The Health Foundation

Statement of Investment Policy – December 2018

1. Introduction

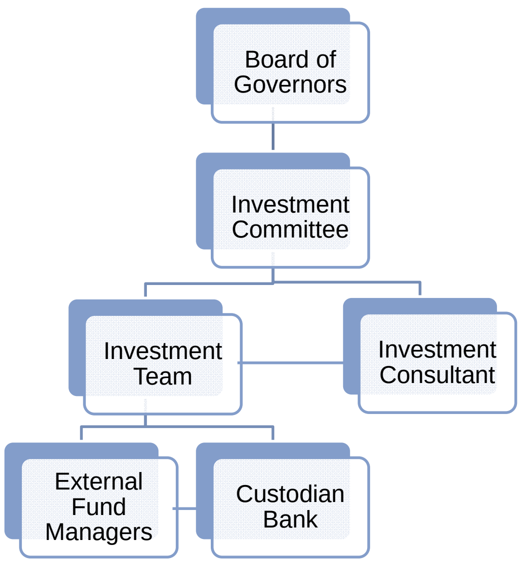
The Board of Governors (“the Governors”) of the Health Foundation (“the Foundation”) have drawn up this Statement of Investment Policy (“the SIP”) to affirm the investment principles that govern decisions about the investment of the Foundation’s expendable endowment. The purpose of this Statement is to establish a clear understanding between all parties as to the objectives, investment policies and goals of the Endowment. It establishes a structure of guidelines and policies within which the Investment Committee and staff can exercise their delegated authority. The SIP is designed to be a strategic document and remains in effect unless revisions are agreed by the Governors. Specific investment policies pertaining to asset allocation, benchmarks and allowable ranges are documented in *Annex A* to the SIP.

2. The Health Foundation and its Mission

2.1 The Health Foundation is an independent charity working to continuously improve the quality of healthcare available in the UK. While the Endowment is technically expendable, the Governors intend it to sustain and support the mission of the Foundation into the indefinite future. To do so it needs to generate an investment return sufficient to support an agreed level of distribution to the operating budget, currently 4% per annum, while preserving and, if possible, growing the real (i.e. after inflation) value of the Endowment’s capital. The total return target is **RPI +5%** per annum (net of all investment fees and costs).

3. Governance

3.1 There are six major parties (or sets of parties) involved in the investment of the endowment:



The Board of Governors, which receives reports and approves major changes in policy.

The Investment Committee, which oversees the Endowment and makes key decisions on policy, managers and advisors.

The Chief Investment Officer (CIO), who manages the Endowment on a day to day basis within agreed limits and proposes more significant changes to the Investment Committee in conjunction with the Investment Consultant.

The Investment Consultant, which advises both the CIO and Committee and provides performance reporting.

The Custodian Bank, which holds the assets of the Endowment and provides accounting services along with currency hedging.

External Fund Managers, who each invest portions of the Endowment within specific mandates agreed by the Committee.

4. The Investment Committee

4.1 The Governors have established a number of Committees of the Governors of the Foundation including an Investment Committee (“the Committee”) whose role is to determine, review and oversee the investment policy of the Foundation.

4.2 The Committee comprises:

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

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

4.4 The Committee reports to each meeting of the Governors. *(see Investment Committee Terms of Reference)*

5. The Chief Investment Officer

5.1 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, the consultant and the appointed custodian. *(see Investment Committee Terms of Reference paragraph 22)*

6. The Investment Consultant

6.1 Cambridge Associates (“Cambridge”) have been appointed as the Investment Consultant for the Endowment effective from 1 January 2014. Cambridge assists the Committee in asset allocation and other investment decisions and in the on-going monitoring of the Foundation's fund managers for the conventional asset portfolio. Cambridge provides the Governors 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. (see Cambridge Associates Defined Services Agreement)

6.2 Cambridge is also retained to advise on investments in hedge funds, private growth investments and core infrastructure. These are held within the Victoria Fund (VF), a bespoke fund which has been set up to house the Foundation's 'alternative' assets' for purposes of administrative simplicity (See section 13). Cambridge manages all transactions and cash flows associated with the VF and any documentation related to manager funding or redemption. Cambridge has nevertheless not been granted delegated authority over the VF and makes decisions only with the agreement of the Foundation. *(see Victoria Fund Limited Partnership Agreement and Management Deed)*

7. The Custodian Bank

7.1 Northern Trust has been appointed as the Custodian Bank for the Endowment. The role of the Custodian Bank covers a number of areas:

7.1.1 To operate bank accounts and facilitate transfers of money.

7.1.2 To hold securities on the Foundation's behalf, where the Foundation has a segregated account with an investment manager, and to reconcile transactions.

7.1.3 To maintain the book of records detailing the values and flows in the Foundation's investment portfolio.

7.1.4 The Custody Bank also buys and sells foreign currency as needed when the Foundation buys or sells investments and puts in place currency hedges as required by the Foundation.

8. The External Fund Managers

8.1 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' roles in practice include the responsibility to:

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

8.1.2 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.

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

9. Investment Objectives

9.1 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:

9.1.1 **Time Horizon:** The Endowment shall be invested for the long term, to the extent that this allows for accountability for investment decisions over a reasonable period. This is understood to mean an investment horizon of 10 years and multiple economic and market cycles.

9.1.2 **Base Currency:** The base currency against which the Endowment shall be judged is sterling.

9.1.3 **Return Target:** The Governor's objective is to seek to maintain the purchasing power of the Fund in real terms, defined as 1% above inflation. The total return target is **RPI +5%** per annum (net of all investment fees and costs).

9.1.4 **Spending Policy:** The Governors believe that the return target is consistent with sustaining a spending rate of 4% over a trailing 3 year average of Endowment value.

9.2 The Foundation recognises that the return target described above cannot be achieved consistently over shorter periods given the inherent uncertainty in capital markets. Hence, the Endowment shall be judged against this target over periods no shorter than 10 years.

10. Risk Tolerance & Management

10.1 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 produces 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 they expect to be rewarded over time, in the form of excess returns.

10.2 **Volatility tolerance:** The Committee believes that the Endowment's tolerance of investment risk in the form of volatility is consistent with that of the risk-equivalent 70/30 portfolio described in section 14. This is expected to result in a long run **volatility range of 13-15 %** and an equity beta in the region of 0.70 – 0.75. The Committee desires to limit the possibility of a 20% fall in Endowment value over 1 year but acknowledges that this possibility cannot be eliminated. Cambridge Associates' modelling suggests the probability of this event is of the order of 20% or one year in five.

10.3 **Concentration risk:** Subject to achieving the total return target, the Committee aims to ensure the asset allocation policy in place results in an adequately diversified portfolio. The overall investment arrangements are intended to provide an appropriate spread of assets by type and spread of individual securities within each asset class.

10.4 **Liquidity risk:** Given the Endowment's long-term investment horizon, the Committee believes that a degree of liquidity risk is acceptable in expectation of earning a return for assuming it. Thus, a proportion of the Foundation's assets are invested in illiquid investments. The greater balance is realisable at short notice.

10.5 **Manager risk:** For most asset classes, the Committee has chosen to employ active management. The Committee believes active management skills exist and can be identified, although not with complete certainty. Risks of choosing an underperforming manager are mitigated by careful monitoring of the managers, the advice of the Investment Consultant and by diversification such that the Endowment is not overly dependent on the success of one manager.

11. Investment Strategy

11.1 The Committee has agreed a broad investment strategy detailed in *Annex A*. The main features of the Foundation's investment strategy are to:

11.1.1 Manage the Endowment on a total return basis.

11.1.2 Focus on "return generating" asset classes which can reasonably be expected to generate attractive real returns over the long term.

11.1.3 Have only limited exposure to "risk reducing" asset classes because of their lower expected returns.

11.1.4 Reduce risk by diversification, but accept that seeking high returns incurs volatility.

11.1.5 Use active managers where it is reasonable to expect that the performance benefits will outweigh the additional costs.

11.2 To achieve its long-term investment objectives, the Endowment shall be invested primarily in asset groupings according to specific roles in the Endowment, namely 'Growth', 'Diversifiers', and 'Low Risk Liquidity', which includes sovereign bonds and a 'Cash Buffer'. The goal of each allocation is to fulfill its role, not necessarily to maximise return. The current Policy Allocation and relevant indices, as well as permitted ranges, are detailed in *Annex A*. Also shown are the asset classes allowable within each role allocation and their individual ranges.

11.3 The Committee shall review the Policy Target annually and may make changes from time to time, recorded in changes to *Annex A*. The bias would be not to change, and it is anticipated that changes will be infrequent. Long term strategic changes may result in modifications to this SIP. *(see Cambridge Associates' Strategic Asset Allocation Review, 6 September 2018 – Investment Committee Papers)*

12. Day–to-Day Management of the Assets

12.1 Within the broad strategic framework outlined in section 11, 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 10. The Committee has the freedom to invest within the allowable assets and permitted ranges laid out in *Annex A*.

12.2 The Committee may from time to time desire to hedge assets not denominated in base currency, where doing so has a meaningful effect on reducing un-compensated volatility. At present, the hedge fund assets are 100% hedged (which is undertaken within the VF). The Endowment’s nominal government bond exposure is also fully hedged (at the share class level).

13. The Victoria Fund (VF)

13.1 When the Foundation decided to start investing in alternative assets (hedge funds, private growth investments and core infrastructure) the Committee acknowledged that this may result in a significant increase in administrative complexity and internal time costs. To mitigate this, it was decided to create a special purpose vehicle – the Victoria Fund or VF – to hold those alternative assets and to outsource the operation of the VF to Cambridge Associates.

13.2 The VF is a Guernsey Limited Partnership, in which the Foundation is the only limited partner (LP). An affiliate of Cambridge Associates is the general partner (GP) and managers the partnership, with each decision requiring the approval of the Foundation.

13.3 The operation of the VF is governed by a partnership agreement, which specifies an investment policy and investment guidelines. Currency hedging transactions, where necessary, are conducted within the Victoria Fund. The Committee can undertake and make changes to the portfolio’s currency hedging as it sees fit.

13.4 While not all investments in the VF were originally selected by Cambridge Associates (e.g. the infrastructure fund Antin), Cambridge Associates takes responsibility for all investments that are currently held within the VF. This involves monitoring the existing managers, determining whether to re-up or not at the next fund raisings in the case of private investments, and bringing forth new manager ideas as appropriate to meet the target and earn the best return within the parameters agreed.

13.5 The VF has its own auditor (PWC) and banker (US Bank).

13.6 The VF also contains a part of the Endowment’s cash balance.

13.7 The VF is not tied to Cambridge Associates and the Foundation would be able to dismiss Cambridge Associates as GP and appoint another organisation to manage the partnership. *(see Victoria Fund LP Incorporated – Replacement of General Partner & Manager and Liquidation of the Partnership – Steps Plan, November 2018)*

14. Benchmarking and Monitoring

14.1 The purpose of benchmarking is to enable monitoring of the success of investment strategies or managers in meeting both the return objectives and risk guidelines of the Endowment.

14.2 By defining ranges around a benchmark it is possible to allow a degree of flexibility while controlling the overall deviation of the Endowment from agreed characteristics.

14.3 There shall be four levels of benchmarking, each with a different purpose, time horizon and intended audience. These are defined in the table on the following page.

Benchmark	What?	Why?	Audience?	Horizon?
Long term return objective	The Endowment's long term return target as defined in section 9, i.e.RPI+5%	This is the ultimate gauge of the Endowment's long term success in sustaining spending and preserving real purchasing power. It is also the yardstick for long term appropriateness of the Policy and Strategic benchmarks.	The Governors	Periods of at least 10 years, encompassing multiple economic and market cycles.
<u>Simple</u> or risk–equivalent benchmark	The simple split between equities and bonds which the Committee believes best represents the Foundation's risk tolerance Represented by a weighted average of 70% MSCI All Country World Index and 30% FTSE World Government Bond Index (GBP hedged)	Easy to understand and implementable with simple cheap passive investment approach. It represents a simple alternative strategy consistent with the Foundation's risk tolerance.	The Investment Committee	Rolling 5 year periods
<u>Policy</u> benchmark	The Investment policy represented by the allocation between the different sub asset classes as described in Annex A Represented by a composite of the simple passive sub asset class indices	This defines the Endowment's long term investment policy agreed by the Foundation with the advice from Cambridge Associates. Facilitates re-balancing	The Investment Committee	Rolling 5 year periods
<u>Manager</u> benchmarks	Indices representing the opportunity set and strategy for individual managers	To judge the effectiveness of active management	CIO	Dependent on strategy

14.4 The Simple Benchmark and the Policy Benchmark, along with associated ranges shall be documented in Annex A to this SIP.

14.5 Comparison between different benchmarks can answer a series of questions, for example:

14.5.1 Simple vs. Policy: *Did the investment policy agreed by the committee add value compared with the simple alternative?*

14.5.2 Actual manager returns vs. individual manager benchmarks: *Did the investment managers add or detract value versus their passive alternatives?*

14.5.3 Long-term Objective vs. Simple Benchmark: *Was the Objective feasible given the chosen risk tolerance?*

15. Responsible Investment and Corporate Governance

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

15.2 For those assets of the Foundation invested in pooled arrangements, the Committee accepts that the holdings 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.

15.3 The Governors have also decided that it would be inappropriate for a health related charity to directly invest in tobacco companies. The Foundation's investment in tobacco companies is as close as practically possible to zero, and this is kept under regular review. The Foundation strives to implement responsible investment that is most aligned to the Foundation's mission and values. There are certain stocks that could be seen as a conflict of interest and, therefore, are negatively screened from the Endowment. However, where possible, the Investment Committee has decided to adopt a formal approach to positive engagement where conflict of interest might arise. Where there are issues related to reputational risk, these must reside with the Board of Governors.

15.4 The Committee also wishes to encourage best practice in terms of activism and voting. They therefore encourage all their 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.

15.5 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.

16. 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.

17. 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.

18. 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.

Statement of Investment Principals - Annex A

Investment Policy Guidelines

	Neutral	Range Low	Range High	Benchmark
Growth	**65.0%**	**50.0%**	**70.0%**	**Growth Benchmark (blend of below)**
Listed Developed Market Equity	40.0%	30.0%	50.0%	MSCI World Index (Net)
Listed Emerging Market Equity	10.0%	0.0%	15.0%	MSCI Emerging Markets Index (Net)
Private Growth Investments	15.0%	0.0%	20.0%	MSCI World Index (Net)
Diversifiers	**25.0%**	**20.0%**	**40.0%**	**30% MSCI World (£ Hedged)/ 70% FTSE WGBI (£ Hedged)**
Property	8.0%	5.0%	15.0%	UK IPD All Balanced Fund Index
Core Infrastructure	5.0%	0.0%	10.0%	30% MSCI World (£ Hedged)/ 70% FTSE WGBI (£ Hedged)
Hedge Funds	12.0%	0.0%	20.0%	HFRI Fund of Funds Diversified (£ Hedged)
Credit	0.0%	0.0%	30.0%	Barclays Global Agg Credit Index (£ Hedged)
Other	0.0%	0.0%	10.0%	
Low Risk Liquidity	**10.0%**	**5.0%**	**15.0%**	**Deflation Hedging Benchmark (blend of below)**
Developed Market Sovereign Bonds	8.0%	0.0%	15.0%	FTSE WGBI Index (£ Hedged)
Developed Market Inflation-Linked Sovereign Bonds	0.0%	0.0%	10.0%	Bloomberg Barclays World Government Inflation-Linked Bond Index (£ Hedged)
Cash Buffer	2.0%	0.0%	15.0%	LIBID 7 Day - £

Explicit	Spending Rate	4% per annum in real terms
	Return Objective	5% per annum net of inflation
	Downside Tolerance	Control probability of 20% fall over 1yr horizon
	Maintain Purchasing Power	Measured by U.K. RPI (retail price index) +1%

Implicit	Expected Equity Beta (relative to MSCI ACWI)	0.70 - 0.75 for Policy Portfolio
	Target Volatility	Set by vol of simple benchmark 70% Equity (MSCI ACWI Net) / 30% Bonds (FTSE WGBI £ hedged)
	Long-term Risk and Return Characteristics	Long-Term Equilibrium Expected Real Return - 6.0% Long-Term Equilibrium Expected Volatility - 13.0% - 15.0%