Council, 15 May 2014

Investment Policy

Executive summary and recommendations

Decision

The Council is asked to discuss and approve the attached Investment Policy.

Background information

In February 2011, the Council approved a change in the previous (2008) investment policy, ending investment in equities, on the recommendation of the Finance & Resources Committee, which discussed a paper on investments in January 2011. The portfolio of equities was duly disposed of in February 2011 and surplus funds have been invested only in bank deposits since then.

The proposed new policy expresses the rationale for investing only in bank deposits and defines the types of bank deposits that are permitted, how investments will be made, and how performance will be reported.

Resource implications

None.

Financial implications

None. The investments currently held comply with the proposed new policy.

Appendices

1. Proposed new Investment Policy
2. Proposed text to disclose Investment Policy in the Annual Report and Accounts
3. Example investment policies as disclosed by other regulators

Date of paper

1 May 2014

Appendix 1: proposed new Investment Policy

Introduction

This policy sets out limits on the types of asset in which HCPC funds may be invested, together with processes for decision making, authorisation and reporting.

This policy applies to all those persons involved in investment activities for or on behalf of the HCPC.

Responsibilities

Council is responsible for approving the policy and monitoring investment performance. The Executive is responsible for advising Council on the policy.

Investments in bank deposits under the policy will be approved by the Finance Director.

Legislation

The HCPC's governing legislation does not specify the types of investment we may hold, but gives an implied power to invest[1].

Objective and definition of investments

The objective of any investment is to achieve a financial gain in the form of income and/or capital appreciation. Hence investments are assets that are not required for immediate operational purposes and are held for the purpose of capital appreciation and/or income generation. Normally, the greater the potential gain, the greater the risk of capital loss, so investors need to be clear on the degree of risk they are willing to accept ("risk appetite").

The HCPC's investment policy provides the framework for the management of funds that are surplus to immediate requirements. The objectives of the policy, in order of priority, are

- to ensure that our funds are held safely;
- to ensure that we have sufficient liquidity to fund our operations; and
- to achieve a return on surplus funds.

[1] *Health and Social Work Professions Order 2001, SI 2002 no 254, Schedule 1, Part 1, Section 16:* Subject to any provision made by or under this Order, the Council may do anything which appears to it to be necessary or expedient for the purpose of, or in connection with, the performance of its functions.

Main categories of investment

Equities
Held primarily in the expectation of capital appreciation. Can also produce income via dividends. Can be held directly in individual companies, or indirectly in funds. Listed investments are liquid, in that they can be sold instantly. High risk, since capital value is subject to performance of the individual company, and companies in the same sector, and the economy in general.

Investment property[2]
Held for rental yield and in the expectation of capital appreciation. Can be held indirectly via funds. Directly held investment properties have high transaction costs and are extremely illiquid: likely minimum 6 months from decision to sell to receipt of proceeds. High risk, since capital value is subject to condition of the property, changes in the surrounding area, and the economy in general.

Bonds, including UK government issued bonds, known as gilt edged securities
Held primarily for interest yield. The redemption value and the interest payments are certain, except in the event of default, so the yield to maturity on a high quality bond is reliable. But capital gains or losses in the period before maturity are possible because bond prices move in response to changes in the market rate of interest and, in the case of lower quality bonds, the perceived risk of default by the borrower. The longer the period to maturity, the larger the possible price movements and the higher the risk. Listed bonds and gilts are liquid.

Bank deposits
Held for interest yield. No risk of capital loss except in the event of the failure of the bank[3]. Liquidity depends on the length of the deposit and the terms. Some fixed term deposits can be redeemed early on payment of an interest penalty. The lowest risk category of investment.

Credit ratings

The risk level of bank deposits and bonds is assessed by credit ratings agencies. The three main agencies are Standard & Poor's, Moody's and Fitch. They use similar scales, ranging from AAA, which is the judged to be the lowest risk of default, to C. Instruments rated BBB- or higher by S&P or Baa3 or higher by Moody's are referred to as "investment grade" – that is, deemed suitable for investment by banks.

HCPC's risk appetite in relation to investments

Over the historical long term, investments in equities and property have produced positive returns in excess of the returns available from bank deposits or bonds.

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[2] HCPC's freehold properties in Kennington are operational, not investment assets.

[3] The UK has a deposit insurance scheme, the Financial Services Compensation Scheme, but it protects deposits up to £85,000 made by individuals and small companies, so the HCPC is <u>not</u> covered.

Therefore a risk neutral investor with funds available to invest for the long term would normally choose to invest at least partly in one of those asset classes.

HCPC's costs are funded by fees charged to registrants. Positive returns on investments via capital gains and/or income would make a contribution towards those costs, and may limit the need for fee increases. Conversely, investment capital losses could impact on operations and/or lead to fee increases.

However, registrants and other stakeholders are likely to place much more weight on a capital loss which causes a fee increase or a reduction in HCPC's operations than they would on a capital gain of the same value. We do not budget for investment income so we are not dependent on it to fund operations. Therefore our risk appetite in relation to investments should be very low.

Investment planning horizon

Although equities and properties have historically performed well over the long term, they can be volatile over the short term. Investors are therefore normally advised to invest in equities or property only if they can afford to take a long term stance. Because of the cyclical nature of registrant renewals, we have peaks and troughs in our cashflow, but we do not have a large permanently investable fund. This is a further reason why equities and property are not appropriate investments for HCPC.

Permitted classes of investment

Given a very low risk appetite and relatively short term investment planning horizon, the only permitted class of investment is sterling bank deposits with terms of up to 24 months. Our banks must be UK registered and must have long term credit ratings of at least A- from Standard & Poor's and A3 from Moody's[4].

Ethical considerations

Investment policies often include an ethical criterion applying to the companies in which investments can be made. In HCPC's pre-2011 investment policy, equity investments were permitted but investments in equities in the gambling, alcohol and tobacco sectors were excluded.

This policy does not allow investment in equities, and it is impractical to apply an ethical criterion to investments in bank deposits. The banks with which we place funds on deposit will lend our funds (mixed with those of all their other depositors) to a very large number of borrowers in a very wide range of industries, and some of their borrowers are likely to be in the gambling, alcohol or tobacco industries. All large banks are likely to be directly or indirectly involved to some degree in lending which could be challenged

[4] We currently bank with Barclays (rated A by S&P, A2 by Moody's), Lloyds (A- and A2 respectively), Natwest (owned by Royal Bank of Scotland: RBS is rated A- and A3) and Santander (Santander UK is rated A and A2).

on ethical grounds. So for practical reasons, this policy does not require an ethical criterion to be applied to the banks with which we place funds on deposit. However, if one of the banks we use was to be seen to be involved in unethical lending, relevant to our role as a health regulator, we would consider moving funds away from it.

Decision making process

Investments in bank deposits will be proposed by the Finance department based on cash flow forecasts and approved by the Finance Director. Because of the low risk and straightforward nature of these bank deposit investments, external professional advice is not required.

Benchmarking and reporting

The target rate of return on investments is that interest earned, as a percentage of average cash and investment balances, should equal or better the Bank of England base rate. Including cash balances in the denominator incentivises the Finance department to make best use of available funds, within the policy and subject to the overriding requirement that cash must be available to pay operational costs as they fall due.

The actual return will be calculated annually and reported to the Council at their Summer meeting, and disclosed in the Annual Report and Accounts.

Review of the policy

This policy will be reviewed by the Council every three years, or more frequently if appropriate due to changes in circumstances.

hcpc health & care professions council

Appendix 2: Draft disclosure of Investment Policy in the 2013-14 Annual Report and Accounts

Our investment policy was revised and approved at the Council meeting in May 2014 and will be reviewed at least every three years. The policy provides the framework for the management of funds that are surplus to immediate requirements. The objectives of the policy, in order of priority, are to ensure that our funds are held safely; to ensure that we have sufficient liquidity to fund our operations; and to achieve a return on surplus funds.

Surplus funds may be invested in sterling bank deposits with terms of up to [24] months in UK registered banks that have “investment grade” long term credit ratings from both Standard & Poor’s and Moody’s.

Appendix 3: examples of other regulators' disclosed investment policies

NMC investment policy as disclosed in NMC 2012-13 annual report and accounts, page 18

Investment policy

47 The NMC has the power to invest its surplus funds as it considers appropriate to generate income. Currently the NMC has a formal investment policy, which limits investment to low and no risk options.

48 NMC funds are held in fixed interest deposit accounts spread across five UK high street banks. The revenue generated from the investments in 2012–2013 was £1.275 million (2011–2012: £1.2 million).

GMC investment policy as disclosed in GMC 2012 annual report and accounts, page 28

Investment policy

116 Our investment policy is to hold general reserves in cash or near cash equivalents to minimise risk in terms of both loss of capital and volatility of investment returns. The investment policy supports the aims of the reserves policy and so is reviewed periodically at the same time as the reserves policy. Our investment policy was reviewed by the Resources Committee on 1 May 2012. From 1 January 2013, our governance arrangements changed and the investment policy will, in future, be considered by the Performance and Resources Board and then approved by Council.

117 Cash required for normal day-to-day working capital is shown on our balance sheet within current assets, whereas cash held for the longer term is shown as investments.

118 In 2012, our investments generated interest of £0.6 million, equivalent to an average annual rate of return of 0.6%. The Resources Committee regularly reviewed investment income, as part of the overall monitoring of our financial performance in 2012.

The GDC does not disclose its investment policy in its annual report and accounts, but does hold investments in equities and bonds, which are professionally managed.