

*To consider*

## **Investment Policy**

### **Issue**

- 1** Proposed changes to the GMC's Investment Policy and associated governance arrangements.

### **Recommendations**

- 2** Council is asked to approve:
  - a** The Investment Policy at Annex A.
  - b** The governance arrangements, including the creation of an Investment Sub-Committee.

# Investment Policy

## Issue

- 3** We hold funds for the following reasons:
  - a** To provide working capital for our operations during the year.
  - b** To deal with any risks that materialise, resulting in an unexpected increase in expenditure and/or a reduction in income.
  - c** To respond to new initiatives and opportunities that may present themselves during the year.
  - d** To manage the time lag between a decision to increase/decrease fee levels and it taking full effect.
  - e** In short, to ensure that the GMC remains a going concern.
- 4** Our free reserves at the end of 2013 were just above £42 million. However, the level of cash we hold varies considerably during the year, and typically ranges between £70 million and £100 million. This is due to peak fee income being concentrated in the summer months, while expenditure is broadly linear throughout the year.
- 5** Guidance from the Charity Commission confirms that investing is a legitimate use of charitable funds, provided that charities manage the associated risks and operate within the law (including the Medical Act 1983, the Charities Act 1993 and the Trustees Act 2000). Usually this means obtaining the best financial return within the level of risk considered by trustees to be acceptable.
- 6** Our current Investment Policy is to hold funds in cash or near cash equivalents. Council has recognised that there are two main concerns with this approach: it fails to provide sufficient protection against a major failure in the banking sector; and the real value of our funds is being eroded by inflation, due to low interest rates.

## *Proposed Investment Policy*

- 7** The Charity Commission provides detailed guidance on a good practice framework for charity investments, and sets out the main issues to be addressed in an investment policy. However, the Commission recognises that specific investment objectives, attitude to risk and governance arrangements are local issues to be determined by trustees and will vary from charity to charity.
- 8** Following earlier consideration of this issue in seminar on 25 February 2014 and work undertaken since to develop a new Investment Policy, based on members feedback

and with the assistance of external advice from Mercer, we have drafted a new Investment Policy, at Annex A, which reflects the following.

### Acceptable level of risk

- 9** An investment policy based on a low risk appetite is likely to generate modest investment returns. Inevitably there will be a revenue risk that we fail to achieve our target returns, but the risk of capital loss is relatively low.
- 10** While an investment policy based on a greater risk appetite may generate greater financial returns there is a greater risk, to both returns and capital, as our investment portfolio would of necessity involve higher risk asset classes. This higher level of financial risk could cause a reduction in our reserves and affect future fee levels, creating reputational risk, particularly if we lose capital.
- 11** Our primary aim is to address the weaknesses in our current Investment Policy. There is no pressing need to increase our risk exposure in order to generate significant additional resources, and so a relatively low risk approach would seem appropriate.
- 12** We may, of course, wish to review our risk appetite and investment policy in the light of experience and to reflect future changes in both our own requirements and market conditions.

### Investment objective

- 13** Our investment objective is, to a large extent, driven by Council's risk appetite. It also needs to be considered within the context of our wider financial position. Free reserves are currently towards the top end of our target range, and we have so far been able to fund new initiatives and meet increased demands for services from our annual fee income and by re-investing efficiency gains.
- 14** A target return of inflation plus 2% is consistent with a low risk appetite. This would allow us to maintain the value of our reserves with a modest improvement in returns, which provides some scope to either limit future fee increases or fund further GMC expenditure.
- 15** While the possibility that additional returns could be used to fund new initiatives is attractive, those returns cannot be guaranteed and so any new initiative may need to rely on conventional income streams. This suggests that we should continue to deal with the funding of new initiatives through our existing business planning and budgeting process.

## Asset classes

- 16** We will continue to need to hold a proportion of our funds in cash, or near-cash equivalents, for working capital purposes. Based on our forecast cashflows we estimate that we need to retain a minimum £20 million.
- 17** The balance of cash held will be invested. Mercer has proposed an asset allocation that reflects our low risk appetite and aims to achieve our investment objective of inflation plus 2%.
- 18** Mercer recommends that equities should represent a core element of the proposed asset allocation, alongside absolute return bond funds, charitable property funds and absolute return funds. Details are set out in the draft Investment Policy at Annex A.

## Ethical and social investments

- 19** It is legitimate for a charity to avoid investments that are perceived as conflicting with its charitable aims, or to encourage investments that may further its aims. Where specific investments are included or excluded from the Investment Policy, there needs to be a clear rationale linked to the charitable aims.
- 20** While there are some clear investments that Council will wish to avoid, such as tobacco and alcohol, Mercer advise that there are dangers in adopting an overly prescriptive ethical investment policy, which may subsequently prove difficult to adhere to, particularly where day to day investment decisions are delegated to fund managers, or where pooled investment funds are used.
- 21** Mercer recommends that we invest only through fund managers who can demonstrate that they adopt a socially responsible approach to investing. Fund manager ratings are available against the following criteria:
  - a** Environmental - how a company performs as a steward of the natural environment.
  - b** Social - how a company manages relationships with its employees, suppliers, customers and the communities where it operates.
  - c** Governance - a company's leadership, executive pay, audits, internal controls, and shareholder rights.
- 22** We therefore propose that we invest only through fund managers who demonstrate the strongest environmental, social and governance (ESG) ratings, and that we specifically exclude investments in companies whose principal purpose is involvement with tobacco and alcohol, as we perceive these as conflicting with our charitable aims.

### *Governance arrangements*

- 23** Council is ultimately responsible for agreeing the Investment Policy, but may delegate operational decision-making and implementation of the Policy.
- 24** A common model is to create an investment sub-committee, comprising a small number of trustees, officers, external professional advisers, and external co-opted members with specific investment experience.
- 25** Also, Mercer recommends that professional fund managers are appointed to give us access to investment specialists, regulated by the Financial Conduct Authority, with the technical experience necessary for the day to day management of our portfolio in line with our Investment Policy.
- 26** We therefore propose a governance structure based on:
- a** Council - responsible for determining and reviewing the overall Investment Policy, objectives, risk appetite and target returns.
  - b** Investment Sub-Committee - responsible for implementing the Investment Policy, appointing and managing fund managers, monitoring performance and reporting to Council.
  - c** Professional fund managers - responsible for managing investments in line with the Policy, and accountable for performance against benchmarks.
- 27** A draft Statement of Purpose for the Investment Sub-Committee is set out at Annex B.
- 28** Subject to Council agreeing this approach, our next steps would be to:
- a** Seek expressions of interest from Council members wishing to serve on the Investment Sub-Committee.
  - b** Advertise for an independent, co-opted member with relevant investment experience, to sit on the Investment Sub-Committee.
  - c** Appoint an external investment adviser, to provide support and guidance to the Investment Sub-Committee.
  - d** Carry out a tender exercise, to appoint professional fund managers. The fund managers approach to ESG issues will be a key element in our selection criteria.
- 29** Once the Investment Sub-Committee was established, and professional fund managers appointed, investments would be made in line with the new Investment Policy, and performance reported to Council.

## Supporting information

### How this issue relates to the corporate strategy and business plan

**30** The management of investments supports all of the strategic aims set out in the corporate strategy and business plan. Specifically, it supports our commitment to make the best use of our resources.

**If you have any questions about this paper please contact: Steve Downs, Assistant Director – Finance and Procurement, [sdowns@gmc-uk.org](mailto:sdowns@gmc-uk.org), 0161 923 6257.**

## Investment Policy

### Introduction

- 1 This Policy sets out the approach we will take with all of the funds at our disposal.
- 2 Our funds can be separated into two categories, those which are required for the day to day operation of the business, our working capital, and those which are held in reserve, our investments.

### Working capital

- 3 Working capital will be held as cash or near cash equivalents in sterling in UK banks which are subject to regulation by the Financial Conduct Authority.
- 4 As a minimum, the bank must hold at least two out of three of the following short term credit ratings:  
  
Moody's      P-1  
  
Fitch          F1  
  
Standard and Poors A-1
- 5 Cash deposits should be spread, subject to a maximum exposure of £30 million per bank. Cash may be held in instant access interest bearing accounts or medium term deposits.
- 6 Where cash is held in medium term deposits, the maturity date should be no longer than 12 months, and no single deposit should exceed £5 million.
- 7 Each year, the Investment Sub-Committee will determine the amount needed to be held in cash, as working capital. The balance of funds will be invested.

## Investments

### *Attitude to risk*

- 8** We have a low risk appetite, we wish to protect against volatility, capital loss and the erosion of asset value by inflation.

### *Objective*

- 9** We seek to generate the best financial return that is consistent with our attitude to risk and therefore aim to achieve a target rate of return on our investments of inflation (RPI) plus 2%, over a rolling five year period.

### *Investments*

- 10** Our investments will be diversified by asset class and by fund manager. Our target strategic asset allocation is:

Equities	40%
Absolute return bonds	27%
Charitable property funds	12%
Absolute return funds	21%

- 11** Actual asset allocations may vary from these targets during the year, due to market movements. Formal rebalancing of the asset allocation will be done on an annual basis, unless the Investment Sub-Committee believes it is prudent not to do so. This will be reported to Council as necessary.

## **Ethical Investment Policy**

- 12** We have adopted an ethical investment approach to ensure that our investments do not conflict with our aims.
- 13** We will invest only through fund managers who demonstrate the strongest ESG (environmental, social and governance) ratings, and we will specifically exclude investments in companies whose principal purpose is involvement with tobacco and alcohol, as we perceive these as conflicting with our charitable aims.

## **Management, reporting and monitoring**

- 14** Council is responsible for determining and reviewing the overall investment policy, objectives, risk appetite and target returns.

- 15** Council has delegated to the Investment Sub-Committee responsibility for implementing the investment policy, appointing and managing fund managers, monitoring performance and reporting to Council. Full responsibilities are set out in the Investment Sub-Committee terms of reference.
- 16** Professional fund managers are responsible for managing investments in line with the policy, and are accountable to the Investment Sub-Committee for performance against agreed benchmarks.
- 17** Each fund manager is required to provide quarterly valuation and performance data.

### **Approval and review**

- 18** The Investment Policy will be reviewed by Council annually, on the advice of the Investment Sub-Committee. This will reflect the Council's overall financial position, its budgetary requirements, and any changes to the reserves policy.

### Investment Sub-Committee Statement of Purpose

#### *Purpose*

- 1 The purpose of the Investment Sub-Committee is to provide a forum for implementing and reviewing Council's Investment Policy.
- 2 Council is ultimately responsible for determining and reviewing the overall Investment Policy, objectives, risk appetite and target returns. Operational decision-making and implementation of the policy is delegated to the Investment Sub-Committee.

#### *Duties and activities*

- 3 The Investment Sub-Committee:
  - a Ensures the management of the assets is consistent with the Investment Policy set by Council.
  - b Monitors the Investment Policy to ensure it remains appropriate, and to recommend changes to Council as appropriate. This includes target returns, level of risk, strategic asset allocation, and ethical considerations.
  - c Implements changes to the Investment Policy as appropriate.
  - d Establishes and monitors the investment management structure to ensure that it is appropriate to meet the agreed Investment Policy. This includes decisions about the number of fund managers used, the proportion of assets managed by each manager, and their mandates.
  - e Implements changes to the investment management structure as appropriate.
  - f Establishes and monitors the actual asset allocation and the mix between managers relative to the strategic allocation and implements changes where rebalancing is needed to maintain the strategic allocation on an annual basis. The Investment Sub-Committee may vary the actual asset allocation in-year, within

tolerances to be agreed, and based on professional advice, but must rebalance the overall allocation in line with the strategic allocation on an annual basis.

- g** Appoints investment fund managers, and independent external advisers to provide professional advice.
- h** Monitors the performance of each fund manager against agreed objectives by means of regular review of the investment results and other information.
- i** Monitors the corporate governance activities, policies and exercising of voting rights of the investment fund managers.
- j** Meets with the investment fund managers on a regular basis to discuss their performance, actions and future strategy.
- k** Monitors the continued stability of the investment fund managers against agreed objectives. Implementing changes to the investment mandates as necessary.
- l** Implements changes to the investment management arrangements as appropriate.
- m** Agrees the terms of appointment of the investment fund managers, including their fee scales.
- n** Monitors and reacts to legislative, financial and economic changes affecting, or potentially affecting, investment policy.
- o** Review the investment policy so that it remains consistent with, and supportive to, Council's overall business plan, budget and reserves policy.

#### *Working arrangements*

- 4** The Investment Sub-Committee meets quarterly. Additional meetings may be scheduled if necessary.
- 5** Draft minutes should be cleared by the chair and circulated to members for comment within two weeks of the meeting. The Investment Sub-Committee approves the minutes at its next meeting. A quarterly report will be presented to Council.
- 6** Membership of the Investment Sub-Committee comprises:
  - a** Two members of Council, one of whom will be appointed as Chair of the Investment Sub-Committee.
  - b** One external, co-opted member, with extensive investment experience.

- c** The Chief Operating Officer, the Director of Resources and Quality Assurance and the Assistant Director, Finance and Procurement. Other staff may attend as necessary.
  
- 7** The Investment Sub-Committee is supported by an independent investment advisor, appointed by the Investment Sub-Committee. Fund managers who are appointed to manage investment funds on behalf of the GMC will be expected to attend Investment Sub-Committee meetings.
  
- 8** A summary of investment performance is reported to Council as part of the normal reporting of financial performance within the Chief Operating Officer's report to Council. In addition, the Investment Sub-Committee will report annually to Council on its activities.