Finance and Resources Committee Meeting – 20th November 2007

Investments Policy

Executive summary and recommendations

Introduction
There is an annual review of the Investments Policy, previously agreed by the Committee on 20th November 2006 – refer Minutes Item 13.2.

Decision
The Committee is requested to approve continuation of the Investments Policy as appropriate.

Background information
On the Balance Sheet, the Investment fund is shown as "Investments" with any cash element (yet to be invested by Rensburg Sheppards) recorded under "Bank balances and cash." In addition to "Investments", short term cash reserves are invested in the money market and there is also a sizeable property investment in the land and buildings of Park House, 20 Stannary St and 22/26 Stannary St. The property element will be revalued after completion of the building project with the current net book value (total land & buildings) of approx £3.3M.[1]

Resource implications
Nil

Financial implications
Investment fund commission charges of approx £12k per annum.

Appendices
- Investment Policy

Date of paper
8th November 2007

[1] Offsetting the various investments are the HPC's Current Liabilities and Deferred Income - refer latest Balance Sheet values.

HEALTH PROFESSIONS COUNCIL (HPC)

INVESTMENT POLICY
(Approved by Committee 20 Nov 2006)

1 INTRODUCTION

HPC commenced operations on 1st April 2002 inheriting the net assets and reserves of the Council for Professions Supplementary to Medicine (CPSM).

The value of the investment portfolio (managed externally) at 1 April 2002 was £2.15M, exclusive of cash balances held for investment.

The 31 August 2005 market valuation of the funds managed by Carr Sheppard Croswaithe Ltd[1] (CSC) totalled £1.54M, after withdrawals of £800k for special project funding since 2002 (LISA and Park House renovations) and a further £250k in May 05 to assist in purchasing Purbrook & Eyres Ltd share capital to acquire the 22-26 Stannary St building space.

2 INVESTMENT POLICY

2.1 **To invest surplus funds in income and capital growth-generating investments, without putting those funds at undue investment risk and without "locking up" the funds when they are needed to run the business i.e. ensure funds aren't locked up for a longer duration than HPC's cash-flow needs, or aren't invested in items that are difficult to convert into their cash equivalents at current market valuation.**

Potential income-generating investments include things like cash term deposits, bonds, equities paying dividends and property, if rental income is obtained from it. Potential capital-growth investments include things like equities (share price increases), real estate (capital value increases), collectibles and bullion such as gold and silver.

Such investment types each have different levels of risk and return, different types of professional expertise required to select, manage and realise the value from them.

2.2 **To utilise a combination of indirect and direct investment methods for investing surplus funds, where appropriate internal control can be maintained, where appropriate external investment expertise can be leveraged and where investment risk can be better diversified or minimised.**

An example of *indirect investment* is outsourcing the investment and management of an investment portfolio (e.g. real estate, shares and bonds) to one or more professional fund management firms. An example of *direct*

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[1] Carr Sheppard Croswaite Ltd (CSC) is a private client investment management business (fund management firm) with offices in London, Reigate, Farnham and Cheltenham. At the time of writing, CSC had £6.1B funds under management (£5.9B at 31 May 05) and on 6th May 2005 were taken over by Rensburg Sheppards PLC Group (www.rensburg.co.uk). Rensburg Sheppards PLC at the time of writing had more than £10B of client funds under management (uncluding the CSC share).

investment is the Finance Dept instructing a trading bank to place surplus cash in the commercial money market for a fixed term. A second example is the HPC choosing to buy London commercial property (Park House and Stannary St, Kennington) to meet its office space needs.

Indirect investment
Typically done by utilising the professional expertise of external fund managers, to ensure funds transferred to them are invested in a diversified portfolio (a mixture of various shares and fixed income products, in different countries, sectors and institutions within a given sector). Fund managers typically charge an annual management fee to administer the portfolio, typically 1-5% of the fund value per annum, regardless of fund performance.

It is important that where HPC uses one or more external fund managers, that they are of sound commercial standing (solvent and reputable) and that regular fund performance reporting occurs. There are two aspects to this – firstly, regular fund reporting at financial month end, to allow timely market valuation of the fund value in the HPC balance sheet. And secondly, at least quarterly sector-benchmarking on fund performance (fund % returns considering both capital and income gains, less fees charged to administer those funds).

Where funds are provided to an external firm of fund managers, they may at times "cash up" some of the equities or bonds and invest in the Money Markey in the short term, to position themselves for purchasing further shares or bonds at cheaper prices. Unless they retain the freedom to act tactically, their ability to generate fund returns that are attractive to HPC will be diminished.

Investment risk minimisation through diversification
Investment risk and return in global capital markets with fast information flows (about price and risk changes) are inherently linked. Some types of investment risk can be minimised by diversification - essentially "not putting all your eggs in one basket". Some risk diversification can be achieved by investing in different, unlinked investment types (property, fixed income, equities) and by diversification within a given investment type e.g. where the fund manager buys shares in a range of companies.

However, within an investment type such as equities, some risk cannot be eliminated no matter how many share types are invested in. For example, the risk that the share market as a whole might suddenly crash is difficult to avoid, other than by buying hedging instruments (the value of which increases as the market value of the underlying products reduce) or avoiding investment in those markets entirely.

Inter-relationships
Investment returns and risk need to be assessed in relation to the HPC Reserves policy and Five Year Plan for assumed fee changes i.e. the three are inter-connected. To elaborate, in the medium term, if fees are not able to rise to offset cost increases, but ongoing compliance with the agreed Reserves policy is maintained, then investment returns need to rise. However, higher investment returns will typically involve incurring increased investment risk (more value volatility and/or greater potential for losses).

Short term money market investments

As well as the approx £1.8M investment portfolio managed by professional funds managers, cash funds (typically £1-2M) are invested directly in the short term in income-generating money market deposits, corporate bonds and a Business Reserve account.

Corporate Bonds versus the Money Market

At the time of writing, Nat West Corporate Bonds could only be invested for a minimum term of three months, while equivalent-yield money market investments could be made for a minimum of one week. Given the lack of an HPC overdraft facility and cash-flow forecasting uncertainty, surplus cash is being invested in the Business Reserve Account and money market account, earning indicative rates of 2% and 5.75% per annum respectively.

Credit Rating of Financial Institutions for Direct Investments

2.3 **Our policy is to directly invest cash reserves in products offered by financial institutions with a Standard and Poor's Credit Rating of at least AA minus (Moody's Credit Rating of AA2) and where the interest rates are market-competitive.** For example, Nat West bank where money market investments are held at the time of writing, have this rating. The HPC obtains three rate quotes from 3 financial institutions with at least the above credit rating, to ensure rates received are market-competitive.

3 ETHICAL POLICY

Because HPC is a health regulator, the investment portfolio fund managers have been requested not to invest in companies trading in tobacco products.

4 FEES

Because of the relatively small size of funds placed indirectly, HPC has limited ability to negotiate fees outside the standard terms. Rensburg Sheppards fund managers are remunerated purely by commissions on transactions. Rensburg Sheppards have confirmed a commission basis of 0.5% on the value of funds managed. This is a £9k annual fee for managing £1.8M investment portfolio funds.

5 BENCHMARKING

Notwithstanding the fund management sector performance indicators outlined in the quarterly valuations provided by Rensburg Sheppards, HPC reserves the right to undertake a review of the performance of the portfolio using other means.

The Fund Manager is invited to attend at least one Finance and Resources Committee meeting per year (more if the Committee requires it so) to provide a summary report on fund performance and address any questions the Committee may have relating to the funds under indirect management.

6 REPORTING

The professional fund manager provides a detailed report to the Finance Department at the end of each month. This forms the basis of the balance sheet valuation of the investments at month end and provides details of all investments in the portfolio (holdings, additions, disposals). Market Valuations are also sought on a periodic basis, on commercial property investments managed directly by the HPC. For details of how commercial property is reported in the HPC balance sheet, please refer to the Notes to the Annual Financial Statements.