The Health Foundation

Statement of Investment Policy – March 2013

1. Introduction

The Board of Governors ("the Governors") of the Health Foundation ("the Foundation") have drawn up this Statement of Investment Policy ("the SIP") to affirm the investment principles that govern decisions about the investment of the Foundation's expendable endowment.

2. The Health Foundation and its Mission

The Health Foundation is an independent charity working to continuously improve the quality of healthcare in the UK.

The objective is for the UK to have a healthcare system of the highest possible quality - safe, effective, person-centred, timely, efficient and equitable. The belief is that in order to achieve this, health services need to continually improve the way they work.

The Foundation is there to inspire and create the space for people to make lasting improvements to health services. Working at every level of the system, the aim is to develop the technical skills, leadership, capacity and knowledge, and build the will for change, to secure lasting improvements to healthcare.

3. Governance

3.1 The Governors have decided on the following division of responsibilities and decision-making for the Foundation.

3.2 The Governors have established a number of Committees of the Board of the Foundation including an Investment Committee ("the Committee") whose role is to determine, review and implement the investment policy of the Foundation.

3.3 The Committee comprises:

- Governors: at least two with appropriate experience, one of whom will be Chairman
- Executives: the Chief Executive and the Director of Finance & Administration
- Up to four independent members (non-voting)

3.4 The Committee oversees the appointment, removal and performance of the investment consultants, the external fund managers and the custodian; and advises the Governors on the availability of funds for the Foundation's charitable activities by applying a pre-determined formula designed to maintain a balance between preserving the value of the expendable endowment and funding annual charitable expenditure.

3.5 This division is based upon the Board's view that it allows for efficient operation of the Foundation overall, with access to an appropriate level of expert advice and service.

3.6 The Committee reports to each meeting of the Board.

3.7 Cambridge Associates (Cambridge) have been appointed as the Investment Consultant for the Fund effective from 1 January 2013. Cambridge will assist the Committee in asset allocation and other investment decisions and in the ongoing monitoring of the Foundation's fund managers of the conventional asset portfolio. Cambridge will provide the Board with the advice required in order to update the SIP as and when necessary. The details of Cambridge's appointment, including the scope of its remit and its fees are set out in a contract entered into between the Foundation and the Investment Consultant. Cambridge is also retained to advise on the constituents of the Victoria Fund, a bespoke fund which has been set up to house the Foundation's private equity and hedge fund portfolios and potentially other more liquid diversifying investments that do not fall into the traditional categories of bonds, equities and property.

3.8 The Committee has chosen to delegate day-to-day management of the Foundation's investments to a number of fund managers. The terms of each fund manager's appointment are contained in the Investment Management Agreement ("IMA") issued by the fund manager to the Foundation. The fund managers' responsibilities are also governed by applicable law. The fund managers' roles in practice include the responsibility to:

- Manage the portfolios of assets within the investment guidelines, objectives and restrictions set out in the respective IMA but, subject to that, exercising discretion as appropriate when investing the portfolio.

- Have regard to the need for diversification of investments so far as appropriate and to the suitability of investments within charity commission guidelines.

- Provide the Committee with a quarterly statement of the assets and cash flows and a quarterly report on the results of past actions and any changes to the investment process and, where possible, on corporate actions and their future policies in that regard.

- Inform the Committee of any changes in the internal performance objective guidelines of any pooled fund used by the Foundation as soon as practicable.

- The Victoria Fund is advised by Cambridge which recommends to the Committee on the appointment of private equity and hedge fund managers. Cambridge is then responsible for reporting back on a quarterly basis as to its performance.

The safe custody of the Foundation's assets is delegated to professional custodians (either directly or via the use of pooled vehicles).

The oversight of the asset managers, the consultants, and the appointed custodian (Northern Trust), is the responsibility of the Chief Investment Officer (CIO).

4. Process For Choosing Investments

The process for choosing investments is as follows:

- Identify appropriate investment objectives
- Agree the level of risk consistent with meeting the objectives set
- Agree a broad asset allocation strategy that is expected to maximise the return (net of all costs) given the targeted level of risk (see section 5)
- Construct a portfolio of investment managers to execute the agreed asset allocation strategy (see section 7)

In considering the appropriate investment managers for the conventional asset portfolio the Governors will obtain and consider written advice of Cambridge Associates Ltd., whom the Governors believe to be suitably qualified to provide such advice. This also applies to the underlying investments of the Victoria Fund LP

5. Investment Objectives and Risk

The Governors' objective is to invest the Foundation's assets in order to maximise returns whilst balancing risk through a diversified asset portfolio. Within this framework the Governors have agreed a number of objectives to help guide them in their strategic management of the assets and control of the various risks to which the Foundation is exposed. The Governors' primary objective is as follows:

- *The Governor's objective is to seek to maintain the value of the Fund in real terms i.e. 1% above inflation. The actual total return target is RPI +5% per annum (net of all investment fees and costs) over 5-7 years in order to sustain a spending rate of 4% over a trailing 3 year average.*

- *To maintain a predicted annual standard deviation of returns in the region of 12% - 14%.*

- *The Foundation looks to ensure as far as is possible that the value of the Fund does not deviate by more than 20%, whilst achieving its total return target. If the value of the Fund should deviate by more than 20% from target, then the Board would seek to review the continued appropriateness of the investment and spending policies.*

6. Risk Management and Measurement

There are various risks to which any investment policy is exposed. The Committee's policy on risk management is as follows:

The Committee recognises that whilst increasing risk increases potential returns over a long period, it also increases the risk of a shortfall in returns as well as producing more short-term volatility in the Foundation's funding position. In addition to targeting an appropriate overall level of investment risk, the Committee seeks to spread risks across a range of different sources, believing that diversification limits the impact of any single risk. The Committee aims to take on those risks for which we expect to be rewarded over time, in the form of excess returns.

The targeted level of risk is defined by the quantitative objectives detailed in Section 5.

- **Concentration risk** – The Committee recognises the risks that may arise from the lack of diversification of investments. Subject to achieving the total return target, the Committee aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. Some investment exposure is obtained via pooled vehicles. The Committee is also aware of concentration risk which arises for example when a high proportion of the Foundation's assets are invested in securities, whether debt or equity, of the same or related issuers. The overall investment arrangements are intended to provide an appropriate spread of assets by type and spread of individual securities within each asset class.

- **Inflation risk** - The risk that investments do not keep pace with inflation. Investing in bonds introduces interest rate risk and inflation risk. Investing in certain bonds may also introduce *credit risk* and *currency risk*.

- **Liquidity risk** - The Committee recognise that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the Investment Committee's long-term investment horizon, the Committee believes that a degree of liquidity risk is acceptable because we expect to be rewarded for assuming it. Thus, a proportion of the Foundation's assets are invested in illiquid investments. The remainder are realisable at short notice.

- **Equity risk** - The uncertainty of the return from equities is captured in the form of *equity risk*. The equity risk may be broken down into the credit risk of the underlying company, and the *volatility risk* associated with the stability of the price of the equity as well as *currency risk* for equities denominated in currencies other than Sterling among other risks, which include the *income risk* of a dividend not being paid.

- **Manager risk** - For most asset classes, the Committee has chosen to employ active management, and has selected investment managers whom it believes have the skill and judgement to add value net of fees. Active management within an asset category is defined as holding a combination of securities that differs from the asset class benchmark. The Committee believes active management skills exist and can be identified but not with complete certainty. Choosing active managers involves manager selection risk, which arises from selecting an active manager that underperforms its benchmark net of management and transaction fees.

- **Property risk** - The return generated by an investment in property can be broken down into income and capital. The income component is subject to interest rate risk and inflation risk. There is also uncertainty as to the long-term level of the income. The capital value of the property is determined by the buyer and seller of the property and is not certain. The risks and uncertainty, including currency risk in the case of properties outside the UK, are captured within *property risk*. Property is a relatively heterogeneous asset category, with sub-categories potentially exhibiting very different behavioural characteristics and attaching risk exposures – property also suffers from *liquidity risk* (see above).

- **Regulatory risk** - Across all of the Fund's investments, we are aware of the potential for regulatory and political risks. *Regulatory risk* arises from investing in a market environment where the regulatory regime may change. This may be compounded by *political risk* in those environments subject to unstable regimes.

- **Exchange rate risk** - This risk arises from unhedged investment overseas. A currency hedging programme has been put in place to manage this risk (see section 5).

- **Counterparty risk -** Some of the investment managers employ derivatives for the purposes of efficient portfolio management, subject to agreed restrictions. Some derivatives are traded on recognised exchanges, whereas others are traded directly with other counterparties - this gives rise to counterparty risk.

The Committee is aware of all the risks above, and endeavours to monitor these as part of their monitoring of the overall investments, albeit they acknowledge that it is not possible to monitor all the risks listed above in real time.

However, the Committee seeks to take on those risks it expects to be rewarded for over time, in the form of excess returns, in a diversified manner. The resulting combination of assets and investment management approaches has been selected to be consistent with the investment objective, risk tolerance and return target detailed above.

7. Investment Strategy

Given the investment objectives the Committee has agreed a broad investment strategy detailed in the table overleaf. The main features of the Foundation's investment strategy are to:

- manage the portfolio on a total return basis
- focus on "return generating" asset classes which can reasonably be expected to generate attractive real returns over the long term
- have only limited exposure to "risk reducing" asset classes because of their lower expected returns
- reduce risk by diversification, but accept that seeking high returns incurs volatility
- use active managers where it is reasonable to expect that the performance benefits will outweigh the additional costs

The Committee believes that the investment risk arising from the investment strategy combined with the risks arising from active management, are consistent with the overall level of return and risk being targeted.

Asset Class	Strategic Benchmark Allocation (%)		Range
Equities	**50.0**		**+/-5%**
UK Equities	5.0	+/-1%	
Global Equities*	35.0	+/-5%	
Emerging Market Equities	10.0	+/-2%	
Bonds	**13.0**		**+/-3%**
Property	**12.0**		**+/-3%**
Alternative Investments	**22.0**		**+/-3%**
Cash	**3.0**		**+/-1%**
Total	**100.0**		

*50% of the Foundation's global equity exposure is hedged back to Sterling

8. Day–to-Day Management of the Assets

The day-to-day management of the assets is overseen by the CIO, who will monitor the assets and make recommendations to the Investment Committee in relation to potential changes to the underlying investment managers.

Within the broad strategic framework outlined in section 6, the Committee is permitted to invest in assets which they believe, having taken expert advice, will deliver superior risk adjusted returns, subject to remaining within the risk parameters outlined in section 5.

For example, within the “bond” allocation, the Committee has freedom to invest in varying types of bond assets such as corporate bonds, high yield or emerging market debt.

The Committee regularly reviews the continuing suitability of the Foundation’s investments, including the appointed managers. Any adjustments would be made with the aim of ensuring the overall level of risk is consistent with that being targeted as set out in Section 5.

The current fund manager structure is set out in the Appendix to this Statement and will be amended as changes occur.

9. Responsible Investment and Corporate Governance

The Committee has reviewed the extent to which their investment managers incorporate Environmental, Social and Governance (ESG) factors into their decision-making process.

For those assets of the Foundation invested in pooled arrangements, the Committee accepts that the assets are subject to the fund managers’ own policies on social, environmental and ethical investment. The Committee has reviewed the policies of each pooled fund in which the Foundation invests and is comfortable with the arrangements in place.

The Governors have also decided that it would be inappropriate for a health related charity to directly invest in tobacco companies. The Foundation has reduced investment in tobacco companies as close as practically possible to zero, and keeps this under regular review.

The Committee also wishes to encourage best practice in terms of activism and voting. They therefore encourage their equity managers to discharge their responsibilities in accordance with their own corporate governance policies, and taking into account current best practice including the UK Corporate Governance Code, UN Principles of Responsible Investment, and the UK Stewardship Code.

The fund managers who invest in equities are expected to report on their adherence to these Codes from time to time. The Committee accepts that by using pooled investment vehicles for its equity investments the day-to-day application of voting rights will be carried out by the fund managers.

10. Training

The Committee shall ensure that they have sufficient expertise and appropriate training to monitor and assess the issues entrusted to them by the Governors.

11. Compliance with this Statement

The Committee monitors compliance with this Statement regularly to ensure that the investment policy is being implemented in accordance with this Statement.

12. Review of this Statement

The Committee will review this Statement at least once every three years and without delay after any significant change in investment policy.

Appendix – Investment Implementation Policy

The Committee has adopted the following investment manager matrix:

Investment Manager	UK Equities %	Global Equities %	Emerging Markets Equities %	Bonds %	Property %	Alternatives %	Cash %	Total %
River & Mercantile	5.0							**5.0**
MFS		12.0						**12.0**
Mondrian		12.0						**12.0**
McKinley		11.0						**11.0**
Aberdeen			6.0					**6.0**
Investec			4.0					**4.0**
Henderson				5.0				**5.0**
M&G*				3.0				**3.0**
Stone Harbor				5.0				**5.0**
Cordea Savills					6.0			**6.0**
BlackRock					6.0	5.5**		**11.5**
Victoria Fund						14.0		**14.0**
Cantab						2.5		**2.5**
Cash							3.0	**3.0**
Total	**5.0**	**35.0**	**10.0**	**13.0**	**12.0**	**22.0**	**3.0**	**100.0**

* This portfolio was not fully drawn and other fixed income opportunities are being considered for the remainder of the fixed income portfolio
**Invested in passive equity and will be used to fund the Foundation's private equity portfolio within the Victoria Fund.

The asset returns each quarter are compared both with the benchmark allocation above (termed the "performance benchmark") and the strategic benchmark set out in Section 6 of the SIP. Details of each fund manager mandate are provided overpage: