Council
5 May 2016
Investment review

Classification	Public
Purpose	For discussion
Issue	This paper reviews the current GOsC investment strategy which has been in place for five years.
Recommendations	1. To note the stock-market investment and its performance as at 31 March 2016. 2. To note the 120-day bond investment and its performance as at 31 March 2016. 3. To note the GOsC holds cash reserves in its current and deposit account to mitigate against unforeseen events. 4. To note the steps being undertaken by the Executive in readiness for a decision paper being presented to Council in July 2016. 5. To consider the contents of the paper providing feedback to the Executive to inform the July 2016 Council decision paper.
Financial and resourcing implications	These are set out in the paper.
Equality and diversity implications	None
Communications implications	None
Annexes	None
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Background

1. In 2010, Newton Investment Management was appointed to help the GOsC develop an investment strategy for investing in the stock market. In 2011, Council agreed an investment strategy for an investment of £500,000 which was based on the following key principles:

    a. Good financial stewardship aims to increase the asset value above inflation;

    b. The investment profile of the GOsC was to be at the lower end of medium risk across a five-year period;

    c. The portfolio needed to be diverse in order to spread the risk of fund fluctuation;

    d. The investment should be made via a fund route rather than a segregated portfolio;

    e. No significant capital additions or withdrawals were anticipated;

    f. The funds could be liquated quickly if required;

    g. That Council should review the investment strategy on a regular basis.

2. The investment strategy was developed following the fall in bank interest rates and the rise in inflation which had resulted in a lack of real returns on the current investments.

3. The investment in the Real Return Fund[1] was made in 2011 and, five years on from that investment, a review of the investment strategy is now required.

4. It is also worth noting, as this forms part of the overall picture, that a separate £500k was invested with Secure Trust Bank in a 120-day bond. The bond was opened in late 2011 and will be referenced later in this paper.

Discussion

Portfolio performance

5. Standard Life Wealth advise the philosophy behind the Real Return Fund is that while it may have a target return of 1 month Libor[2] + 4% as its stated objective, preservation of capital is of greater importance. The return target remains important but only if the risks taken to achieve it are in proportion.

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[1] Newton's private client business was purchased by Standard Life Wealth in 2013. The transfer of assets from Newton to Standard Life Wealth was completed in October 2013.
[2] Libor - The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would charge if borrowing from other banks.

6. For the past few years the Real Return Fund has been cautiously positioned predominately because of concerns about rising debt levels in the global economy. At present Standard Life Wealth do not consider the risks of investing heavily in equities to be justified as debt levels continue to rise. As the Real Return Fund is unconstrained (meaning that it seeks a targeted level of return while not being required to follow market indices) the manager of the fund can position the fund as he/she considers appropriate.

7. By way of comparison the fund performance over the last five years is as follows:

Annual fund performance (December – December) %				
2010-2011	2011-2012	2012-2013	2013-2014	2014-2015
-0.75%	2.98	4.88	2.67	2.82

8. It was agreed when launching the investment strategy that income generated is reinvesting back into the fund in furtherance of the aim of maintaining the overall value of capital.

9. GOsC invested £500,000 in the Real Return Fund in 2011. As at 31 March 2016, the market value of the fund stood at £569k. The market value of the fund has increased by 3.64% from the valuation as at 31 December 2015 (£549k).

10. The effect of inflation over the period of the investment means that a lump-sum value of £569k today would have been worth £496k in 2011, fractionally less than the £500k sum invested in the portfolio.

Bond performance

11. As mentioned at paragraph 4, GOsC invested £500,000 in a 120-day bond with Secure Trust Bank in late 2011. As at 31 March 2016, the total value of the bond stood at £559k. The bond currently earns 1.99% AER, which is a lower rate of interest than when we first opened the bond.

12. The effect of inflation over the period of the investment means that a lump-sum value of £559k today would have been worth £488k in 2011, slightly less than the £500k sum invested in the bond.

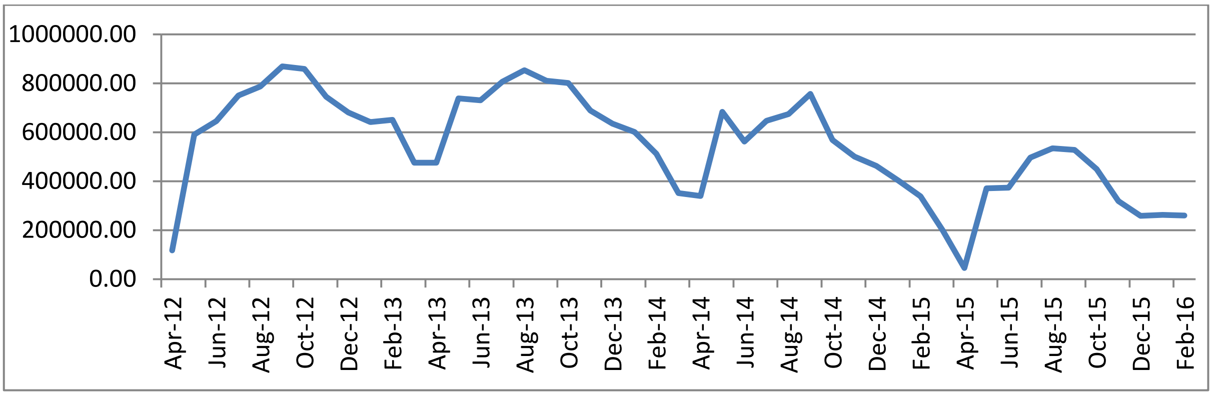
GOsC reserves

13. Through careful financial management, GOsC has built up a healthy reserve position so that it is able to withstand any unforeseen events which might occur. The level of reserves was established in order to mitigate concerns particularly around fitness to practise complaint volumes which can have a great degree of volatility and which incur significant expenditure. This approach served GOsC

well in financial year 2014-15 when a year-end deficit was incurred due to increased fitness to practise expenditure levels.

14. It is worth noting that in addition to the £500k stock market investment and the £500k investment in the 120-day bond, GOsC also maintains a healthy current and deposit account balance for day-to-day operational expenditure.

15. Over the last four years the average current and deposit account balance has been £550k, with the highest position being £870k (September 2012) and the lowest position being £45k (April 2015). It is worth noting that the average account balance in the last two financial years has been slightly lower (£430k) due to the effect of fee reductions and the deficit position in financial year 2014-15.



16. In addition, during this period the GOsC had a short-term loan of £400k for some building redevelopment. This loan was repaid in full in July 2015 following regular monthly repayments.

17. It is therefore worth noting that the GOsC has never had to drawn down funds from the stock-market investment or the 120-day bond and has never had to use any overdraft facility to funds its day-to-day operation nor does the GOsC have any outstanding mortgage debt.

Areas of consideration

18. There are a number of considerations for Council including:

    a. Whether the profile of any investment should be subject to a greater degree of risk in order to generate a greater level of return

        i. Council is asked to note that the investment is funded by registrant fees and there would be need to be a robust rationale for why GOsC would want to subject the funds to a greater degree of risk in order to generate a greater return.

        ii. The Executive takes the view that maintaining an investment so that the asset value continues to increase above inflation remains good financial stewardship and protecting registrant fees is a more appropriate aim than trying to generate a new income stream by exposing the investment to a greater degree of risk.

b. Whether to tie-up funds for a longer period of time

   i. As mentioned earlier in the paper, the GOsC has never drawn down funds from either the stock market investment or the 120-day bond, and it has a healthy current and deposit balance to cover any unforeseen events.

   ii. The Executive's view is that this should provide Council with assurance that it can, if it wished, look at investment options which restrict our immediate access to the funds for a longer period of time.

c. The balance of investments between stock-market and bonds.

   i. The two investments were opened in 2011 and it is interesting to note that up until the quarter ended 31 March 2016, the 120-bond was performing better or at least equally with the stock-market investment. Therefore, while Council may wish to explore what alternative stock-market options exist, it should be open to investing in bonds if the interest rates prove sufficiently attractive.

   ii. It is worth noting that the Chancellor, during his recent budget, reported that 'storm clouds are starting to gather again over the global economy'. Given the uncertainty around the global economy, Council may prefer to withdraw from the stock-market to avoid the risk of a sustained shock to the market posing a threat to its long-term investment aims being protection of the capital investment arising out of registrant fees.

   iii. However, if wishing to retain a stock-market investment, the principles on which the original investment strategy was founded would appear to remain sound and should be reapplied.

Actions for Council

19. Council is not being asked to make a decision about the future composition of its investment at the May meeting. Instead, the Executive is seeking to advise Council about the steps it intends to take over the coming weeks and months ahead with a view to bringing a decision paper to the July 2016 Council meeting.

20. In preparation for a decision paper being presented to Council in July 2016, the Executive is undertaking market research and continues to do so, including exploring how similar sized organisations manage their investments.

21. The Executive has issued a request through the UK Inter-Regulated Group (UKIPG) forum for organisations to share with us their experience and approach

to managing their own investments. The Executive can provide a verbal update at the meeting about the responses received from UKIPG members.

22. Given the strong performance of the 120-day bond, the Executive has liaised with the provider Secure Trust Bank about what other investments options might exist. While at this time they are not currently offering any new products we have been placed on an alert list for when new products become available. It is not known whether any new products would become available before a decision was required of Council in July 2016.

23. The Executive has also undertaken desk research to identify what bonds might be available for investment. A review of the bond market has highlighted the potential exists for funds to be invested in fixed term bonds for periods of 1 year up to 3 years. While investing funds in a fixed term bond for up to three years might be too lengthy a time period, up to 18 months should not be overlooked.

24. As at the end of March 2016, desk research has indicated that available bonds include:

Bank	**Term**	**Rate**
Aldermore	12 months	1.65%
Hampshire Trust Bank	12 months	1.65%
OakNorth Bank	12 months	1.62%
OakNorth Bank	15 months	1.66%

25. At this stage, Council is not required to make a formal decision; however, in light of the information contained within this paper it is reasonable to conclude that the performance of the stock-market investment and 120-day bond ensures the capital of the GOsC is protected.

26. To inform the July 2016 paper the Executive would find it helpful to receive any feedback from Council about what it considers to be the key issues around the investment strategy review.

Recommendation:

1. To note the stock-market investment and its performance as at 31 March 2016.

2. To note the 120-day bond investment and its performance as at 31 March 2016.

3. To note the GOsC holds cash reserves in its current and deposit account to mitigate against unforeseen events.

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