Investec
Wealth & Investment

Charity Matters

Autumn 2017

Out of the Ordinary

Welcome

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Welcome to our Autumn 2017 issue of Charity Matters.

A lot has happened since our last newsletter, and I am thrilled to announce we have recently been joined by Mike Marsham as Head of our Charities business. Mike was with BlackRock for 13 years and had most recently been responsible for their charities business.

I remain Head of Investec Wealth & Investment (IW&I) for London and will keep my role as an Investment Manager on the Charities Team, looking after clients as before. Our team has had tremendous stability evidenced by the longevity of our Investment Managers who, on average, have been with the firm for over 16 years and this, combined with Mike's arrival, gives me great confidence in the offering we have for UK charity clients.

The two most prominent themes driving markets this year are arguably economics and politics. Economics remains largely supportive, as 2017 thus far has been a year of synchronous global growth: for the first time since 2010, both the developed and emerging economies are growing in concert. On the other hand, the geo-political landscape has proven to be a source of trepidation for financial markets. The UK's unexpected general election, and even more surprising result, led to the Conservatives suffering a shock loss of majority. In Europe, although Angela Merkel won the German election, this was marred by the right-wing AfD managing to secure 13% of the vote, suggesting that the populist sentiment palpable across Europe earlier in the year is yet to dissipate.

In keeping with politics, in our first article, David J Richardson looks at the Cuban Missile Crisis and draws similarities with this and the current tensions between US president Donald Trump and North Korea's Kim Jong-un. Subsequently, John Wyn-Evans, our Head of Investment Strategy, explores the recent proliferation of Bitcoin and whether it can be viewed as a viable alternative to fiat money.

Elsewhere, Bola Okunade interviews Jamie Thomson, our Head of Operational Risk and Data, about the risks that charities face, such as cyber breaches. Then, Andrew Mackie, a Senior Associate at Penningtons Manches LLP looks at the new draft Charities Bill and how it will affect not-for-profit organisations.

We do hope you enjoy reading the aforementioned articles and, as always, if there are any issues you would like to be covered in subsequent publications, please let us know.

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Senior Investment Director
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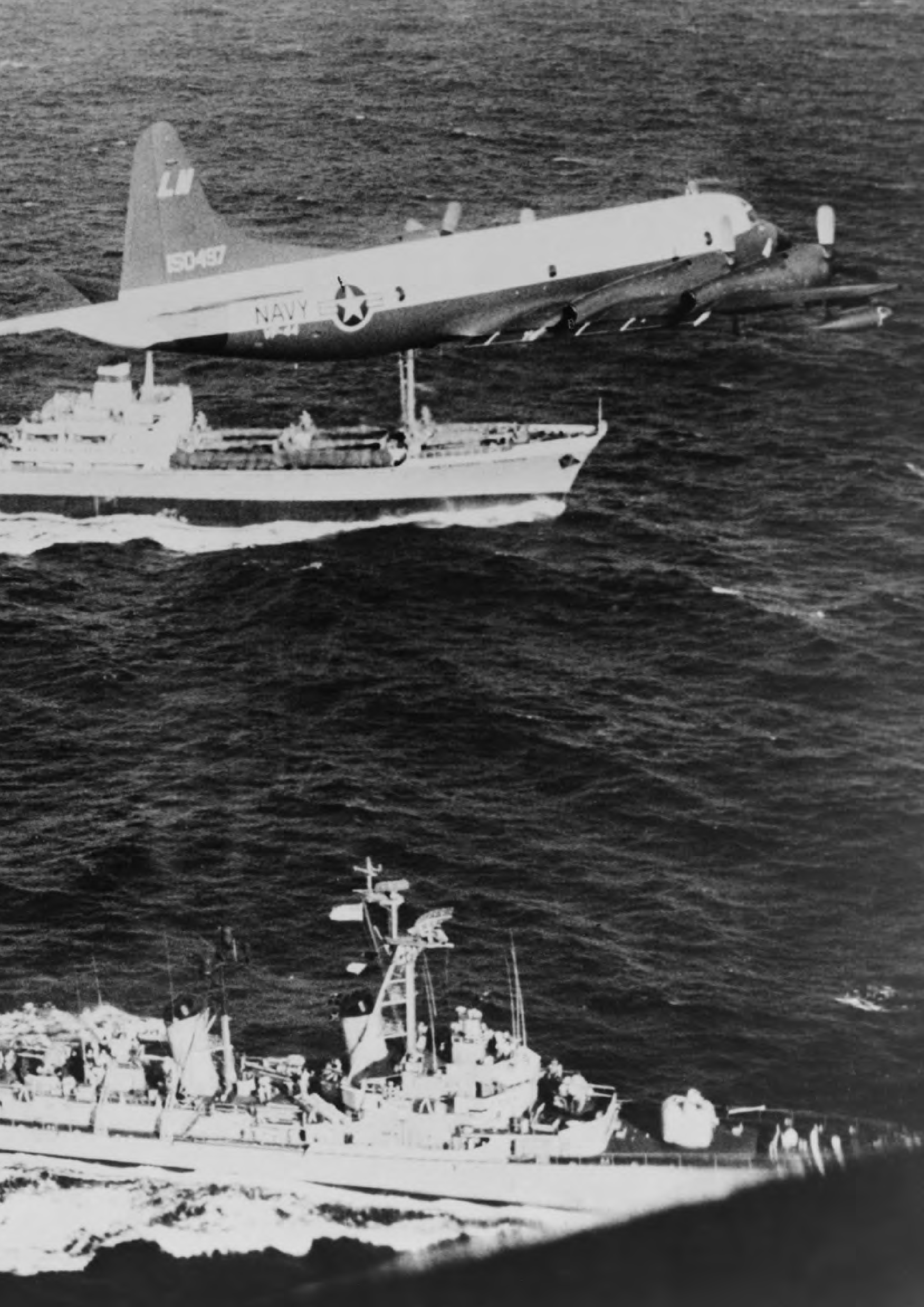
David J Richardson looks at the Cuban Missile Crisis

As the rhetoric and tensions escalate between Donald Trump's USA and Kim Jong-un's North Korea, we now find that Iran has test-fired a new missile with the apparently claimed range to hit 'anywhere in the Middle East'. Whilst concerns should not in any way be understated it is instructive once again to look at history to see if it offers any precedent to help investors gauge likely outcomes and timeframes.

The intuitive comparator is the Cuban Missile Crisis of 1962 which historians often claim as the closest that the world came to nuclear war and which typified the atmosphere during the Cold War. This may predate the majority of our readers but was a real fear at the time.

The coup and countercoup that was the story of post-war Cuba was finally ended by Fidel Castro's 1958 revolution and in the aftermath the country became very closely tied politically and economically to the Soviet Union. It nationalised many US owned businesses. The US, led by the World War Two commander, President Dwight Eisenhower, became concerned at this and covertly arranged a CIA organised invasion of Cuba, comprising anti-Castro Cuban exiles, to overthrow Castro and reinstate a pro-US government. All was prepared, but the 1960 US presidential election saw the up and coming Massachusetts Senator John F Kennedy win a surprise victory against Richard Nixon. Nevertheless the new president, strongly supported by his military advisors, decided to go ahead in April 1961. The invasion force came ashore at the Bay of Pigs. It was a disaster and was easily repulsed by Castro's forces, cementing their leader's reputation and position.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In response to the failed invasion, and the US stationing missiles in Italy and Turkey, the Soviet leader Nikita Khrushchev agreed to Castro's request to station nuclear missiles in Cuba, ostensibly to repel a repeat of the Bay of Pigs invasion.

After a period of two weeks, in October 1962, the world held its breath as bluster and bombast were traded back and forth between Kennedy and Khrushchev. Gradually, the two seemed to find common ground with intercessions by many world leaders, including the Pope, and the inarguable consequences for humanity of failure to reach agreement.

Eventually the Soviets agreed to remove their missiles from Cuba in return for an undertaking by the US that they would not organise another invasion and the little matter of the removal of US ballistic missiles from Italy and Turkey. The human race was able to relax its breath. Indeed, the optimists claimed that some good came out of the crisis, as it led to the establishment of a telephone hotline from Washington to Moscow, much used thereafter.

In the end Castro comfortably outlived both Kennedy, who was assassinated in 1963, and Khrushchev, who died of natural causes in 1971. When asked what he felt might have happened if it had been Khrushchev who had been assassinated, the British Prime Minister, Harold Macmillan, remarked that he did not think Aristotle Onassis would have married Mrs Khrushchev!

Such historical introspection may be interesting, even nostalgic for some, but is only instructive if it can be related to current events. A key difference with the North Korea crisis is that the Cold War is long ended. Whilst China and the US may have different objectives in the Pacific region, China is unlikely to be regarded as an enemy and would be reluctant to have a nuclear war on its doorstep. A further difference is that whilst senior military figures were said to be urging Kennedy on, one is left with the impression that the military advisors are holding Trump back on jingoism. Indeed, the danger for many may be that rhetoric or miscalculations by the commanders in chief could lead to an outcome that neither leader nor their military wants.

In terms of stock markets, always a good guide to sentiment, the US Standard and Poor's Index fell just under 9% in 1962 and then rose by 22% in 1963, illustrating the old adage that 'time in the market is much more important than timing the market'. So far in 2017 the North Korean crisis has caused markets to fall a couple of percent and they have since recovered their losses either reflecting a sangfroid amongst investors not apparent in the 1960s or more likely an inability of investors to know what action to take against an unlikely but potentially catastrophic event.

> "Indeed the danger for many may be that rhetoric or miscalculations by the commanders in chief could lead to an outcome that neither leader nor their military wants."

Soviet freighter ANESOV, escorted by a United States Navy plane and the destroyer, USS BARRY, as it leaves Cuba loaded with missiles signalling the end of Cuban Missile Crisis. October 1962.

Fad or future currency?

“As was seen most notably in the hacking of the Mt Gox exchange, when almost half a billion dollars’ worth of Bitcoins just disappeared, owning Bitcoin is not necessarily risk-free.”

By: John Wyn-Evans
Head of Investment Strategy
Investec Wealth & Investment

John Wyn-Evans, Head of Investment Strategy at IW&I, looks at the recent interest in Bitcoin and questions whether this new form of money needs to be held.

All the ingredients for life on earth were available in the primordial soup, but it took some unknown catalyst to create the right combinations. Similarly, all the technology to enable cryptocurrencies was around from the 1990s, but it took the financial crisis to provide the impetus required for Satoshi Nakamoto, whoever (s)he might be, to launch Bitcoin in early 2009. Like all good manias (and I believe we are witnessing a mania of sorts), the enthusiasm for Bitcoin has credible roots.

Bitcoin was born out of the chaos of the financial crisis. With banks going bust, the global financial system seizing up and no counterparty deemed reliable, an alternative currency suddenly had real attractions. Furthermore, a currency which had a limited issuance could be viewed as a counterweight to fiat currencies which could be created by central banks. Crucially, it was a currency that could live in its own closed system, free from government interference, as it used the blockchain distributed ledger technology to authenticate and record transactions made over the internet.

Not surprisingly, Bitcoin initially attracted technology geeks and those of a more anarchic bent, but was quickly adopted by more criminal elements, not least through the Silk Road website, a hub for drug dealing. The site’s founder currently languishes in a US prison, sentenced for life with no possibility of parole! However, despite the ongoing attentions of regulators, Bitcoin has continued to flourish and has spawned a raft of other alternative currencies. At the last count, there are more than 1,000 of them, some quite large (Ethereum, Ripple, Litecoin), and many very small. If all the cryptocurrencies in existence with an issued value of more than $1bn were aggregated into a single company, they would be the fourth largest in the FTSE100 Index. Bitcoin, by itself would rank sixth and the next biggest, Ethereum, would be twenty-sixth.

Let us now consider the key characteristics of a currency – to be a ‘store of value’ and a ‘medium of exchange’. The dollar value of Bitcoin and its imitators has been volatile to say the least, and thus difficult to describe as a store of value. Medium of exchange? I have yet to encounter an establishment that offers me the opportunity to spend Bitcoins – maybe I am just not hip enough! However, it still seems to be a relatively difficult currency to spend, although there are notable exceptions. The Boston staff restaurant of Fidelity, the fund manager, accepts Bitcoin, for example. But, it might take an Amazon to start accepting it for the concept to become more mainstream.

So how does one acquire a Bitcoin, or similar cryptocurrency? The purest form of acquisition is through ‘mining’. In the early days, mining could be undertaken by an individual with a laptop and a bit of nous, but the process has now become industrial as the value of cryptocurrencies has risen, with huge computing power and supplies of electricity required.

Bitcoins can also be purchased through an exchange, or acquired in return for goods or services provided.

Are cryptocurrencies as secure as they are cracked up to be? As described earlier, unless you ‘mine’ your own Bitcoins, the preferred acquisition route is through an exchange of some sort, and this is the weak link in the system – the so-called ‘trusted third party’. As was seen most notably in the hacking of the Mt Gox exchange in 2014, when almost half a billion dollars’ worth of Bitcoins just disappeared, owning Bitcoin is not necessarily risk-free.

So who has been buying Bitcoin? The big buyers in 2015 and 2016 were the Chinese, as money flooded out of the country when the currency was devaluing. As the government tried to close the official floodgates, the easiest route out was on-line. Canny Japanese housewives, sometimes described collectively as the world’s biggest currency hedge fund, also latched onto the trade.

Having spent time debunking Bitcoin, I can see why people might want to buy some as an option against the tail-risk of cryptocurrencies becoming the norm – even if governments, central banks and banks are going to fight it tooth and nail. A misdirected nuke from Kim Jong-un could be the catalyst, for example, or another round of money-printing by central banks. But, it is certainly not an asset class in its own right as some of its proponents claim, and as such, we have no current intention of adding it to client portfolios.

Perhaps some degree of regret is felt by the gentleman who paid 10,000 Bitcoin for two Papa John’s pizzas on 22 May 2010, deemed to be the first real world transaction with a cryptocurrency. Had he not spent them, they would be worth $57 million, which is equivalent to $28.5 million per pizza. It is inevitable that we will hear more stories about people who have made or lost a fortune, just as one hears of people who bought Apple or Amazon for peanuts.

All prices and valuations are correct at the time of writing on 26 October 2017.

Data protection for charities

By: Bola Okunade
Trainee Investment Manager
Charities Team
Investec Wealth & Investment

Bola Okunade interviews Jamie Thomson, IW&I's Head of Operational Risk and Data

Data protection and cybersecurity are garnering more attention than ever in the headlines. Successful cyber-attacks have become more prevalent and cybercriminals are growing more sophisticated. As the world becomes increasingly interconnected through digitisation and the 'Internet of Things' for instance, information technology is becoming central to the operations of many organisations including charities. Whilst this enables them to operate more efficiently, it also presents an opportunity for adversaries to steal personal data and carry out cyber-attacks.

The breach to Yahoo's security network in 2016 resulted in the release of over 500 million users' personal information, illustrating that cyber criminals can infiltrate even the most robust protection networks. No organisation is immune – charities should ensure that data protection and cybersecurity are a top priority.

I sat down with Jamie Thomson, the Head of Operational Risk and Data at IW&I, and asked him some questions on data protection and cybersecurity, and how these issues are affecting IW&I and the not-for-profit sector.

Why should charities protect themselves?

In May 2018, the new General Data Protection Regulation (GDPR)[1], a European wide directive, will replace the existing Data Protection Act. This will introduce stricter rules on how data is processed and will place greater onus on organisations to safeguard personal data. Apart from this, charities also have a duty of care to their donors and beneficiaries to make sure that the personal information they hold is kept secure and does not fall into the wrong hands. Attacks can have detrimental effects such as a significant disruption to the provision of services, economic loss (through financial penalties or remediation costs), reputational damage and perhaps, most importantly, a breach of trust.

What are some of the common sources of security threats?

The most common security threat that is often underestimated is internal to a charity and comes in the form of 'personnel risk', as sensitive data can be lost or stolen through employees and volunteers.

External threats include cold calling scams, phishing attacks (where criminals send emails that contain infected or malicious links) hackers, online banking and websites. Suppliers could also pose

a significant threat if basic due diligence is not undertaken.

How can charities protect themselves against some of the risks you have mentioned?

It is important to have mechanisms and processes in place which will enable the early detection of vulnerabilities and thus the prevention of potential attacks. This can include conventional methods such as up to date firewalls and antivirus programmes, which act as a line of defence should a hacker attempt to compromise a charity's IT system.

Where feasible, charities should ensure that there is someone with specific responsibility for data protection. Additionally, all employees should be adequately trained prior to commencing their roles and on an ongoing basis. Training should include how to identify and respond to data breaches, and can be done online to reduce costs.

Confidential information sent via email will increasingly be encrypted. We would advise against forwarding work-related emails to personal email accounts. As phishing scams become increasingly widespread, individuals should refrain from opening unexpected links and attachments, even if the sender appears familiar. All in all, staff should be cognisant of anything unusual that could arouse suspicion.

With regard to third party suppliers, charities should make sure they know who they are doing business with. Ask questions to ascertain your suppliers' levels of security and the procedures they have in place to ensure data is kept safe. Additionally, charities should be aware of how suppliers recruit staff i.e. are background checks employed, and to what extent?

We are aware of various instances of invoice fraud in recent times. How can charities protect themselves against this?

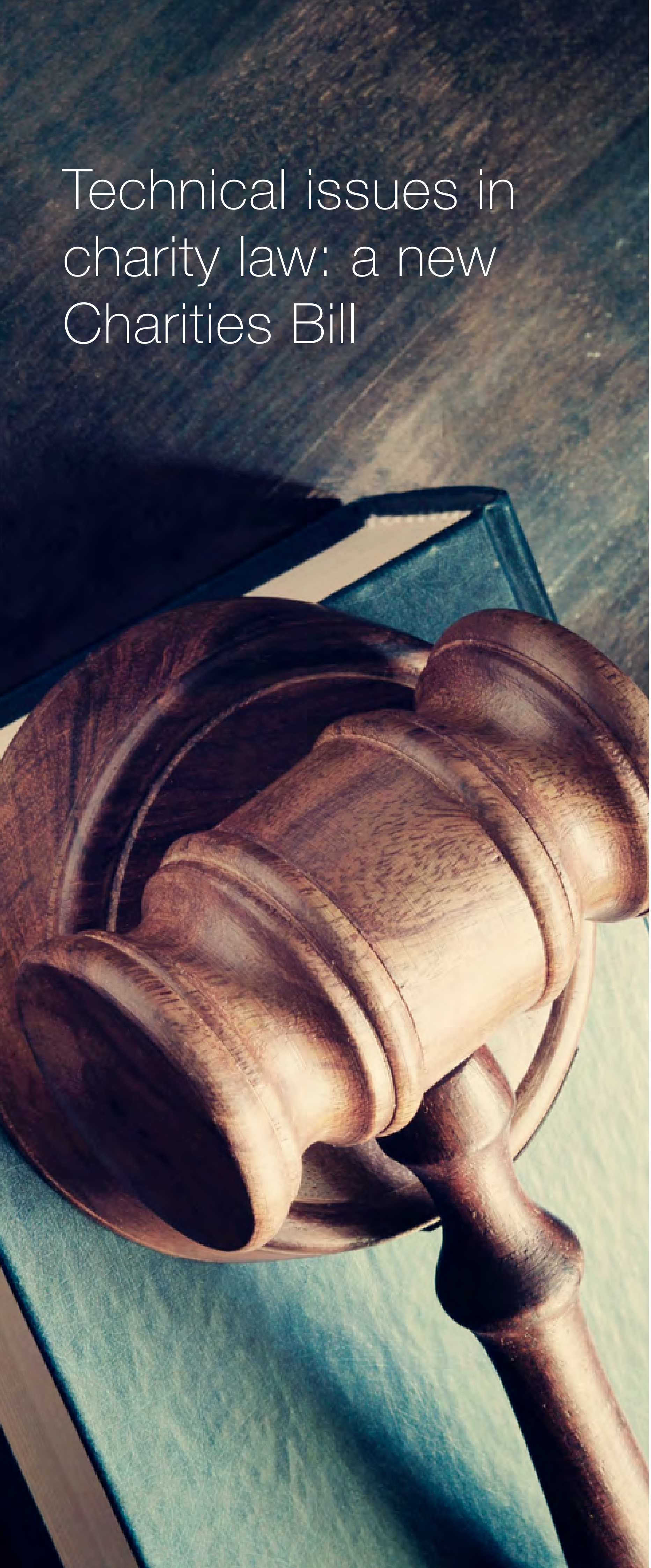
To facilitate risk mitigation, charities should have verification steps prior to making any payment, and a segregation of duties across the payments process to provide adequate levels of oversight. They should place strict controls on who has access to and is authorised to pay out and receive money. Furthermore, they should be aware of common triggers for suspicion such as payment requests with tight deadlines and requests for a change of address and/or bank details. This is why, for example, we always telephone our clients when we receive email requests for money.

Finally, how should charities respond to data breaches and cyber security incidents?

It is not possible to guarantee that all assets and information will be 100% safe. If you find that your charity has been compromised, it is important that you have a defined action plan in place which sets out the immediate steps required to help minimise the fallout of any such breach. This can include details on communication with relevant authorities, donors and beneficiaries, and the media. Under the GDPR, organisations will be required to report any material breaches to appropriate authorities within 72 hours, and non-compliance could lead to fines of up to the higher of 4% of annual turnover or €20m. Hefty fines and the fear of reputational damage should help ensure that all organisations including charities take action to protect themselves going forward, however it should be viewed and acknowledged as a key priority anyway.

[1] Further information can be found on the Information Commissioner's website www.ico.org.uk/for-organisations/data-protection-reform and we would encourage charities to review this information on a regular basis to keep abreast of new developments.

Technical issues in charity law: a new Charities Bill



By: Andrew Mackie
Senior Associate
Penningtons Manches LLP

The Law Commission was created in 1965 to keep the statute book ‘as fair, modern, simple and cost-effective as possible’. Of late, it has been concentrating on ‘Technical Issues in Charity Law’ and, on 14 September – following a two-pronged consultation process that began in March 2015 and ended in October last year – it published its much-anticipated report.

Stretching to a hefty 466 pages and including a draft Charities Bill, the report contains 43 recommendations, which it is hoped will remove some of the unnecessary burdens that the law currently places on charity trustees and resolve some of the inconsistencies in the rules that apply to charities of different types. As the title of the report suggests, the proposals are largely technical in nature but, if implemented, they should lead to some genuinely practical benefits.

“It will bring clarity to areas of the law that have long been considered uncertain and, in the words of the Law Commission, ‘allow charities to get on with the job of helping people’”

Several recommendations in the report are designed to make it easier for charities to amend their governing documents, and to ensure that a more standardised procedure applies across the range of charity structures. The most fundamental amendments (known as ‘regulated alterations’) will still require the consent of the Charity Commission but unincorporated charities in particular will be given a much wider power of amendment than they currently enjoy, putting them more on a par with charitable companies and charitable incorporated organisations (CIOs). The report also recommends that charities established by Royal Charter or Act of Parliament are given statutory power to amend their constitutions, which is likely to be welcomed.
In addition, it recommends an alignment of the procedures that are applied to corporate and unincorporated charities wishing to alter their charitable purposes, and proposes a single set of criteria for the Charity Commission to consider when deciding whether or not to give its consent.

The report also recommends that charities are given more flexibility over the advice they obtain when they sell land, and that some of the associated administrative burdens are lifted.
In particular, it recommends that the range of professionals that charities can approach for advice is broadened, and that the list of matters to be included in advisers’ reports is simplified and rationalised. The Law Commission estimates that these changes alone could save the sector almost £3 million every year.

Another suggested change relates to failed charity appeals. As things stand, where too little has been raised in an appeal, trustees must attempt to contact the donors to offer them a refund, which can be disproportionately costly. Taking the view that donors would be unlikely to expect trustees to incur such expense – or that they might even disapprove of it – the Law Commission recommends that trustees be permitted to retain small donations (up to £120 in a year) and apply them for other purposes unless the donor has requested otherwise. It also suggests that trustees be given power to apply appeal funds of up to £1,000 for new purposes without having to seek Charity Commission consent.

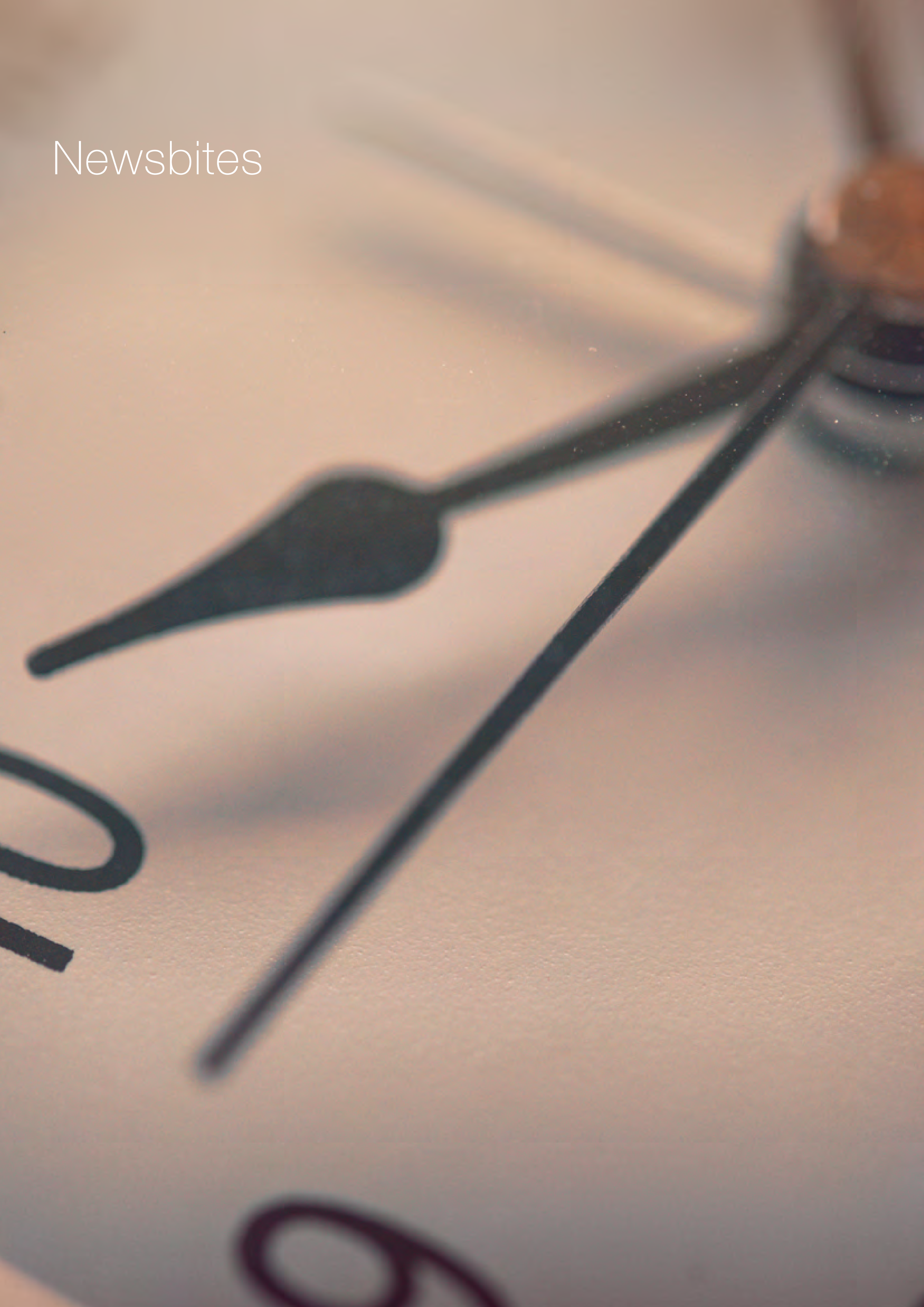
The report recommends a number of changes designed to facilitate charity mergers and incorporations and addresses a problem that has affected the register of mergers since its introduction, and which has led to the retention of numerous shell charities that would otherwise have been wound up had there not been a risk of them missing out on legacies.

Other helpful recommendations in the report include:

- more flexibility for charities to use permanent endowment (assets that must be retained as capital, rather than being spent as income), including a power to borrow against the fund, provided that it is recouped over time;
- new rules on the power to make ex gratia payments, with a sliding scale of permitted amounts depending on the charity’s size;
- the ability for the Charity Commission to ratify the appointment of trustees where there is some doubt over the validity of their appointment; and
- a power for the Charity Commission to require a charity to pay a trustee, or authorise a payment to be retained, where a he or she has carried out work and it would be inequitable for him or her not to be remunerated.

Of course, while the Law Commission can make recommendations, only Parliament can change the law and it is not yet known when the draft Charities Bill will be put forward for review. However, as it is unlikely to be deemed controversial it may well be fast-tracked, using a procedure that was approved in 2010 to improve the rate of implementation of Law Commission reports. Either way, if the Bill survives the Parliamentary process unscathed, it is likely to have a positive impact on the sector as a whole – not least because it will bring clarity to areas of the law that have long been considered uncertain and, in the words of the Law Commission, ‘allow charities to get on with the job of helping people’.

Newsbites



Ethical screening

Approximately a third of our charity and not-for-profit clients, by number, have ethical, social and governance considerations. Our investment process naturally avoids investments which we deem to be inappropriate for our charity client base, and we also work with our clients to ensure that their unique requirements are accommodated within their investment policy and portfolios. We employ the services of an independent company called *Ethical Screening* to ensure that we are kept abreast of the pertinent issues with regard to ethical and socially responsible investing, which are always changing.

Please do get in touch with the team if you would like further information.

Our private client offering

Rachel Kerr
Charities Team
Investec Wealth & Investment

Rachel Kerr is a private client investment manager who has been with the firm since 1992. In 2005, she joined the Charities Team to offer private client expertise to the trustees of charities whose funds we manage. Rachel is embedded in the investment process of the Charities Team, while taking into account other issues such as tax and pensions for her clients. Like the rest of the team, Rachel's aim is to provide a bespoke and personal service over the long-term for her clients, as we believe that our ability to offer portfolios based on our clients' requirements is a key advantage that we offer.

IW&I's new Online Portfolio Valuation Service

We have been busy developing our new online portfolio valuation service and we hope that once you migrate to the new system you will find the following functions useful:

- Historic valuations
- Real time positions
- Up-to-date pricing and values (15 minutes delayed)
- Historic statements/transactions
- Tablet and smartphone options available for Apple and Android
- One log-on page for both private and IFA users
- Can link other Investec accounts so you can view all accounts.

We have a dedicated team that will be able to assist you in the migration but in the first instance you should contact your IW&I Investment Manager.

Charity finance options

Over the last couple of years we have become aware of an increasing number of charities willing to borrow money in order to meet their objectives more effectively. Their reasons for doing this can range from wishing to kick start an income generating project, to building or refurbishing properties. Some have found it a way to meet the rising need for support from their beneficiaries. Borrowing will not be suitable for many charities and it is crucial that they prepare thoroughly before taking on loan finance.

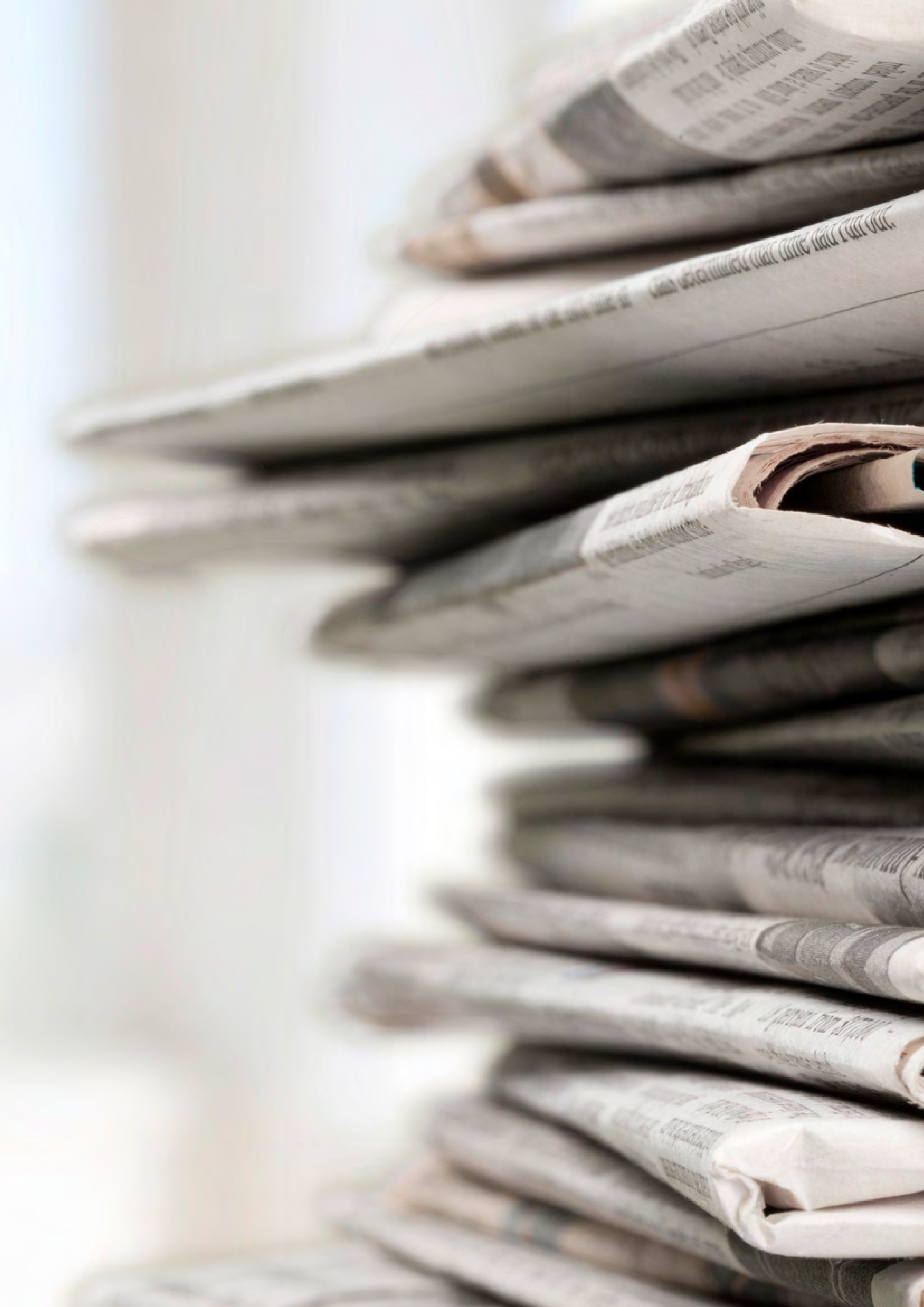
A growing loan finance provider is CAF Bank, owned by Charities Aid Foundation (CAF), a charity well known for its services and support for the charitable sector. CAF Bank provides flexible secured loans from £50,000 to £5 million for UK charitable organisations, repayable over 2-25 years. CAF offers a free guide explaining the potential benefits and risks of repayable finance which you can download at www.cafonline.org/finance.

Whilst we cannot comment on the merits of different forms of finance, we thought it might be useful for some charities to know of finance options that may be available to them.

MiFID II – update on Legal Entity Identifier (LEIs) – the clock is ticking…

Since our last report in the spring edition we have had a great response from our Charities Team clients receiving over 90% of the authority forms back. However, clients who have not yet responded should note:

- From 3 January 2018, without a valid LEI, financial institutions will no longer be able to transact in exchange traded investments on behalf of entities.
- For more detailed information see our website www.investecwin.co.uk/mifid2 or contact your investment manager.



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Belfast	02890 321002	**Exeter**	01392 204404	**London**	020 7597 1234
Birmingham	0121 232 0700	**Glasgow**	0141 333 9323	**Manchester**	0161 832 6868
Bournemouth	01202 208100	**Guildford**	01483 304707	**Reigate**	01737 224223
Cheltenham	01242 514756	**Leeds**	0113 245 4488	**Sheffield**	0114 275 5100

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