# Review of Investment Principles and Strategy

<table>
<thead>
<tr>
<th>Purpose of paper</th>
<th>The purpose of this paper is to present to Council the current investment principles and an investment strategy proposal for the General Dental Council (GDC).</th>
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</thead>
<tbody>
<tr>
<td>Action</td>
<td>For decision</td>
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<tr>
<td>Status</td>
<td>Public session</td>
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| Corporate Strategy 2016 - 2019 | **Performance Objective 2**: To improve our management of resources so that we become a more efficient regulator.  
Business Plan 2017 | **Priority 1**: Continue to build a cost effective and efficient organisation. |
| Decision Trail   | The Council last approved the investment principles in December 2016.  
The Finance and Performance Committee reviewed the current investment principles at its meeting on 22 November 2017 and agreed to recommend these to Council for approval. Additionally, the Committee discussed the proposed investment strategy for the GDC. |
| Next Steps       | Not applicable                                                                                                                                                                                |
| Recommendations  | The Council is asked to:  
- Approve the investment principles as set out in Annex 1  
- Note the proposed investment strategy. |
| Authorship of paper and further information | Gurvinder Soomal, Executive Director, Registration and Corporate Resources  
020 7167 6333, GSoomal@gdc-uk.org  
Melanie Stewart, Head of Finance and Procurement  
020 7167 6094, MStewart@gdc-uk.org |
| Appendices       | Annex 1: GDC Investment Principles                                                                                                    |
Executive summary

1. As a result of accumulated and projected surpluses, the GDC’s business model is such that it is projected to have cash funds of between £20.0m and £55.0m over the three-year period 2018 – 2020 (the variation is due to seasonal differences in income receipts and expenditure patterns).

2. At present, funds are held in the bank current account or on short term bank deposit earning less than 0.5% per annum, while the current CPI is 2.8%. Whilst the capital element is reasonably secure (assuming a stable UK banking sector), the purchasing power of cash will shrink year on year.

3. This paper explores the option of investing up to £15m of available cash in instruments other than cash deposits, creating the opportunity to achieve investment returns greater than currently available from bank deposits (after deducting fees), whilst not exposing any capital to excess risk.

4. The Finance and Performance Committee (“the Committee”) reviewed the current investment principles at its meeting on 22 November 2017. Additionally, the Committee discussed the proposed investment strategy for the GDC. The Committee agreed with the:
   - rationale for £5m being maintained as available cash
   - suggested profile for investment, both in respect of the seasonal minimum and maximum levels of projected cash
   - ethical investment principles set out in the paper.

5. The Committee agreed to recommend the investment principles, as set out in Annex A, to Council for approval.

6. The Council is asked to:
   - approve the investment principles as set out in Annex 1
   - note the proposed investment strategy.

Introduction and background

7. In December 2010, following a tender evaluation process, Smith & Williamson were appointed as the GDC’s investment advisor to assist the GDC in the development of an investment strategy that takes account of the GDC’s statutory role as regulator, its accountability to Parliament, and, as a result, its need to invest prudently, avoiding unnecessary risks.

8. The GDC business model is such that, at the time, it normally had cash funds of between £17.0m and £34.0m, the variation being due to seasonal differences in income receipts and expenditure patterns. Funds were being held in bank current accounts or short-term bank deposits, earning less than 1.5% per annum, which was substantially below the CPI which was running in excess of 4% at the time. Whilst the capital element was reasonably secure, purchasing power of the cash was shrinking year on year.

9. With advice from Smith & Williamson, an investment strategy was developed that recommended investing up to £12.0m of available cash in instruments other than cash deposits, creating the opportunity to achieve investment returns greater than was available from bank deposits (after deducting fees), whilst not exposing any capital to excess risk.

10. The objective was to achieve returns that mitigated the shrinking buying power of cash by investing a total of £12m in “real assets” (equities, property, commodities etc) as follows:
   - UK Equities £1.0m
   - Overseas Equities £1.0m
   - UK Fixed Interest £10.0m
11. Being prudent, even allowing for the fact that investments would be realisable at current market value within 7 days, it was proposed that a minimum of £5.0m to be kept in available cash in the bank current account on a continuing basis. To accommodate monthly seasonal variations, remaining cash balances were to be managed by the Finance team on short term deposit, for periods up to 3 months in length.

12. At its December 2011 meeting, Council approved the proposed investment strategy and principles and the Finance & Business Planning Advisory Committee ratified implementation of the strategy in May 2012.

13. To implement the agreed strategy, £12m was transferred to Smith & Williamson (£10m on 30 April 2012 and £2m on 31 May 2012) from available cash balances in a mix of equities and fixed interest securities. The funds were invested in accordance with an agreed profile, based on Smith & Williamson understanding of the investment markets, during Q2 and Q3 of 2012. In addition, the GDC’s holdings in five investment trusts (with a value at 31 December 2011 of £579,000) were also transferred to Smith & Williamson’s management.

14. In 2014, GDC liquidated £6.1m of investments held in order to boost cash balances over the last six months of 2014, largely to fund the redevelopment cost of the GDC’s premises at 37 Wimpole Street. Following receipt of annual retention fees in December 2014, the £6.1m was reinvested in January 2015 and a further £11.5m was divested throughout 2015 resulting in a net £5.4m reduction in the value of the GDC’s investments in the year.

15. At 31 December 2015, the value of investments held in equity funds was £3.5m. However, having reviewed the monthly cash flow for 2016 and 2017, it was evident that a significant proportion of the investments would need to be liquidated in Q4 to ensure that the stated policy minimum of £5.0m was maintained in cash funds. Given this and the increased risk of significant equity value fluctuations following the EU referendum outcome, the investment manager was instructed to divest the majority of the portfolio during August and September 2016 in an orderly fashion. The net sale proceeds totalled £3.0m, leaving £0.8m of its portfolio invested, mainly in unit trusts that have been held for a number of years.

16. The 2017 budget cash flow projections at the time suggested that it would unlikely that there would be medium term cash funds available to reinvest, at least for the next two to three years. However, by leaving funds invested, the investment accounts could remain open so that investments could easily be made again in the future, if required.

17. The following table summarises the returns achieved from the initial investment:

<table>
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<tr>
<th></th>
<th>Initial investment 2012</th>
<th>Increase in value 2012 – 2016</th>
<th>Dividends &amp; interest 2012 – 2016</th>
<th>Investments as at 31 Oct 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td>Unit trusts [as at 31 Dec 2011]</td>
<td>579</td>
<td></td>
<td></td>
<td>931</td>
</tr>
<tr>
<td>Fixed interest</td>
<td>10,000</td>
<td>(263)</td>
<td>1,075</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
<td>223 *</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,579</strong></td>
<td><strong>885</strong></td>
<td><strong>1,415</strong></td>
<td><strong>1,154</strong></td>
</tr>
</tbody>
</table>

* cash sum that has accumulated in the equity portfolio that needs to be reinvested or returned to the bank account

The GDC’s finances - reserves and cash

18. Cash is accounted for on a daily basis and reported on monthly as part of the management accounts reporting pack. As a result of accumulated and projected surpluses, the GDC’s business model is such that it is projected to have cash funds of between £20.0m and £55.0m.
over the three-year period 2018 – 2020. The variation is due to seasonal differences in income receipts and expenditure patterns. At present, funds are held in the bank current account or on short term bank deposit, earning less than 0.5% per annum, while the current CPI is 2.8%. Whilst the capital element is reasonably secure (assuming a stable UK banking sector), the purchasing power of cash will shrink year on year.

19. Reserves are measured on an annual basis at 31 December, and at 31 December 2016 stood at £12.2m, including the unrealised investment reserve of £0.7m but excluding the pension reserve of £0.6m.

20. Key assumptions that affect both cash and reserves are:
   a. Annual retention fees from dentists are received in quarter 4 of each year but credited to the income & expenditure account in the following January each year (£34.4m in 2018 budget)
   b. Annual retention fees from dental care professionals are received in June / July of each year and credited to the income & expenditure account in August of that year (£7.6m in 2018 budget)
   c. Expenditure is incurred throughout the year at around £3.5m per month (2018 budget, excluding depreciation, is £40.9m), in both cash terms and charged to the income and expenditure account
   d. Capital expenditure is funded out of cash resources and charged to the income and expenditure as depreciation in future years, over the period in which the asset will be used. The 2018 budgeted capital expenditure is £0.6m and the depreciation charge is £1.0m.

Investment strategy and risk appetite/profile

21. The GDC’s investment strategy should reflect projected cash balances, not the level of reserves held at year end, as well as accommodate the monthly seasonal variations in cash balances. Being prudent, even allowing for the fact that an investment strategy is likely to involve investments that are realisable at current market value within 7 days, it is suggested that a minimum of £5.0m is kept in available cash bank current accounts on a continuing basis.

22. It is proposed that the GDC risk profile remains ‘low to medium’, seeking to achieve returns broadly equal to inflation. This will reduce the proportion of the GDC’s investments held in equities since the capital value of investment in financial instruments, other than cash, can go down as well as up, potentially exposing the GDC to a risk of diminution in the value of investments made and hence a reduction in reserves. This risk is generally accepted to be greater when viewed in the short term [one to two years], with higher expectation of capital growth over a longer term [say five years plus]. All investments would be realisable within 7 working days, apart from short term bank deposits that may be unavailable for up to 3 months.

23. A low to medium risk profile can be measured by reference to the volatility of returns. A low to medium risk profile would expect less volatility than the FTSE All Share index which is made up entirely of equities. However lower volatility achieved through investing in a diversified portfolio also generally results in lower returns over a longer time period, but this is considered acceptable because the risk of significant loss is also lower.

24. All investments would be in a Nominee company name to minimise any risk of advisor default.

Proposed investment profile

25. As indicated above, the value of cash to be included in an investment strategy should be linked to projected cash balances. It is suggested that the investment profile be adopted, based on the minimum level of projected cash balances. Other short-term cash balances will be managed by the Finance team through the use of short term (up to 3-month bank deposits)
at one or more UK clearing banks - currently Lloyds Banking Group. A complete investment profile would be established over a number of months, dependent on market situations.

26. The justification for investing a proportion of available cash in instruments other than cash deposits is the opportunity to achieve investment returns greater than currently available from bank deposits after deducting fees, whilst not exposing any capital to excess risk. The objective here is to seek to achieve returns that mitigate the shrinking buying power of cash as a result of an increase in the rate of inflation. Investment advisors will seek to achieve this through investing in “real assets” (equities, property, commodities etc).

27. A suggested profile for when the investment strategy is fully implemented is:

<table>
<thead>
<tr>
<th>Finance team managed:</th>
<th>Seasonal <strong>minimum</strong> level of projected cash [Oct/Nov]</th>
<th>Seasonal <strong>maximum</strong> level of projected cash [Dec]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account cash</td>
<td>£5m</td>
<td>£5m</td>
</tr>
<tr>
<td>Short term bank deposits</td>
<td></td>
<td>£35m</td>
</tr>
</tbody>
</table>

| Smith & Williamson managed: | £15m |
| A mix of UK equities, overseas equities and UK fixed interest securities |

| GDC total funds available | £20.0m | £55.0m |

28. A proposal for a split of the investment between UK equities, overseas equities and UK fixed interest will need to be developed after consultation with Smith & Williamson, for consideration by the Committee.

29. Moreover, the Council is currently developing a new fees policy and it will be consulting on the new policy in January 2018. We will be developing a costed corporate plan for 2019 and beyond that will allow us the opportunity to review fee levels following the feedback from that consultation. Consequently, any decision made on investment levels will need to be revisited in due course to ensure that it reflects any decision to change the fee levels.

**Cash flow projections**

30. Under the proposed investment strategy, projected cash balances can be analysed as follows:
Ethical investment

31. The current investment principles statement makes no reference to ethical investment as that will be considered as part of the investment profile. However, it is suggested, that the GDC’s investment strategy should be to avoid or, where this is not possible, minimise to the greatest extent, investment in these broadly defined sectors:

   a. Alcohol
   b. Tobacco
   c. Healthcare

Exclusion of alcohol, tobacco and the healthcare sector is considered appropriate as all have a specific impact on oral health, or in the case of healthcare, could be seen as a conflict of interest for the GDC.

32. Smith & Williamson have previously provided a list of major companies in the above sectors to be considered for exclusion for the purposes of the GDC’s investment, and it is proposed that they are asked to update this list. Excluding such companies may hinder the ability of the investment advisors to maximise returns from investment in equities.

Recommendation

33. The Council is asked to:

   • approve the investment principles as set out in Annex 1
   • note the proposed investment strategy.
**GDC Investment Principles**

**Introduction**

1. This statement of Investment Principles is aimed at providing a guide to how the Investment Strategy is implemented.

**Investment Principles**

2. The GDC will aim to achieve an investment risk profile that seeks to achieve returns broadly in line with inflation.

3. Reserves would potentially be available for investment for 5 years duration, but the ability to liquidate some investments at short notice should be maintained.

4. The GDC would always retain ultimate decision-making powers in relation to investments, however day to day decision making powers could be delegated to the Investment Manager on terms to be agreed.

5. Specific companies or broad identifiable market sectors, as agreed from time to time between the GDC and the Investment Manager, will be excluded from the investment portfolio, in lieu of setting an “ethical” investment policy.

6. Investment income will either be reinvested or remitted to the GDC, in accordance with terms agreed with the Investment Manager.

7. Custody of investment documents [share certificates etc] will be agreed between the GDC and the Investment Manager, however where they are held by the Investment Manager they will be in the name of a Nominee company.

8. All investments would be realisable within 7 working days, apart from short-term bank deposits that may be unavailable for up to 3 months.

9. Short-term funds will be deposited with clearing banks as approved from time to time by the GDC, currently Lloyds Banking Group.