Committee and Date	Item
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PENSION FUND TREASURY STRATEGY 2010/2011

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Summary

This report proposes the Pension Fund Treasury Strategy for 2010/2011 for the small cash balances that the Administrating Authority maintains to manage the day to day transactions of the Fund. These transactions include the payment of pensions and transfers out together with the receipt of contributions from employers and transfers into the Fund. From the 1st April 2010 these balances can no longer be pooled with Shropshire Council's balances and will be invested separately in accordance with the Pension Fund Treasury Strategy.

Recommendations

Members are asked to:-

a) Delegate authority to the Scheme Administrator to implement the revised Local Government Pension Scheme (LGPS) Regulations 2009 with regard to the management of the Pension Funds day to day cash and any subsequent guidance issued.

b) Approve the Pension Fund Treasury Strategy.

c) Authorise the Scheme Administrator to place deposits in accordance with the Pension Fund's Treasury Strategy from 1st April 2010.

d) Delegate authority to the Scheme Administrator to add or remove institutions from the approved lending list and amend cash and period limits as necessary in line with the Administering Authority's creditworthiness policy.

Report

Background

1. The Fund has assets of £900m of which £897m is currently managed by the Funds investment managers and held by the Funds Global Custodian, Northern Trust. Shropshire Council as the Administering Authority maintains a small working cash balance. This Treasury Strategy relates solely to the Pension Fund cash managed by Shropshire Council as the Administering Authority.

2. The Administering Authority aims to keep the Pension Fund cash held for day-to day transactions to a minimum level. Fund cash is currently pooled with the cash balances of Shropshire Council and invested on the money markets in accordance with Shropshire Council's Treasury Strategy. The Pension Fund receives interest at the Local Authority 7 day LIBID rate.

3. The new investment regulations issued by the DCLG in December 2009 no longer permit pension fund cash to be pooled with the cash balances of Shropshire Council from 1st April 2010. In view of these changes a separate Pension Fund Treasury Strategy has been produced for 2010/2011.

Investment Policy

4. The Fund's investment policy is based on the Treasury Strategy adopted by Shropshire Council. The investment policy will have regard to the Communities for Local Governments (CLG) Guidance on Local Government Investments which was issued in March 2004 and subsequent revisions, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management Code of Practice.

5. The investment priorities for the management of Pension Fund cash balances are the security of capital and the liquidity of its investments. The Fund will also aim to achieve the optimum return on its cash investments commensurate with proper levels of security and liquidity.

6. The CLG guidance requires Shropshire Council to categorise their investments as either "specified" or "non specified" investments. Shropshire Council as Administering Authority for the Pension Fund will adopt these same categorisations for the investment of Pension Fund cash. Specified investments are deemed as "safer" investments and must meet the following conditions:-

   - be denominated in Sterling

   - have less than 12 months duration

   - not constitute the acquisition of share or loan capital

- be invested in the government or a local authority or a body or investment scheme with a “high” credit rating.

7. The Fund is required to specify its creditworthiness policy and how frequently credit ratings should be monitored. It must also specify the minimum level of such investments.

8. The Fund is required to look at non specified investments in more detail. It must set out:

   - Procedures for determining which categories of non-specified investments should be used

   - The categories deemed to be prudent

   - The maximum amount deemed to be held in each category

   - the maximum period for committing funds

9. As all of the Funds investments will be placed in sterling for periods up to 12 months with highly credit rated institutions all investments will be classified as specified investments. It is recommended that the maximum limit of £4 million is set for other Local Authorities and institutions which are Part Nationalised and £2 million for institutions which meet the minimum credit ratings but are not supported by the Government. Any changes to the minimum credit ratings or maximum limits must be approved by the Scheme Administrator.

10. The Fund may use for the prudent management of its cash balances any of the specified investments detailed on Appendix A.

11. In order not to rely solely on institutions credit ratings there have also been a number of other developments since the credit crunch crisis which require separate consideration and approval. Nationalised and Part Nationalised Banks in the UK effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government therefore they have been assigned an F1+ short term rating and a support rating of 1 both of which are the highest possible ratings. However, as they are no longer separate institutions in their own right the credit rating agencies cannot assign them an individual rating for their stand alone financial strength. For this reason Lloyds TSB, Royal Bank of Scotland (RBS) and National Westminster Bank which are part of the RBS group are included on the approved counterparty list.

12. With security and liquidity of capital the main priority, an account may also be set up with the UK Debt Management Office, a counterparty with the highest level of security, as deposits are effectively being placed with the UK Government.

13. In addition, a UK banking support package has been put in place to ensure the security of the UK banking system by supporting for following institutions with a £500 billion support package:-

- Abbey
- Barclays
- Lloyds TSB
- HSBC
- Nationwide Building Society
- Royal Bank of Scotland
- Standard Chartered Bank

14. Although the UK government has not given a blanket guarantee on all deposits placed with these institutions this additional support provides extra security meaning that credit ratings alone are not relied upon. With the exception of Standard Chartered Bank all of the institutions listed above meet the Funds current minimum credit criteria so can therefore be included on the approved lending list.

15. Local Authorities are not credit rated but where the investment is a straightforward cash loan, statute suggests that the credit risk attached to English and Welsh local authorities is an acceptable one (Local Government Act 2003 s13). Local authorities are therefore included on the approved list.

16. The use of AAA rated Money Market Funds (MMFs) may be considered but only with the express approval of the Scheme Administrator.

Creditworthiness Policy

17. It is proposed that the Fund will adopt the same methodology as Shropshire Council when determining the minimum credit ratings to be used. The Creditworthiness policy has been adopted from Shropshire Council's Treasury Strategy who use information provided by their treasury advisor, Sector Treasury Services. This service has been progressively enhanced over the last year following the problems with Icelandic Banks in 2008. Sector use a sophisticated modelling approach with credit ratings from all three rating agencies Fitch, Moody's and Standard and Poor's. In accordance with the revised Treasury Management Code of Practice they do not rely solely on the current credit ratings of counterparties but also use the following as overlays:-

    - Credit watches and credit outlooks from credit rating agencies
    - Credit Default Swap (CDS) spreads to give an early warning of likely changes in credit ratings

- Sovereign ratings to select counterparties from only the most creditworthy countries

18. This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used to determine the duration of investments and are therefore referred to as durational bands. The Fund is satisfied that this service now gives a much improved level of security for its investments. It is also a service which would not be able to replicate using in-house resources.

19. The selection of counterparties with a high level of creditworthiness will be achieved by a selection of institutions down to a minimum durational band with Sector's weekly list of worldwide potential counterparties. The Fund will therefore use counterparties within the following durational colour bands:-

    - Purple – 2yrs
    - Blue – 1 year (only applies to Nationalised and Part Nationalised UK Banks)
    - Orange – 1 year
    - Red – 6 months
    - Green – 3 months
    - No Colour – Not to be used

20. Although the maximum period limit is currently 2 years the Fund will take a more prudent approach and not invest for any longer than 12 months.

21. All credit ratings are monitored continuously and formally updated monthly by the Administering Authority. The Administering Authority is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service. The Fund will use the same policy when constructing its approved lending list. If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Funds minimum criteria, the further use of that counterparty will be withdrawn immediately.

22. Sole reliance will not be placed on the use of this external service. Officers also use market data and information and regularly monitor the financial press.

Country Limits

23. It is recommended that the Fund will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies). However, following the problems with Icelandic Banks lending is currently restricted to the UK only which has the highest possible sovereign credit rating of AAA.

Investment Strategy

24. The next financial year is expected to see investment rates continue at historically low levels. The Bank Rate has remained at 0.50% since March 2009. It is not expected to rise to 0.75% until the third quarter of 2010. It is expected to end the financial year at 1.50% following a further 0.25% rise in December 2010 and a 0.5% rise in March 2011. This view is based on the latest forecasts obtained by the Administering Authority's treasury advisor, Sector Treasury Services.

25. It is anticipated that balances available for investment will be between £3 - 8 million which will be invested short term in accordance with the Pension Fund lending list at Appendix B. The list shows separate lending and period limits for investment of Pension Fund cash. An updated lending list will be approved by the Scheme Administrator on 1st April 2010 prior to the placing of any deposits.

26. Short term cash flow requirements limit the scope for longer term investments. For cash flow generated balances we will seek to utilise the business reserve account with National Westminster Bank and short dated deposits (overnight - 3 months) in order to benefit from the compounding of interest.

27. All investments will be made in accordance with the Funds treasury strategy and in accordance with the DCLG investment regulations.

Short Term Borrowing

28. The current banking and investment arrangements mean the Fund has not needed to borrow on the money markets to fund day to day transactions. The new banking and investments may mean that it is necessary to borrow in the short term to finance payments.

29. The new investment regulations give the Administering Authority an explicit power to borrow for up to 90 days, for the purpose of the pension fund. This will enable borrowing for cash flow purposes such as to ensure that scheme benefits can be made on time. Any borrowing needs to have an identifiable income from which repayment of the borrowed amount and related interest can be funded.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) N/A
Human Rights Act Appraisal The recommendations contained in this report are compatible with the Human Rights Act 1998.
Environmental Appraisal There are no direct implications for the environment arising from this report.
Risk Management Appraisal Thorough assessment of the LGPS Investment Regulations and their implications for the Fund mitigates any regulatory risk to the Fund.
Community / Consultations Appraisal NA
Cabinet Member NA
Local Member NA
Appendices A – Specified Investment Schedule B – Pension Fund Lending List