

COMMITTEE	PENSIONS COMMITTEE
DATE	29 MARCH 2010
TITLE	TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2010/11
PURPOSE OF THE REPORT	TO ASK THE PENSIONS COMMITTEE TO ADOPT THE STRATEGIES
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1. NEW REGULATIONS

On the 1 January 2010 the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI. 2009 No. 3093) came into force. These new investment regulations:

- 1.1 seemed to suggest that pension fund cash was no longer permitted to be pooled with the cash balances of the administering authority from 1 April 2010;
- 1.2 gave the administering authority an explicit power to borrow for up to 90 days, for the cash flow purposes of its pension fund; and
- 1.3 required the pension fund to have a separate bank account from 1 April 2011 (The Fund already complies with this as it has three bank accounts with their own bank account numbers within Gwynedd Council's group of accounts with Barclays Bank).

2. RELEVANT GUIDANCE

However, on the 4 March 2010, the Communities and Local Government Department (CLG) issued an informal interim guidance on pooling. This seemed to contradict some people's interpretation of the above regulations as it seemed to suggest that we could continue to pool pension fund cash with the Council's cash balances.

3. ADVISOR'S GUIDANCE

Due to uncertainty in how to interpret the regulations, we asked Hymans Robertson, the Pension Fund's advisers, for advice on the above regulations and subsequent guidance. They stated that the CLG guidance seemed to backtrack somewhat on the regulations, which seemed to prohibit any pooling of Council and Pension Fund money. Their advice was that we could continue pooling if we could satisfy the following 4 criteria, that

- 3.1 the Pensions Committee makes a request that the pension fund cash assets be pooled with the Council's assets;
- 3.2 the pooling must be for the purpose of treasury management of pension fund cash only and the pension fund should not be "lending" to the Council e.g. by using a positive pension fund cash balance to offset an overdraft Council cash position;

- 3.3 the pension fund cash must have the same economic rights as the Council cash i.e. get the same investment return including sharing in any default or loss of capital as the Council cash assets over the period of investment; and
- 3.4 There needs to be a formal framework for how this is conducted which needs to be shared with the pension fund auditor so they can verify the workings and also compliance with regulatory requirements.

4. CURRENT SITUATION

Historically, the Council has complied with 3.2 and 3.3 above. Also details of how Gwynedd Council calculates the interest paid (to the Pension Fund on their cash balances during the year), are provided to the auditors when they carry out their annual audit. However, from 1 April 2010, the auditors will also be required to check our compliance with the regulatory requirements.

5. THE PENSION FUND'S INVESTMENT STRATEGY

In view of the above and in accordance with the Welsh Assembly Government's Statutory Guidance on Local Government Investments, which requires an authority to produce an Annual Investment Strategy, it is considered best practice for the Gwynedd Pension Fund (the "Fund") to adopt Gwynedd Council's Treasury Management Strategy Statement (TMSS) for 2010/11, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's TMSS for 2010/11 was approved by the Full Council on 25 February 2010.

6. CIPFA GUIDANCE

The Fund will also have regard to the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes.

7. THE PENSION FUND'S CASHFLOW

The Fund has net inflows from its dealings with its members, so in any month, the income from contributions and transfers-in significantly exceed the pensions, transfers-out and costs paid out. Once there is sufficient surplus cash it is transferred to one or more of the Fund's investment managers. Normally up to around £5 million is held back for cashflow purposes, in particular in respect of pension payments and funding calls from the private equity funds. However in the past due to known commitments, there have been times when the surplus cash held in the Fund's bank accounts with Gwynedd Council has been over £20 million.

8. POOLING IN ORDER TO MAXIMISE RETURNS

Currently all the Fund's surplus cash is pooled with the cash balances of Gwynedd Council and invested with counterparties in accordance with Gwynedd Council's Treasury Management Strategy Statement. At the end of the financial year, Gwynedd Council pays interest over to the Pension Fund based on the Fund's daily balances over the year. This can continue if the Pensions Committee requests that the pension fund's surplus cash balances are pooled with the Council's cash balances. It's apparent that by pooling the fund can take advantage of economies of scale, and as a result can attract better interest rates, reduce bank costs and avoid the duplication of work within the Council.

9. COUNTERPARTIES (Banks)

Currently the Council only invests with the 8 institutions who are part of the Credit Guarantee Scheme. However, as conditions in the financial sector have begun to improve, in order to diversify the Counterparty list (Appendix C), another 19 overseas banks have now been added to Gwynedd's list of counterparties. These additions have been approved by the Council on 25 February 2010, and the new list will be implemented from the 1 April 2010 onwards.

10. SCOPE

The proposed strategy will not deal with the cash held by the Fund's investment Managers for settlements etc.

11. RECOMMENDATIONS

11.1 The Pensions Committee is asked to approve the attached Treasury Management Strategy Statement and the Annual Investment Strategy for 2010/11, as amended for the Gwynedd Pension Fund (Appendix A), and the list of counterparties shown in Appendix C.

11.2 The Pensions Committee is also asked to make a request to the Council (even though it's not a separate body) that the Pension Fund's surplus cash balances is still allowed to be pooled with the Council's general cashflow from 1 April 2010 onwards.

TREASURY MANAGEMENT STRATEGY STATEMENT
AND ANNUAL INVESTMENT STRATEGY 2010/11 TO 2012/13

1. Introduction

CIPFA has defined Treasury Management as:

“the management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of its treasury management activities. The main risks to the Council’s treasury activities are:

- Liquidity Risk (Inadequate cash resources);
- Market or Interest Rate Risk (Fluctuations in interest rate levels);
- Inflation Risk (Exposure to inflation);
- Credit and Counterparty Risk (Security of Investments);
- Legal & Regulatory Risk;
- The risk of failing to receive the best possible rate of interest available.

The purpose of this Treasury Management Strategy Statement is to approve the:

- Treasury Management Strategy for 2010-11;
- Use of Specified and Non-Specified Investments.

2. Balance Sheet and Treasury Position – Not applicable to the Pension Fund

3. Outlook for Interest Rates

The interest rate outlook as at January 2010, is provided by the Council's treasury advisor, Arlingclose Ltd, and is shown below.

	Dec-09	Mar-10	June-10	Sep-10	Dec-10	Mar-11	June-11	Sep-11	Dec-11	Mar-12
Official Base Rate										
Upside Risk				+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	0.50	0.50	0.50	0.50	1.00	1.50	2.00	2.50	3.00	3.00
Downside Risk					-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1 Year LIBID										
Upside Risk				+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	1.25	1.25	1.25	1.50	1.75	2.25	3.00	3.50	4.00	4.00
Downside Risk					-0.25	-0.25	-0.50	-0.50	-0.50	-0.50
5 Year Gilt										
Upside Risk		+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	2.60	2.70	2.80	2.90	3.00	3.25	3.50	3.75	4.00	4.25
Downside Risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10 Year Gilt										
Upside Risk			+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25
Central Case	3.60	3.75	3.75	4.00	4.00	4.25	4.25	4.50	4.50	4.75
Downside Risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
20 Year Gilt										
Upside Risk		+0.25	+0.50	+0.50	+0.50	+0.25	+0.25	+0.25	+0.25	+0.25
Central Case	4.10	4.25	4.50	4.75	4.75	5.00	5.00	5.00	5.00	5.00
Downside Risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
50 Year Gilt										
Upside Risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	4.00	4.25	4.50	4.50	4.50	4.75	4.75	4.75	4.75	4.75
Downside Risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Arlingclose's current interest rate view is that the Bank Rate:-

- will remain at 0.5% until Q4 2010 when it will rise to 1.0% and to 1.5% in Q1 2011.
- it is expected that it will continue its gentle rise until it reaches 3.0% in Q1 2012.

However, there is a downside risk to these forecasts from downgrades to sovereign ratings and/or political instability.

Their economic forecast is as follows:

- The Bank of England forecasts GDP to grow by 4% in 2011 but concedes growth could be impeded by restrictions in bank credit and consumers' cautious spending behaviour. This is an optimistic forecast in our view; evidence of recovery is scant with weak real economic data and rising unemployment.
- The employment outlook remains uncertain. Pay freezes and job cuts will continue into 2010.
- Inflation is not an immediate worry. The Bank's forecast is for CPI to rise in the next few months from higher commodity prices and VAT reverting to 17.5%, but is forecast to remain below 2% in the short term, only surpassing the target in 2012.
- The UK fiscal deficit remains acute. Cuts in public spending and tax increases are now inevitable and more likely to be pushed through in 2010 by a new government with a clear majority.

- The net supply of gilts will rise to unprecedented levels in 2010. Failure to articulate and deliver on an urgent and credible plan to lower government borrowing to sustainable levels over the medium term will be negative for gilts.

4. **Borrowing Requirement and Strategy** – Not applicable to the Pension Fund

5. **Debt Rescheduling** – Not applicable to the Pension Fund

6. **Investment Policy and Strategy**

Guidance from the Welsh Assembly Government on Local Government Investments requires the setting of an Annual Investment Strategy (AIS).

Investment Policy

To comply with this Guidance, the Council’s general policy objective is the prudent investment of its treasury balances. The Council’s investment priorities are the security of its capital and liquidity of its investments rather than yield. The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. Investment instruments identified for use in the financial year are listed below under the ‘Specified’ and ‘Non-Specified’ Investments categories.

Specified Investments:

All such investments will be sterling denominated, **with maturities up to a maximum of 1 year**, meeting the minimum ‘high’ credit criteria where applicable.

	Minimum ‘High’ Credit Criteria	Use	Maximum Period
Debt Management Account Deposit Facility (DMADF)	High Security although DMADF is not credit rated.	In-house	1 year
Term Deposits with Local Authorities	High Security although Local Authorities are not credit rated.	In-house	1 year
Term Deposits and Certificates of Deposit with banks and building societies including callable deposits with maturities up to 1 year.	Short Term minimum F1 or equivalent. Long Term minimum A+ or equivalent. The Council will also take into account information on corporate developments of and market sentiment toward investment counterparties.	In-house	1 year

Non-Specified Investments:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use:

	Minimum Credit Criteria	Use	Maximum Maturity Period	Maximum % of Portfolio
Term Deposits and Certificates of Deposit with banks and building societies	Short Term minimum F1 or equivalent. Long Term minimum AA- or equivalent. The Council will also take into account information on corporate developments of and market sentiment toward investment counterparties.	In-house and Fund Managers	2 years	50% of all the Council's portfolio.
Money Market Funds	AAAm	In-house and Fund Managers	Daily Liquidity	50% of all the Council's portfolio.

The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Council uses credit ratings to derive its counterparty list (Appendix C). The Council and its Treasury Advisors, Arlingclose, will continue to maintain a counterparty list and will assess and update the credit standing of the institutions on a regular basis. This assessment will take into account factors such as:

- the individual credit ratings (minimum long term A+);
- credit default swaps;
- a country's net debt as a percentage of its Gross Domestic Product;
- access to government guarantee schemes;
- potential support from a well-resourced parent institution; and
- its share price.

If a downgrade results in a counterparty no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. If a body is placed on negative rating watch (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near the floor of the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body.

Investment Strategy

The Council's in-house managed funds are mainly cash-flow derived and there is a core balance available for investment over a 2-3 year period. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Given due consideration to the Council's level of cash balances over the next 3 years, the need for liquidity, its spending commitments and provisioning for contingencies, the Council has determined that £40m of its overall cash balances may be held in non-specified investments during the year.

The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates are likely to remain at very low levels which will have a significant impact on investment income. The Council's strategy must however be geared towards this development whilst adhering to the principal objective of security of invested monies.

Conditions in the financial sector have begun to show signs of improvement, albeit with substantial intervention by government authorities. In order to diversify the counterparty list (Appendix C), the use of comparable non-UK Banks for investments is now considered appropriate. The sovereign states whose banks are to be included are Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US. These countries, and the Banks within them have been selected after careful assessment of the factors noted above. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these factors and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

7. **Balanced Budget Requirement** – Not applicable to the Pension Fund

8. **2010/11 MRP Statement** – Not applicable to the Pension Fund

9. **Reporting on the Treasury Outturn**

The Head of Finance will report to the Pensions Committee on treasury management activity and performance as follows:

(a) Mid year and year end review against the strategy approved for the year.

(b) The Council will produce an outturn report on its treasury activity no later than 30 September after the financial year end.

10. **Other items** – Not applicable to the Pension Fund

APPENDIX B

PRUDENTIAL INDICATORS 2010/11-2012/13 – Not applicable to the Pension Fund

GWYNEDD COUNCIL'S LIST OF AUTHORISED COUNTERPARTIES

Term Deposits / Call Accounts

Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
UK	DMADF, DMO	No limit	No limit
UK	UK Local Authorities	£10m (£10m)	1 year
UK	Abbey	£20m (£15m)	2 years
UK	Bank of Scotland/Lloyds	£20m (£15m)	2 years
UK	Barclays	£20m (£15m)	2 years
UK	Clydesdale	£20m (£15m)	2 years
UK	HSBC	£20m (£15m)	2 years
UK	Nationwide	£20m (£15m)	2 years
UK	Royal Bank of Scotland	£20m (£15m)	2 years
Australia	Australia and NZ Banking Group	£5m (£0m)	1 year
Australia	Commonwealth Bank of Australia	£5m (£0m)	1 year
Australia	National Australia Bank Ltd	£5m (£0m)	1 year
Australia	Westpac Banking Corp	£5m (£0m)	1 year
Canada	Bank of Montreal	£5m (£0m)	1 year
Canada	Bank of Nova Scotia	£5m (£0m)	1 year
Canada	Canadian Imperial Bank of Commerce	£5m (£0m)	1 year
Canada	Royal Bank of Canada	£5m (£0m)	1 year
Canada	Toronto-Dominion Bank	£5m (£0m)	1 year
Finland	Nordea Bank Finland	£5m (£0m)	1 year
France	BNP Paribas	£5m (£0m)	1 year
France	Calyon (Credit Agricole Group)	£5m (£0m)	1 year
France	Credit Agricole SA	£5m (£0m)	1 year
Germany	Deutsche Bank A	£5m (£0m)	1 year
Netherlands	Rabobank	£5m (£0m)	1 year
Spain	Banco Bilbao Vizcaya Argentaria	£5m (£0m)	1 year
Spain	Banco Santander SA	£5m (£0m)	1 year
Switzerland	Credit Suisse	£5m (£0m)	1 year
US	JP Morgan	£5m (£0m)	1 year

*Investments in Non-UK banks will be restricted to a maximum limit of 40% of the portfolio, with a £10m country limit.

Instrument	Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
Gilts	UK	DMO	No limit	No limit
AAA rated Money Market Funds	UK/Ireland/Luxembourg	Money Market Funds	£5m per name	Daily Liquidity
Other MMFs and CIS	UK	Collective Investment schemes	£5m per name	Daily Liquidity