

Agenda item:	10
Report title:	Review of Investment Policy
Report by:	Neil Roberts , Director of Resources and Quality Assurance nroberts@gmc-uk.org , 0161 923 6230
Considered by:	Investment Sub-Committee
Action:	To consider

Executive summary

At the request of Council, the Investment Sub-Committee has reviewed the investment policy and proposes a number of changes:

- A three-tier approach to investment be adopted, to reduce the risk of material outright loss and minimise the chance that we do not have sufficient cash available to meet our short term liabilities
- A target rate of return on funds under management of CPI plus 2%
- A strengthened ethical dimension to the policy
- The removal from the policy of the pre-defined asset allocation.

In light of the policy changes the Investment Sub-Committee also recommends changes to its Statement of Purpose.

Recommendation

Council is asked to:

- Approve the revised investment policy ([Annex A](#)).
- Agree the proposed amendments to the Statement of Purpose of the Investment Sub-Committee ([Annex B](#)).

Issue

- 1 Council discussed the investment policy in closed session on 23 April 2015, and agreed that it should be reviewed by the Investment Sub-Committee.
- 2 This paper proposes a number of changes to the investment policy, and the Sub-Committee's statement of purpose, in the light of that review.

Funds available for investment

- 3 Based on estimated future cash-flows, the Investment Sub-Committee recommends a three tier approach:
 - a Hold £20 million as working capital for normal cash-flow purposes, which equates to just over two months operating costs.
 - b Invest £10 million under management. This prudent level of investment creates the potential for returns above inflation while limiting the reputational and financial risks arising from a fall in the value of our investments.
 - c Hold the balance of funds in medium term deposits. This would generate higher returns than cash and would avoid the risks of constantly changing the level of investments under management. The level of funds available to hold in term deposits will vary during the year, estimated between £30 million and £60 million in 2015. The amount available in 2016 will be, to a large extent, dependent on the budget set by Council.
- 4 This three-tier approach reduces the risk of material outright loss and minimises the chance that we do not have sufficient cash available to meet our short term liabilities. The amounts held as working capital and invested under management should be reviewed annually by Council.

Funds under management – investment objective

- 5 We have a low risk appetite. We wish to protect against volatility, capital loss and the erosion of asset value by inflation.
- 6 Our investment objective is to seek to generate the best financial return that is consistent with our attitude to risk. The Investment Sub-Committee has concluded that a target rate of return on funds under management of inflation (CPI) plus 2% (net of fees), over a rolling five year period, would be appropriate. We expect fund managers to invest in a range of asset classes to provide sufficient diversification.
- 7 The current policy is to invest only through fund managers who demonstrate the strongest ESG (environmental, social and governance) ratings, and to specifically exclude investments in companies whose principal purpose is involvement with tobacco and alcohol, as we perceive these as conflicting with our charitable aims.

- 8** The Sub-Committee concluded that the policy should be strengthened: by expanding the list of excluded investments to encompass gambling, pornography, high-interest rate lending, cluster munitions and landmines; by investing in companies that we believe further or charitable aims; and through stewardship by using voting rights (either directly or through our fund managers) to influence the corporate behaviour of those companies in which we have an interest.
- 9** The current policy specifies an asset allocation i.e. a pre-defined mix of asset categories such as stocks, bonds and property. Given that the proposed policy sets a clear target return for investments, with enhanced ethical requirements, the Sub-Committee concluded that the inclusion of a pre-defined asset allocation would be unduly restrictive and fetter the fund managers' ability to fulfil the policy's target return and ethical objectives. The asset allocation is therefore removed from the revised policy at Annex A. However, the asset allocations will be reviewed periodically by the Investment Sub-Committee to ensure that they remain consistent with our low risk appetite. Where more than one fund manager is used, the Investment Sub-Committee will also monitor the aggregate asset allocation to ensure it provides sufficient diversification.
- 10** Annex B sets out a revised Statement of Purpose reflecting the policy changes outlined in this paper. As the Investment Sub-Committee has two external co-opted members with extensive investment experience, the Sub-Committee considered that there was no need to appoint a permanent independent external adviser, but agreed to retain the flexibility to engage external advisers to undertake a periodic review/health-check of the investment arrangements.
- 11** Subject to the approval of the revised investment policy and revised Statement of Purpose, the Investment Sub-Committee will carry out a tender process to appoint one or more fund managers with the aim of having funds placed under management by 31 December 2015.

10 – Review of Investment Policy

M10 – Annex A

Investment Policy

Introduction

- 1 As a matter of prudent financial management we must hold sufficient free reserves to meet the financial risks we face, and to ensure that our regulatory independence is underpinned by a strong and stable financial base.
- 2 The need for reserves coupled with the pattern of registration and retention fees received during the year means that we hold significant cash sums. They arise as a consequence of our being in business.
- 3 This ~~Policy~~ policy sets out the approach we will take with all of the funds that we hold ~~at our disposal~~.
- 4 Our funds can be separated into ~~two~~ three categories: those which are required as working capital for the normal day to day operation of the business; ~~our working capital,~~ and those which are held in reserve, our investments we invest under management; and the remaining cash balance which fluctuates during the year.

Working capital

- 5 We will hold £20 million as ~~W~~working capital for normal cash-flow purposes. This amount will be reviewed annually by Council.
- 6 ~~Funds~~ will be held as cash ~~or near-cash equivalents~~ in instant access interest-bearing accounts ~~sterling~~ in UK banks which are subject to regulation by the Financial Conduct Authority.
- 7 As a minimum, the bank must hold at least two out of three of the following short term credit ratings:
 - Moody's ~~P-1~~ P-2
 - Fitch F1

- Standard and Poor's ~~A-1~~ A-2
- 8 Funds will be managed by the Director of Resources and Quality Assurance who will seek to secure the most advantageous interest rates available, within the constraints of the policy. Funds may be moved between banks during the year to achieve this, but the primary requirements for working capital funds are security and liquidity.

Funds under management

- 9 We will invest £10 million under management. This amount will be reviewed annually by Council.
- ~~10 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.~~
- ~~11 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.~~
- ~~12 Each year, Council will determine the amount needed to be held in cash, as working capital. The balance of funds will be invested.~~

~~Investments~~

Attitude to risk

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

Objective

- 14 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 funds under management ~~our~~ ~~investments~~ of inflation (~~RPI~~ CPI) plus 2%, over a rolling five year period.

~~Investments~~

- 15 ~~Our investments will be diversified by asset class and by fund manager. Our target strategy~~ Asset allocations will be determined by the fund managers in order to achieve the target return and ethical considerations set out in this policy. Fund managers may invest through a mutual fund, segregated portfolio, or a combination of both.
- 16 The asset allocations will be reviewed periodically by the Investment Sub-Committee to ensure that they remain consistent with our low risk appetite. Where more than one fund manager is used, the Investment Sub-Committee will also monitor the aggregate asset allocation to ensure it provides sufficient diversification.

~~17 is:~~

~~Equities 40%~~

~~Absolute return bonds 27%~~

~~Charitable property funds 12%~~

~~Absolute return funds 21%~~

- ~~18 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 considerations

- 19 We have adopted a comprehensive an ethical investment approach. We seek to avoid those investments that we believe conflict with our charitable aims, and we may invest in companies whose activities are consistent with, or supportive of, our charitable aims. We may also use our position as an investor to influence the corporate behaviour of those companies we invest in. ~~to ensure that our investments do not conflict with our aims.~~
- 20 We will invest only through fund managers who demonstrate the strongest ESG (environmental, social and governance) ratings credentials. ~~and we~~ We seek to will specifically exclude investments in companies whose principal purpose is involvement with tobacco, ~~and~~ alcohol, gambling, pornography, high-interest rate lending, cluster munitions and landmines. ~~, as we perceive these as conflicting with our charitable aims.~~

Remaining cash balances

- 21 The balance of funds held by the GMC during the year, not held as working capital or invested under management, will be held in medium term deposits.
- 22 Medium term deposits will be held in UK banks which are subject to regulation by the Financial Conduct Authority. As a minimum, the bank must hold at least two out of three of the following short term credit ratings:
- Moody's P-2
- Fitch F1
- Standard and Poor's A-2
- 23 The maturity date for medium term deposits should be no longer than 18 months, and no single deposit should exceed £5 million. Term deposits should be spread, on a rolling maturity basis, subject to a maximum exposure of £40 million per bank

(including any funds held as working capital in instant access interest-bearing accounts).

- 24** Funds will be managed by the Director of Resources and Quality Assurance who will seek to secure the most advantageous interest rates available, within the constraints of the policy.

Management, reporting and monitoring

- 25** Council is responsible for determining and reviewing the overall investment policy, objectives, risk appetite and target returns.
- 26** 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's statement of purpose ~~terms of reference~~.
- 27** Professional fund managers are responsible for managing investments in line with the policy, and are accountable to the Investment Sub-Committee for performance. The Investment Sub-Committee may determine benchmarks against which to measure performance. ~~against agreed benchmarks.~~
- 28** Each fund manager is required to provide quarterly valuation and performance data.

Approval and review

- 29** 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.

10 – Review of Investment Policy

M10 – Annex B

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 appointment of fund managers, the number of fund managers used, the proportion of assets managed by each manager, and their mandates.
 - e Agrees the terms of appointment of the investment fund managers, including their fee scales.
 - f Implements changes to the investment management structure as appropriate.

- g Monitors the actual asset allocations chosen by the fund manager, to ensure that the allocation is consistent with the agreed Investment Policy. Where more than one fund manager is appointed, the Investment Sub-Committee will also monitor the aggregate asset allocation to ensure it provides sufficient diversification.
- ~~h 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.~~
- ~~i Appoints investment fund managers, and independent external advisers to provide professional advice.~~
- j Monitors the performance of each fund manager against agreed objectives by means of regular review of the investment results and other information.
- k Monitors the corporate governance activities, policies and exercising of voting rights of the investment fund managers.
- l Meets with the investment fund managers on a regular basis to discuss their performance, actions and future strategy.
- m Monitors the continued stability of the investment fund managers against agreed objectives. Implementing changes to the investment mandates as necessary.
- ~~n Implements changes to the investment management arrangements as appropriate.~~
- ~~o Agrees the terms of appointment of the investment fund managers, including their fee scales.~~
- p Monitors and reacts to legislative, financial and economic changes affecting, or potentially affecting, investment policy. The Investment Sub-Committee may engage external professional advisers to undertake a periodic review/health-check of the investment arrangements.
- q 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 Four members of Council, one of whom will be appointed as Chair of the Investment Sub-Committee.
 - b ~~Two or three~~ external, co-opted members, 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~~ **will be** 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.