Committee and Date	Item
Pensions Committee 18 March 2016 10.00am	**11** Public

PENSION FUND TREASURY STRATEGY 2016/17

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1. Summary

1.1 This report proposes the Pension Fund Treasury Strategy for 2016/17 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 1 April 2010 these balances have been invested separately in accordance with the Pension Fund Treasury Strategy.

2. Recommendations

2.1 Members are asked to delegate authority to the Scheme Administrator (Section 151 Officer) to manage the Pension Funds day to day cash balances.

2.2 Members are asked to approve, with any comments, the Pension Fund Treasury Strategy.

2.3 Members are asked to authorise the Scheme Administrator (Section 151 Officer) to place deposits in accordance with the Pension Fund's Treasury Strategy.

2.4 Members are also asked to delegate authority to the Scheme Administrator (Section 151 Officer) 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

3. Risk Assessment and Opportunities Appraisal

3.1 Risk Management is part of the Pension Fund's structured decision-making process by ensuring that investment decisions are taken by those best qualified to take them.

3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.3 Compliance with the CIPFA Code of Practice on Treasury Management, adhering to the Council's Treasury Policy Statement and Treasury Management Practices together with the rigorous internal controls will enable the Fund to manage the risk associated with Treasury Management activities and the potential for financial loss

3.4 There are no direct environmental, equalities or climate change consequences arising from this report.

4. Financial Implications

4.1 There are no direct financial implications arising from this report.

5. Background

5.1 The Fund has assets of over £1.48 billion which are managed by the Funds Global Custodian, Northern Trust. Shropshire Council as the Administering Authority maintains a small working cash balance (currently around £4 million). This Treasury Strategy relates solely to the Pension Fund cash managed by Shropshire Council as the Administering Authority.

5.2 The Administering Authority aims to keep the Pension Fund cash held for day-to-day transactions to a minimum level. Fund cash is currently managed separately and invested on the money markets in accordance with Shropshire Council's Treasury Strategy. A separate Pension Fund account is credited with investment income.

5.3 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 must be approved each year.

6. Investment Policy

6.1 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 Government (CLG) Guidance on Local Government Investments, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA Treasury Management Code of Practice.

6.2 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.

6.3 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 quality.

6.4 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.

6.5 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

6.6 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 (Section 151 Officer).

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

6.8 In order not to reply 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. This is because the Government owns significant stakes in the banks and this ownership is set to continue despite a partial return of some Lloyds shares back into private ownership. Capita are still supportive of the Fund using these institutions with a maximum 12 month duration. For this reason Royal Bank of Scotland (RBS) and National Westminster Bank which are part of the RBS group are included on the approved counterparty list.

6.9 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.

6.10 The use of AAA rated Money Market Funds (MMFs) may be considered but only with the express approval of the Scheme Administrator (Section 151 Officer).

7. Creditworthiness Policy

7.1 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, Capita Asset Services. This service has been progressively enhanced following the problems with Icelandic Banks in 2008. Capita 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
- Soveriegn ratings to select counterparties from only the most creditworthy countries

7.2 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.

7.3 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 Capita's weekly list of worldwide potential counterparties. The Fund will therefore use counterparties within the following durational colour bands:-

- Yellow – 5yrs e.g. AAA rated Government debt, UK Gilts, Collateralised Deposits
- Dark Pink – 5 years for Enhanced Money Market Funds with a credit score of 1.25 (Not currently used)
- Light Pink - 5 years for Enhanced Money Market Funds with a credit score of 1.5 (Not currently used)
- Purple - 2yrs (Council & Pension Fund currently has maximum of 1 year)
- Blue - 1 year (only applies to nationalised or part nationalised UK Banks)
- Orange - 1 year
- Red - 6 months
- Green – 100 days
- No colour – not to be used

7.4 Although the maximum period limit is currently 5 years the Fund will take a more prudent approach and not invest for any longer than 12 months.

7.5 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 Capita's 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.

7.6 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.

8. Country Limits

8.1 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 which currently has a sovereign credit rating of AA+ and Sweden which has the highest possible sovereign rating of AAA. The S151 Officer has delegated authority to revert back to placing investments in countries with a minimum sovereign credit rating of AA- in line with Capita's revised creditworthiness policy if required.

9. Investment Strategy

9.1 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 December 2016. By March 2018 the bank rate is expected to rise to 1.25%. This view is based on the latest forecasts obtained by the Administering Authority's treasury advisor, Capita Asset Services.

9.2 It is anticipated that balances available for investment will be between £3 - 15 million which will be invested short term in accordance with the approved lending list. Separate lending and period limits have been approved for investment of Pension Fund cash.

9.3 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 accounts with National Westminster Bank and Svenska Hadelsbanken and short dated deposits (overnight - 3 months) in order to benefit from the compounding of interest.

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

10. Short Term Borrowing

10.1 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 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) Pension Fund Treasury Strategy 2015/16, Pensions Committee 20 March 2015
Cabinet Member N/A
Local Member N/A
Appendices A. Specified Investment Schedule