.

"I know from experience that if you see five or six firms, by the time you've seen the sixth you've forgotten what the first and second have said," Mesquita says. "It's a very tiring process as it is, and you can end up confusing yourself."

He also questions the sense in having the incumbent manager in the formal presentation process to trustees, as they should be fully cognisant of their manager's capabilities. It is much better to meet with the incumbent manager after digesting the presentations, to discuss issues arising and address any shortcomings. The process should not be necessary unless something is wrong with the existing service. However, Brennan takes a different view and, as a trustee, believes in giving the manager a chance to "sing for their supper".

Boards can give themselves an easier time of arriving at the shortlist by being very clear about what they are asking for in the first place. Brennan advises charities to ensure the questionnaire charities put in front of prospective investment managers is as specific as possible.

Failing to set a framework that allows for an 'apples for apples' comparison can make the already difficult process harder, and result in a charity missing out on the

full benefit a well-managed switch could offer.

Brennan says this is particularly true when it comes to fees and performance numbers. Being specific about what you are asking for and stating the exact time periods you are interested in ensures consistency when comparing manager A and manager B.

And as the charity investment space can be a crowded field, looking beyond bottom-line returns can be rewarding.

"Some performance numbers are not going to be wildly different. A lot of the big houses do similar things. The other piece of information you can ask for is volatility. If you've got two managers delivering the same thing but one's less volatile then you're going to get a smoother ride and that might suit you."

It is also important for trustees to ensure they receive explanations for any information they do not understand throughout the tendering exercise. Trustees have a right to ask for things to be put in plain English, and this can in fact shed light on whether there is substance to the information provided.

"Insist that people don't use jargon, and don't be afraid to ask questions," Barber says. "I'd encourage all the trustees to engage, and to say 'sorry but I don't understand that; could you explain it and put it into context?'"

Barber stresses the importance of being patient, and taking whatever time is necessary to ensure a thorough process. Simply put: if it's worth doing, it's worth doing right.

"Don't make a quick decision. Be persistent – if you don't understand something, don't just take somebody's word for it. Make sure you understand it. The managers that care and want to build a long term relationship will happily sit down, offer to go to the trustees and explain things."

Expertise

A lot will rest on the level of expertise across the board of trustees. Many charities are fortunate in that they have acting investment professionals and finance experts on their board.

Where this is not already in place, the Charity Investors Group produces a register through which charities can look for trustees with finance experience. Trustees Unlimited, the joint venture between Bates Wells Braithwaite, NCVO, and Russam GMS can also help link charities with experts prepared to volunteer their experience.

Finance related trustee vacancies can also be advertised through the Charity Finance Group, and CFG and CIG have co-produced an excellent guide on formulating investment policy statements that covers approval and review.

But Mesquita sounds a note of caution. Boards should remain vigilant that they do not drift into deferring all investment decision making to one trustee, in situations where investment experience is limited.

This experience is undoubtedly helpful, but it is important to ensure a range of views are represented and that decisions are subjected to the appropriate level of oversight.

"Charities are in a fantastic position that they can call on expertise and people will give their time and knowledge freely. But lay trustees need to be careful that they don't get bamboozled by the 'financial expert' or just look to them to make the decision for them. Actually, people with limited or no knowledge generally ask really good searching questions by applying common sense."

Finally, professional consultants can play an important role in advising charities on everything from their investment policy to manager selection.

"It's what they do day-to-day so they're very experienced," Barber says. "Most are independent, they're unbiased. Where the trustee board might think it's all about the investments, a consultant will look at other criteria such as the corporate structure, manager incentives, regulatory compliance and stability of the investment team." ■