CHARITY INVESTORS' GROUP

THE FORUM FOR INVESTMENT DEBATE

Charity Commission Consultation on the regulation of common investment funds

Response deadline 11th September 2013

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Overview

The Charity Investors' Group outline below a brief summary of the views of our members, which include the majority of the managers of Common Investment Funds. Some will also be submitting their own responses. We cannot claim to represent all of our members but summarise the views of those that have engaged with us in this consultation period. We have been involved with the Charity Law Association's response, and support their comments.

Our members highlight the importance of CIFs for charity investors, particularly smaller charities who are unable to directly access charity investment expertise themselves. Our response seeks to preserve the benefits of charity specific vehicles managed for and on the best interests of the charitable investor.

The move to indirect regulation of the CIFs under AIFMD, rather than direct regulation by the Charity Commission, is clearly a step back in regulatory terms. We do, however, understand and have sympathy with the principal that the Charity Commission should not be the primary regulator for financial products, even if they are charity specific.

It is a pity that the establishment of the Charity AIF has been put on hold, as this would seem to solve many of the regulatory challenges faced. The proposed 'way forward' seems a half way house, which removes the Charity Commission's regulatory oversight, and relies on an indirect regulation of the fund managers. In general, it is our members' view that Common Investment Funds should be authorised investment funds, by the FCA, but that the structure needs to be charity specific and accommodate the existing funds (income smoothing in particular). There is not a consistent view across our members on what form this structure should take although NURS seems to be the most discussed. We understand that the Charity AIF is currently not an option, but there is a feeling amongst our members that it would be welcomed back on the agenda.

In the interim, with a lack of regulatory guidance, there is a view that the charity investment industry needs a best practise guide for pooled funds. This could provide standard format fund documents to ensure investors are made aware of all of the key facts and risks before investment. This is something that the Charity Investors' Group would be happy to help with.

Our members are very keen to ensure that existing mechanisms of income smoothing are retained as this is an important characteristic for charity investors.

Our members would also like to use this opportunity to again highlight the anomaly of VAT being charged on investment managers fees within the funds. This means that CIFs are at a disadvantage to other investment vehicles and charity investors are being unfairly penalised. The Charity Investors' Group have been campaigning for many years for the removal of this VAT charge.

Our members would be interested to learn more about existing funds moving to a single scheme (with or without a Board). This was only very briefly touched on in the consultation document.

Our members continue to highlight the tax advantage of CIFs, particularly in the property asset class, through the stamp duty exemption. There is a concern that if new funds are unable to offer this tax benefit it would limit choice and competition in this asset class. In addition the CIF tax structures have been easy to understand for the lay trustee.

It is agreed that as the reporting requirements under AIFMD are more onerous it is likely that costs within the CIFs will increase. There is a view that this and the wider impact of these changes need to be passed to Trustees. The Charity Investors' Group would like to offer its assistance in the production and distribution of this information to CIF investors through our fund manager members.

The consultation questions

1. *CIFs are unregulated funds which will now be subject to certain requirements regarding oversight by the FCA under the AIFMD implementing provisions:*

   a) *Do you consider that the investment and borrowing powers of such funds should be similar to those permitted for authorised investment funds? Or*

   b) Are you content for such funds to have the same investment powers as any other charity and a borrowing power which permits temporary borrowing for the purpose of making payments from the fund?

Although our members express a mixture of these views, the majority consider that the investment and borrowing powers permitted for authorised funds would be adequate. Most existing CIFs are currently operating under similar powers. If the regulation is moving towards authorised investment funds (in one form or another) in our view it would not make sense to have a number of different structures in a relatively small market. However, property common investment funds operate under wider powers and specific allowances should be made for existing and prospective funds in this asset class.

2. Do you consider that investment funds for charities should be established as authorised investment funds fully regulated by the FCA or do you consider they should continue to be unregulated funds created by the Charity Commission? Please give reasons for your view.

Although some of our members have expressed a preference to maintain the status quo it is the majority view that the future of pooled charity vehicles should be within an authorised investment fund regulatory environment. However, we support this with the following caveats
- that the authorised structure must be charity specific
- that the ability for income smoothing must be retained
- that the VAT charge on investment manager fees must be removed

We do believe that it is imperative that a specific Charity Authorised Investment Fund structure is established and as such the Charity Commission should retain a role in regulating the fund as a 'charity'. Although tax advantages of CIFs have been eroded, still some remain (namely stamp duty on purchases). This could be retained.

In addition, there are other, perhaps less tangible but possibly even more important, benefits, listed below:

- Charity specific funds would tend to be managed by specialist investment managers who should have relevant knowledge and who should be able to give more appropriate advice to UK charity investors. These funds would encourage more relevant 'know your client' experience.

- Charity specific funds are more likely to follow strategies appropriate to UK charities – perhaps with longer time horizons, income biases, lower volatility of distributions or inflation linked/total return approaches. Income smoothing is an important characteristic to retain.

- Charity specific funds are more likely to have appropriate governance (perhaps with independent boards or Charity Commission input)

- Charity specific funds are more likely to have relevant responsible investment approaches

- Charity specific funds are more likely to have lower fees (as is evidenced by the current CIF average fee vs. the market)

- A charity specific fund label would help charity investors (or their advisors) identify and find those funds designed specifically for their marketplace.

The Charity Investors' Group believes passionately in the benefit of specialist financial advice and management for charities and as such would only support a move to an authorised fund approach if there were to be a charity specific structure established.