20 April 2018

INVESTMENT RESERVES POLICY STATEMENT

CFA SOCIETY OF THE UK

A. Scope and Purpose

1. **Scope**
The Investment Reserves Policy Statement (IRPS) governs the investment reserves which are the residual portion of the Society's reserves over and above the operating reserves. These investment reserves are eligible for investment by the Investment Committee (IC) according to its mandate and investment parameters.

2. **Purpose**
The IC is mandated by the Board of Directors of CFA UK as a standing committee reporting to the Finance Committee and Board to oversee and make investment decisions regarding the investment reserves portfolio. The purpose of the Committee is to contribute to the long term financial stability of CFA UK by preserving and growing the real capital value of the Society's investment reserves.

B. Governance

1. **Responsibility**
The IC is responsible for determining, executing and monitoring investment policy of the investment reserves portfolio. Fuller details of responsibilities and procedures can be found in the Terms of Reference of the IC, which are reviewed and approved by the Finance Committee of the CFA UK Board.

2. **Asset Allocation**
The IC determines the asset allocation and fund styles appropriate to meet the objectives of the investment reserves portfolio. The IC considers the expected real returns, expected standard deviation and expected correlations of various asset classes and sub-classes while applying appropriate diversification to create parameters for the portfolio.

3. **Fund Selection**
The IC is responsible for selecting funds based on their asset exposures, styles and managers to achieve the portfolio objectives. In selecting the most appropriate fund style (passive, active or liquid alternative), the IC considers information asymmetry, i.e. whether or not the particular asset class lends itself to a manager gaining an "edge" through superior knowledge. In making fund selection decisions, the committee considers expected risk and return, liquidity, transparency, manager alpha, risk management skill and cost, among many considerations.

4. **Portfolio Monitoring**
The IC monitors the performance of the investment reserves portfolio on a quarterly basis, at a minimum. In addition to managers' reports, it relies on statistical analyses provided by a third-party contractor which include a portfolio risk and return analysis versus benchmark over multiple historical time horizons, portfolio allocation statistics over multiple historical time horizons, fund correlation analysis, fund liquidity profiles and fund fees analysis.

5. **Conflicts of Interest**
No investment reserves should be invested with any firm or in any vehicle which may, as a result of the transaction, directly financially benefit a Director, member of staff, member of the Finance Committee or member of the IC, without the prior approval of CFA UK's Board

of Directors. An existing investment need not be sold in the event that a potential conflict arises as a result of someone joining as an IC member or Board member after an investment is made.

6. **IRPS Review and Update**
The IRPS is agreed by the IC, endorsed by the Finance Committee and approved by the Board of CFA UK and distributed to all of these parties in final form. The IRPS is reviewed and amended as necessary at intervals of not more than 3 years from the date of approval by the Board.

C. Investment Return and Risk Objectives

1. **Investment Objectives**
The overall investment objective is to preserve and grow the real capital value of the investment reserves. The return objective is to generate a return over a medium-term horizon of 3 – 7 years in excess of 1% over inflation as represented by the UK CPI. The risk objective targets a low to medium risk level for the total portfolio in the range of a 6% - 12% p.a. standard deviation.

2. **Risk Tolerance**
The risk tolerance of the Investment Reserves portfolio is moderate, consistent with the medium risk range target. It can accept a certain degree of volatility in order to achieve its return objective over a minimum 3-year investment horizon. It may also accept certain levels of manager risk, hedging risk, leverage risk and complexity risk to achieve its objectives.

3. **Liquidity Constraints**
Under ordinary circumstances income is not required, so liquidity requirements do not constrain the portfolio strategy. Therefore, the portfolio will normally be fully invested and will seek to invest in fund classes that accumulate rather than distribute income and dividends. However, all invested funds must be able to be liquidated within 3 months.

   In the extraordinary circumstance of a precipitous short-term decline in the operating revenues of CFA UK or a sudden and critical need for a major capital investment by CFA UK, substantial amounts of cash may be required quickly. The timing and amounts of these extraordinary liquidity needs are unknown. Therefore, a certain proportion of the investment reserves portfolio will be held in highly liquid, low volatility investments.

   Highly liquid, low volatility investments are defined for this purpose as funds which have no redemption fee, can be liquidated within 5 business days and have an expected standard deviation of less than 5%. The benchmark to estimate the proportion of the total reserve portfolio for this purpose will be 15% of CFA UK's Total Annual Forecast Revenues.

4. **Foreign Currency Exposure**
The domestic UK market is not sufficiently broad to achieve the diversification objectives of the investment reserves portfolio, so non-UK investments will be a significant feature of the portfolio. To minimise the foreign currency risk in the portfolio, the IC will invest in UK Sterling hedged share classes wherever available and advisable. The IC will exercise best efforts to limit unhedged non-Sterling currency exposure across portfolio funds to 30% of the total investment reserves portfolio.

5. **Liquid Alternatives Considerations**
   The IC may identify positive investment alpha and/or low-negative correlation in certain liquid alternative strategies which assist in achieving portfolio objectives. It is acknowledged that these strategies may also involve higher degrees of complexity, manager risk and unstable expected returns and therefore require sufficiently offsetting positive alpha and/or hedging benefits to the portfolio.

6. **Taxation of investments**
   CFA UK pays corporation tax on the interest income and distributions it receives from investments held according to the type of asset as follows:
   Movements in valuation on debt instruments or funds where the majority of the underlying assets are debt instruments, are taxable (or deductible) broadly in line with fair value accounting treatment.
   Equities are taxed under the capital gains regime at the time they are sold. Unrealised revaluation gains or losses of equity investments before sale are not taxable (or deductible). Unrelieved capital losses can be carried forward to offset future capital gains.

D. Investment Parameters

1. **Permissible Investments**
   The investment reserves can be invested in passive (index/ETFs), active (long only managers) or liquid alternatives (involving hedging, leverage or complexity) funds. Direct investment in equity shares, bonds or derivatives is not permitted. Fund investments in illiquid and private assets are not permitted.

   Funds invested in the asset classes in the table below are permitted in the indicated ranges as a percentage of the total reserve portfolio.

PERMISSIBLE INVESTMENTS			
ASSET CLASSES			
	MINIMUM	**TARGET**	**MAXIMUM**
FIXED INCOME			
GOVERNMENT	0%	7%	20%
INFLATION-LINKED	0%	3%	10%
INVESTMENT GRADE CREDIT	10%	16%	40%
NON-INVEST GRADE CREDIT	0%	7%	15%
SUB-TOTAL		**33%**	
EQUITIES			
DEVELOPED MKTS - LARGE-MID CAP	20%	30%	60%
DEVELOPED MKTS - SMALL CAP	0%	5%	10%
EMERGING MARKETS	0%	7%	20%
SUB-TOTAL		**42%**	
OTHER			
REAL ESTATE	0%	3%	10%
COMMODITIES	0%	7%	15%
MULTI-ASSET	10%	15%	40%
SUB-TOTAL		**25%**	
TOTAL		**100%**	

2. **Capital Markets Assumptions**
Guideline asset allocation parameters are formed based on the long term expected median return, standard deviation and inflation assumptions for each asset category as well as the expected correlation between these categories. A real return target for each category and the portfolio overall is produced based on the target percentage of each asset class from the "Permissible Investments" table above. The expected return portion of this analysis is displayed in the table below.

CAPITAL MARKETS ASSUMPTIONS -2018				
ASSET CLASSES				
	LT EXP. RETURN	**LT EXP. RISK**	**REAL RETURN***	**TARGET WEIGHTS**
FIXED INCOME				
GOVERNMENT	1.2%	6.5%	-0.78%	10%
CORPORATE	2.5%	7.1%	0.49%	23%
EQUITIES				
DEVELOPED MARKETS	6.2%	16.8%	4.12%	35%
EMERGING MARKETS	8.4%	19.0%	6.27%	7%
OTHER				
REAL ESTATE	5.0%	12.8%	2.94%	3%
COMMODITIES	6.1%	17.2%	4.02%	7%
MULTI-ASSET	4.5%	6.8%	2.45%	15%
TOTAL EXP. PORTFOLIO RISK/RETURNS	**4.71%**	**9.45%**	**2.65%**	

**UK Inflation (CPI) assumed at 2% (Sarasin & Partners forecast and 15-year RPI at 3.0% - 1.0%)*

3. **Asset Allocation**
Strategic asset allocation targets and ranges as well as the underlying long-term capital markets assumptions should be reviewed and updated, at a minimum, every 3 years. Actual asset allocations may diverge significantly from targets in the short term due to tactical market views, asset value changes and fund asset or risk dynamics. However, if portfolio asset allocation drifts outside the minimum and/or maximum limits, the IC will act to rebalance the portfolio to within the original limits within 3 months.

4. **Risk Controls**
To control fund and manager concentration risk, no one fund investment will comprise more than 20% of the total investment reserves portfolio. To control foreign currency exposure, non- Sterling exposure will be limited to a maximum of 30% across the whole portfolio on a best efforts basis. Liquidity risk will be managed as defined in section C3.

All prospective portfolio investments will be analysed on the basis of their benchmark, expected risk and return, the liquidity of the fund and the underlying investments and their total expense ratio. For active funds and liquid alternative funds, investment, operational and reputational risks will also be analysed as they apply with reference to the "Additional Considerations" for due diligence listed in Appendix I.

E. Performance Measurement and Monitoring

1. **Performance Measurement Metrics**
   Portfolio return will be measured over the short, medium and long term on an absolute and benchmark relative basis relative to UK CPI. Portfolio risk is measured primarily on the basis of standard deviation of monthly returns, both absolute and benchmark relative levels. Tracking error, information ratio and alpha relative to benchmark are also measured. Portfolio risk-adjusted return is measured by the Sharpe and Sortino ratios. Medium term correlations between portfolio funds are also measured.

2. **Performance Monitoring and Reporting**
   The IC monitors the portfolio, at a minimum, quarterly based on a comprehensive return and risk report produced from brokerage reported figures by a third party on a GIPS basis. The report includes fund allocations, total and fund attribution returns, portfolio return, risk and correlation metrics, as well as fees, liquidation timing and cost analysis. In addition, the latest monthly reports from each fund are reviewed quarterly. The IC reports performance to the Finance Committee and the CFA UK Board semi-annually.

APPENDIX I

Additional Considerations for Fund Due Diligence

In addition to the benchmark, expected risk and return, liquidity and cost assessments applied to all funds the following additional considerations will be taken into account according to the fund style when performing due diligence. It is expected that a member of the IC will meet with Active and Liquid Alternative fund managers every 24 months at a minimum.

A. Passive

1. Index methodology (e.g. weighting, concentration, revision frequency, leverage)
2. Premium/Discount to Index history
3. Trading volume
4. Derivative usage in fund construction

B. Active

1. Active risk (Tracking error)
2. Index relative return
3. Information Ratio
4. Manager experience/track record
5. Peer relative performance

C. Liquid Alternative

1. Review both Fund and Management Company
2. Perform both qualitative and quantitative analysis
3. Inspect both operational and investment process
4. Determine detailed investment strategy (e.g. systematic, discretionary, relative value) and source and quality of expected returns (e.g. alpha, active beta)
5. Gain detailed understanding of risk (e.g. distribution of returns, higher moments, maximum expected drawdown, expected leverage ranges, realised volatility vs target, risk management skill)
6. Assess manager team and service provider risks (e.g. depth of talent, alignment with fund, administrator independence, custodial arrangements, auditor reputation)