Council, 24 May 2017

Investment policy

Executive summary and recommendations

Introduction

Our investment policy is part of HCPC's corporate governance framework. The policy was last reviewed by Council in May 2014, and at that time it was agreed that the policy would be reviewed at least every three years.

While other corporate governance documents are being reviewed by Council in September, the reserves policy and the investment policy are summarised in the annual report and accounts, so it is appropriate that those policies are updated prior to finalisation of the 2016-17 annual report and accounts.

The only change proposed from the current policy is to allow short dated UK government bonds ("gilts") as a permitted class of investment. However the yield currently available from short dated gilts is 0.15%, whereas the yield available from fixed term bank deposits is around 1%, so we are unlikely to invest in gilts in the short term.

Decision

Council is asked to discuss and approve the attached investment policy

Resource implications

None

Financial implications

None directly

Appendices

1. Proposed updated 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

15 May 2017

Appendix 1: Proposed updated investment policy

1. **Introduction**

1.1. The investment policy is part of HCPC's corporate governance framework, and is consistent with our legislation and our strategic intent. It is also consistent with HM Treasury's guidance for the financial management of public bodies[1]. The~~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.

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

2. Responsibilities

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

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

3. Legislation

3.1. The HCPC's governing legislation does not specify the types of investment we may hold, but gives an implied power to invest[2].

4. Objective and definition of investments

4.1. 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").

4.2. 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] https://www.gov.uk/government/publications/managing-public-money

[2] *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.

5. Main categories of investment

Equities

5.1. 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[3]

5.2. 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.

Corporate b~~B~~onds~~, including UK government issued bonds, known as gilt edged securities~~

5.3. Held primarily for interest yield. The redemption value and the interest payments are fixed~~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.

UK government issued bonds, known as gilt edged securities

5.4. Held for interest yield or as a store of value. The redemption value and the interest payments and therefore the yield to maturity are virtually certain. Capital gains or losses in the period before maturity are possible because gilt prices move in response to changes in the market rate of interest. The longer the period to maturity, the larger the possible price movements and the higher the risk. Gilts are liquid. Short dated gilts are therefore the lowest risk sterling denominated investment[4].

Bank deposits

~~5.4.~~5.5. Held for interest yield. No risk of capital loss except in the event of the failure of the bank[5]. Liquidity depends on the length of the deposit and the

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

[4] Following the Brexit vote, the UK government no longer has the highest possible credit rating, but its credit rating is higher than that of any commercial bank. Several foreign governments have higher credit ratings than the UK government but a foreign government bond would be inappropriate because of exchange rate risk.

[5] 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 not covered.

terms. Some fixed term deposits can be redeemed early on payment of an interest penalty. The lowest risk category of investment.

6. Credit ratings

6.1. 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.

7. HCPC's risk appetite in relation to investments

7.1. The Council have agreed[6] that HCPC's risk appetite in general should be low. Factors affecting our risk appetite specifically in relation to investments are discussed below.

~~7.1.~~7.2. 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. 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.

~~7.2.~~7.3. 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.

~~7.3.~~7.4. 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.

8. Investment planning horizon

8.1. 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.

[6] Council 7 December 2016, agenda item 13

9. Permitted classes of investment

9.1. Given a very low risk appetite and relatively short term investment planning horizon, the only permitted classes of investment are~~is~~ bonds issued by the UK government (“gilts”) with up to 24 months to maturity and sterling bank deposits with terms of up to 24 months[7].

9.2. 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[8]. In order to reduce our exposure to an individual bank, no more than 67% of total cash will be held under one banking licence at any time.

Commented [AG1]: NatWest no longer meets this threshold. At the moment we only have £54k at NatWest and their fixed term rates have not been competitive for some time, so excluding NatWest would not have a major impact.

However, Barclays and Santander are both at or near the threshold and on negative ratings watch, and there are not many alternative banks that do meet the threshold, so we may need to reduce the threshold anyway

10. Ethical considerations

10.1. 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.

10.2. 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 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.

11. Decision making process

11.1. 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.

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[7] As of April 2017, the yield on short dated gilts is approximately 0.15%, whereas we are still able to obtain about 1% on two year fixed term bank deposits. So despite the slightly higher risk relating to bank deposits, we are likely to continue to place all available to invest funds in bank deposits, until gilt yields are more attractive.

[8] We currently bank with Barclays (rated A- (Negative) by S&P, A1~~2~~ (Negative) by Moody’s), Lloyds (A~~-~~ and A1~~2~~ respectively), Natwest (owned by Royal Bank of Scotland: ~~RBS is rated A-~~BBB+ and A3) and Santander (Santander UK is rated A (Negative) and A~~2~~a3 (Negative)).

12. Benchmarking and reporting

12.1. 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.

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

13. Review of the policy

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

Appendix 2: Draft disclosure of investment policy in the 2016-17 Annual Report and Accounts

Our investment policy was revised and approved at the Council meeting in May 2017 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 bonds issued by the UK government ("gilts") with up to 24 months to maturity, and 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 2015-16 annual report and accounts, pages 21-22

Investment policy

88 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.

89 NMC funds are held in fixed interest deposit accounts spread across four UK high street banks. The revenue generated from the investments in 2015–2016 was £0.643 million (2014–2015: £0.641 million).

GMC investment policy as disclosed in GMC 2015 annual report and accounts, page 57

Investment policy

In 2015, we reviewed our investment policy to improve yield while maintaining an appropriate degree of security and liquidity. Our previous policy was 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 new investment policy separates our funds into three categories:

- those that are needed as working capital for the normal day-to-day operation of the business
- those we invest under management
- the remaining cash balance, which fluctuates throughout the year.

We will hold £20 million as working capital, as cash in instant access interest-bearing accounts. We will invest £10 million under management starting in the early part of 2016, and the balance of our funds will be held in medium-term deposits. For funds under management, we have a low-risk appetite and wish to protect against volatility, capital loss and the erosion of asset value by inflation. We aim to achieve a target rate of return on funds under management of the consumer price index plus 2% to 5%, over a rolling five-year period. We have appointed CCLA as our fund manager, investing through their COIF Ethical Fund.

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.