

Schedule 2: FS Investment Policy for Community Endowments

1 Introduction

- 1.1 Foundation Scotland [FS] is a grant making charity which seeks to build endowment funds and distribute funding for the benefit of communities in Scotland. FS invests funds in several ways to ensure that it is able to sustain its distribution activity. However, it recognises the risks that investing brings and the importance of ensuring these are properly managed.
- 1.2 This document sets out FS's Investment Policy which ensures that it:
 - 1.2.1 Manages the risks associated with investment activity.
 - 1.2.2 Provides the basis on which the mandate for the management of its investments are delegated to others.
 - 1.2.3 Complies with legal and regulatory requirements.
 - 1.2.4 As a charity, FS does not wish to incur tax on investments and therefore only allows investment in approved charitable investments as defined in sections 558 and 561 of the Income Tax Act 2007. Under current HMRC guidelines, FS is not liable for either Capital Gains Tax on its investment portfolios and will pursue an investment policy to ensure this status is maintained
- 1.3 This Policy has been prepared using the Scottish Charity Regulator [OSCR] guidance "Charity Guidance: Guidance and Good Practice" [November 2018]. The legal position in Scotland with regard to Programme Related Investment and Mixed Motive Investments has been checked with OSCR.
- 1.4 Stewardship of FS's investments is one of the main responsibilities of the Board of FS. The Board has delegated this responsibility to the Finance and Investment Committee [FIC].

2 FS's Investment Context

- 2.1 Under section IV of FS's Memorandum of Association FS has the following powers in relation to its investment activity: -
 - To invest and deal with the monies of the Foundation not immediately required in or upon such investments, securities or property as may be thought fit.
 - To employ as a professional investment manager any person who is entitled to carry on investment business under the supervision of the Financial Services Authority (or its successors) and to delegate to any such manager the exercise of all or any of its powers of investment on such terms and at such reasonable remuneration as the Board thinks fit, and to enable investments to be held for the Foundation in nominee names, but subject always to the provisions of the Charities Act.

3 Investment Objectives

3.1 Permanent Endowments

3.1.1 Through its discretionary managed portfolios FS pursues an investment objective of maximising total return from income and capital growth whilst seeking to maintain the real value of its investments taking into account any withdrawals for grant making. The portfolios have a medium risk profile and seek diversity across a range of asset classes with the bulk predominantly invested in pooled funds. Income is either re-invested or held as cash for distribution. Where FS is entrusted with a fund whose donor has a finite time-frame to utilise their donation, FS may adjust the investment objective specific to these funds to reflect the donor's ultimate objectives.

3.1.2 The Board agrees a level of cash to be withdrawn from the funds on an annual basis from capital and income, should the Community request this service. The level is reviewed annually to try and achieve long term sustainability. In setting the withdrawal rate the FIC will consider a range of issues including but not exclusively: investment performance, inflation, needs of beneficiaries and also the needs of FS. The current level of withdrawal can be provided, if relevant, however it is noted that a Community may choose to build funds in the medium-term, i.e. no funds are withdrawn on an annual basis, until such time the Community requires these funds.

3.2 Client Cash

3.2.1 FS holds cash in respect of non-invested grant making funds. The majority of these funds are held in interest bearing deposit accounts with sums being transferred to FS's operating bank account as grants are made. The procedures around the management of cash accounts and the banks used is covered under FS's Treasury Management Policy.

3.2.2 Some funds, with the agreement of the Board, are held in their own dedicated bank accounts. For operational efficiency FS aims to keep such segregated bank accounts to a minimum permitted only in exceptional circumstances.

4 Risk

4.1 The Board recognises that the investment process exposes FS to a number of risks - consistent with the Investment Objectives noted in section 3 – and that inevitably capital values and income will vary from time to time and may result in lower capital values. The long-term nature of the organisation is such that the Board understand and accepts these risks. The risk mitigation protocol is set out below.

4.2 Capital and Income Risk

4.2.1 The risk of loss of capital or income as the value of investments change is managed by having a diverse investment portfolio spread over a number of Investment Managers.

4.3 Market Risk

4.3.1 The risks arising from general market movements, inflation, interest rates, exchange rates and company specific issues are managed by regular monitoring of Investment Manager performance against the benchmark and face to face meetings with Investment Managers. Investment will only be permitted in markets with accepted financial regulations.

4.4 Valuation Risk

4.4.1 With the exception of the Investment Property, all investments are independently valued and valuations verified against published prices each year by External Audit.

4.5 Counterparty Risk

4.5.1 With the exception of cash deposits, FS does not undertake any investments directly and relies on a number of Investment Managers with whom it has discretionary mandates. The mandates with these managers are reviewed at the time of their presentation to the FIC and their insurance coverage is checked annually.

4.5.2 It is the policy of FS to be as helpful as possible to potential donors. It will accept donations of investments as a transfer from a donor's personal investment portfolio and allow them to remain invested with the donor's investment manager subject to a minimum level see 6.1. These assets are overseen by FS and in line with this Policy.

4.5.3 FS holds its cash at UK clearing banks whose credit ratings are checked regularly. In addition it has sums on deposit with the Nationwide Building Society whose ratings are also checked regularly.

4.6 Ethical Risk

4.6.1 There are no specific environmental, social or governance (ESG) restrictions on the majority of the investment portfolios. Where they exist, donors are advised to invest in a separate fund - currently the Newton SRI Fund for Charities. The ethical policy for this fund is defined by Newton's Investment Oversight Committee in consultation with investing clients. The ethical exclusions are available from Newton Investment Management.

4.6.2 Notwithstanding the foregoing, the Trustees consider that both fund managers and Board directors of invested companies have an increasing stewardship responsibility to all their stakeholders. They also believe that funds and companies which ignore ESG issues may be more at risk of reputational, and consequently financial damage. Portfolio managers will be directed to be mindful of this when selecting funds and companies for inclusion in FS portfolios. However it is noted that ESG judgements are subjective by nature. Due consideration will also be paid to materiality of holdings where ESG concerns pertain.

4.6.3 The FIC, which monitors the performance of the Investment Managers and the operation of the Investment Policy, is composed of members who have had links with and senior positions within Investment Management Firms. Conflicts of Interest are declared at each meeting and links to firms are fully disclosed under the Conflicts of Interest Register.

5 Types of Investments

5.1 The discretionary mandates with Investment Managers allow for investment in:-

- Interest bearing cash
- Equities
- Bonds and Gilts
- Buildings or Land
- Investment Funds / Unit Trusts

5.2 The investment objective as set out in 3.0 drives the portfolio weightings and will vary from manager to manager. Historically this has resulted in approximately 80% in equities, 15% in fixed income and 5% in cash or alternatives.

6 Classification of Investment Portfolios

6.1 FS will accept transfers of investment assets as donations. Below approximately £500k the policy would be to transfer these assets into the pooled fund that FS has chosen for its main investment vehicle. The timing of this transfer would be with the agreement of the donor and FS. Above £500k FS will allow the donor to use either: a recognised investment manager as described below as "Stand alone Discretionary Portfolio".

6.2 FS is the custodian of many small trusts as well as its own assets. Given the nature of these funds this necessitates the use of a unitised vehicle to ensure an efficient administration of the investments held. The ideal investment vehicle is considered to be a balanced Charity Investment Fund (CIF). Other pooled funds, investment or unit trusts may be used. Where a donation is made by way of a transfer of invested assets and the fund is to be converted to a CIF, FS will undertake to move these assets in an efficient and managed way. This would not apply to Donor Managed Funds.

6.3 The Board has determined that FS will permit a variety of investment portfolios described as follows:

- Pooled Discretionary Funds - these funds comprise donations to FS which become part of the pooled investment portfolio and which are invested in a unitised fund or directly in pooled investment or unit trust funds. There will be no direct equities held in this fund. There may be situations where the sum donated is of a size that the funds are directed to a cash account rather than being in an invested fund. This is considered a preferred strategy for donations of less than £10,000.
- Stand-alone Discretionary Funds - these funds usually comprise portfolios which have been donated to FS for the purpose of philanthropic giving but which at the request of the donor, and are of a large enough size, are segregated. The minimum size for such a fund is £500,000 or a lower sum with a commitment to build the fund to this level within a 5 year period. The portfolio would be managed by an Investment Manager approved by FS.

7 Unitising and Pooled Funds

7.1 Where a donor does not have a sufficiently large fund to create a distinct portfolio, usually between £10,000 and £500,000, their monies will be invested in a pooled fund currently with Newton Investment Management Ltd. Their investment will purchase a precise number of units in one of their funds with further additions, sales and dividend reinvestments altering that number. The current market price will generate a value for their fund.

8 Monitoring Investment Performance

8.1 Measuring Investment Performance

8.1.1 The Board have delegated the review and monitoring of investment performance to the FIC. The FIC reviews the performance of the portfolios against agreed benchmarks on a quarterly basis and the minutes of these meetings are reviewed in turn by the Board.

8.2 Review the Services Offered by Investment Managers

8.2.1 A review of the Terms and Conditions offered by the individual Investment Managers will be undertaken every 3 years or more regularly on an individual basis where there is a change of circumstances i.e. in the case of a takeover or merger of one of the Managers, loss of key personnel in the Manager or notification of a material change in their Terms and Conditions.

8.3 Intervention

- 8.3.1 As a result of a period of consistent underperformance over a 3 year period the FIC will instigate a more detailed review of performance and initiate dialogue with the said Manager and/or donor to resolve the issue which might lead to the funds being moved to a new Manager.
- 8.3.2 Managers' performance is regularly reviewed, if there became an unacceptable risk because of over reliance on a single manager, our policy is to seek diversification as appropriate.

9 Reporting Requirements for Investment Managers

- 9.1 FS requires Investment Managers to produce a suite of reconciled reports to an agreed format within 5 working days of the month end. The suite to include a list [with SEDOL Codes] of all transactions undertaken in the previous month and a valuation report of all holdings [with SEDOL Codes].
- 9.2 Investment Managers will also be expected to attend the FIC once every 18 months at which they are expected to present a summary of their portfolios performance over the previous 12 months and their view of the next 6 months. The FIC has the discretion to ask Investment Managers with smaller funds to present at least every 24 months

10 Investment Policy Review and Approval

- 11 The Investment Policy will be subject to an annual review by the FIC who will consider the policy and if appropriate make recommendations to the Board of Trustees to consider.
- 11.1 A summary of the Investment Policy will be included in the Annual Report and Accounts.