



Subject	Investment Strategy		
Status	Open Session		
Purpose	For Note		
From	Marc Stoner, Head of Finance and Resources		
History	Parent Committee	First Submitted	Revision Number
	N/A	15/09/2016	1

If you have any queries on this paper, please contact Marc Stoner on 020 7580 5861

1. Purpose

To agree the Investment Strategy for 2016/2017, including the diversification of the equities portfolio.

2. Recommendations

- i. That no changes be made to the Boards current attitude to risk and the strategy should remain as:
 1. Protect the real value of capital
 2. Achieve growth within the capital, with lower to medium risk
 3. Maintain required liquidity
- ii. Based on the recommendation from the Boards Investments Broker, the Boards investment policy restrictions should be amended to enable diversification outside of the UK, as outlined in XIII. below

3. Terms of Reference

Under the Board's Scheme of Decision Making, the strategy on investments goes directly to the Board.

4. Open

5. Contribution to the Board's Purpose and Objectives

In delivering the Act, ARB's objectives are:

Protect the users and potential users of architects' services
Support architects through regulation.

To manage the organisation's finances prudently whilst delivering ARB's statutory requirements and objectives.

6. Key Points

- I. The specialist investment advice is provided to the Board by Quilter Cheviot Investment Management and managed on a day to day basis by Executive Director, James Malcolmson.
- II. Prior to July 2014, the Boards attitude to risk, in relation to its Investment Strategy, was a low tolerance. This meant investment was only in UK fixed income deposits.
- III. At its July 2014, the Board advised its Investment Broker that its main priority was preservation of capital. The Board was advised, by the Broker that the Board should consider adopting a more flexible strategy as the current strategy was no longer low risk due to the vulnerability of interest rate rises, which were being speculated on in both the UK and USA. The Board agreed to amend the strategy to:
 1. Protect the real value of capital
 2. Achieve growth within the capital, with lower to medium risk
 3. Maintain required liquidity

The above change in strategy meant the Board increased diversification of its portfolio to include equities. (See investment policy at Annex A). The 2014 change to the policy moved the Boards risk profile from Lower to Lower/Medium (an explanation of the risk categories is attached at Annex B)

- IV. At the July 2015 Board meeting, the Boards Investment Broker presented his annual report to the Board, where he advised that the change made by the Board to its investment strategy had resulted in some additional growth.

At the Board meeting queries were raised as to whether there was any ethical criteria attached to ARB's investment strategy. It was felt that while there are 'ethically clean' funds available, the Board has no ethical obligation to invest in such funds. The Board's objectives, as outlined in (para III) must be the priority in order to fulfil the role of protecting the assets/capital of ARB. Individual's views or indeed an ethical stance should be secondary. Imposing an ethical stance is likely, but not necessarily, to increase the risk as it will exclude areas of the market that might be appropriate to incorporate thereby maintaining a lower risk strategy.

The Board agreed to make no changes to its existing strategy.

- V. At its July 2016 meeting, the Board had a discussion as to whether it should increase its risk tolerance, set targets for the Investment Broker to achieve and go out to tender the service. It was agreed, by the Board, that the Boards existing strategy should be maintained, pending the Operational Management Group undertaking further investigations into the matters raised by the Board.
- VI. Following on from the matters raised at the July Board meeting, we have reviewed the performance of the portfolio over the last 5 years, which generated approximately £678k (25.2% return, net of commission and fees). During the last 12 months to 22 August 2016, the return was £278k (4.2% after commission and fees).

The Investment broker has also maintained his current management fee of 0.25%, which the executive feels, demonstrates value for money.

- VII. It is this return on investments, combined with the increased income from the growth in the Register that has allowed ARB to hold the 2016 year. It was anticipated that the fee would have had to increase to raise the level of reserves required for the closure fund and maintain a level of free reserves to meet any financial risk faced by the organisation.
- VIII. We have also undertaken some research into other bodies investment strategies and in discussion with the Boards Internal and External auditors, a low risk strategy is common among regulators with some setting targets such as CPI + 2% or a return in line with inflation.
- IX. The Boards existing strategy appears to be in line with other similar bodies and achieving a slightly higher return within the Boards risk tolerance.
Whilst having a target (even a low target) it reduces the flexibility that the Investment Broker currently has in meeting the Boards strategy. The objective would be to generate an appropriate return that is consistent with the Boards attitude to risk.
- X. The Executive are also committed to testing the market in relation to the provision of Investment Broker services and in conjunction with the Boards Internal Auditors will undertake the exercise later in the year. At that stage, we will also seek further clarification on how the market perceives the setting of targets and explore the benchmarking of services and performance further.
- XI. At the last Board Meeting, included in the presentation was a chart showing the return of the UK market versus the US ([Annex C](#)). In order to grow the capital, the Broker suggested diversifying exposure outside of the current UK restriction.
- XII. Having explored the Brokers advice further with him, he has explained, that it would not increase the risk by going overseas particularly into the US. It would reduce the risk by increasing the diversification and the reliance on the UK market. As an example, after the Referendum at the end of June, the UK market fell the two days before recovering and moving on to the current level. As we have 100% UK equity exposure we did not have the diversification to reserve capital in this short term downside that was experienced by the market.
- XIII. The Boards Investment Broker, is recommending the Board consider the following diversification which is within the current risk appetite of the Board:-

Reduce the current UK equities by £400k

- Place £250k in USA equities
Place £150k in European equities

- XIV. The above-proposed change would not have any impact on raising funds for day-to-day operations. The majority of our direct UK sovereign gilt funds are short dated due to the importance of preservation of capital and the liquidity that we need in order to meet the Board's cash flow requirements. We also hold conservatively run corporate bond funds rather than direct individual corporate bonds. The benefit of this is further protection and a more cautious stance in the exposure to the debt market.

The organisation only passes funds for investment that are not required in the short term, which is currently around 6 months. A cash flow is provided to the Boards Investment Broker, which highlights our cash requirements. The Board should now consider the recommendations as outlined above.

7. Risk Implications

The Boards current attitude to risk is lower to medium in relation to its investments. This is achieved through having a diverse portfolio of investments as recommended by the Board's Investment Broker. There is obviously risk in any form of investment but this is to achieve an agreed return beyond that currently being experienced by holding cash. The Board could be criticised by holding so much cash on deposit where the current returns are negligible and also eroded by inflation particularly with the outlook for a further cut in UK rates being flagged up by the Bank of England.

Given the Board buys in its investment expertise, it should be guided by the advice of the Broker, unless it feels it has a valid reason not to do so and requires further advice.

8. Resource Implications

The level of reserves and the on-going high number of applications to join the Register will be factored in when the Board decides the level of the 2017 fee. It should be noted that holding this level of reserves was a factor in the Board holding the fee at £107.00 for 2016.

9. Communication

ARB is committed to seeking cost-saving initiatives to help ensure value for money. Sound budget planning and the prudent management of ARB's financial resources contribute towards maximising cost savings.

10. Equality and Diversity Implications

None currently identified.