COMMITTEE	PENSIONS COMMITTEE
DATE	22 MARCH 2011
TITLE	TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2011/
PURPOSE OF THE REPORT	TO ASK THE PENSIONS COMMITTEE TO ADOPT THE STRATEGIES
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1. 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 2011/12 was approved by the Full Council on 3 March 2011.

2. 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.

3. 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.

4. 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 is 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.

5. COUNTERPARTIES (Banks)

The counterparty list **(Appendix C)** has been updated to reflect the latest recommendations. The Spanish banks have been removed and 6 banks have been added to the list. Two banks have had name changes which have been amended on the list. These changes are noted in bold print on the list of Authorised Counterparties in **Appendix C** with the previous limits shown in brackets. The amendments were approved by Full Council on 3 March 2011, and the new list will be operational from 1 April 2011 onwards.

6. SCOPE

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

7. RECOMMENDATIONS

7.1 The Pensions Committee is asked to approve the attached Treasury Management Strategy Statement and the Annual Investment Strategy for 2011/12, as amended for the Gwynedd Pension Fund (Appendix A), and the list of counterparties shown in Appendix C.

7.2 The Pensions Committee is also asked to make a request to the Council (even though it is not a separate body) to allow the Pension Fund's surplus cash balances to be pooled with the Council's general cashflow from 1 April 2011 onwards.

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2011/12 TO 2013/14

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 Council always seeks to achieve the best possible rate of interest commensurate with the risk it is willing to take. 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);
- Refinancing Risk (Impact of debt maturing in future years);
- Legal & Regulatory Risk;

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

- Treasury Management Strategy for 2011-12;
- Use of Specified and Non-Specified

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

3. Outlook for Interest Rates

The interest rate outlook as at January 2011, is provided by the Council's treasury advisor, Arlingclose Ltd, and is shown below.

	Mar 2011	Jun 2011	Sept 2011	Dec 2011	Mar 2012	Jun 2012	Sept 2012	Dec 2012	Mar 2013	Jun 2013
Official Bank Rate										
Upside risk	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**	**2.75**
Downside risk			-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
1-yr LIBID										
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	**1.65**	**1.90**	**2.15**	**2.40**	**2.50**	**2.50**	**2.75**	**3.00**	**3.25**	**3.50**
Downside risk	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5-yr Gilt										
Upside risk	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	**2.75**	**3.00**	**3.25**	**3.50**	**3.75**	**4.00**	**4.00**	**4.00**	**4.00**	**4.00**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
10-yr Gilt										
Upside risk	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central Case	**3.90**	**3.75**	**3.75**	**4.00**	**4.25**	**4.50**	**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	-0.25	-0.25
20-yr Gilt										
Upside risk	+0.25	+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central Case	**4.50**	**4.75**	**5.00**	**5.00**	**5.00**	**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	-0.25
50-yr Gilt										
Upside risk	+0.25	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50	+0.50
Central Case	**4.25**	**4.50**	**4.75**	**4.75**	**4.75**	**4.75**	**4.75**	**4.75**	**4.50**	**4.50**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Arlingclose's interest rate view at January 2011 is that the Bank Rate:-

- will remain at 0.50% until Q3 2011 when it will rise to 0.75%, to 1.00% in Q4 2011 and 1.25% in Q1 2012.
- it is expected that it will continue its gentle rise until it reaches 2.75% in Q1 2013.

The path of base rate reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates. Uncertainty surrounding Eurozone sovereign debt and the risk of contagion will remain a driver of global credit market sentiment.

Their economic forecast at January 2011 is as follows:

- The framework and targets announced in the Comprehensive Spending Review (CSR) to reduce the budget deficit and government debt are as announced in June and focuses on how the cuts are to be distributed. The next fiscal milestone will be the Office Of Budget Responsibility's assessment of the CSR's implications for growth, employment and inflation.

- The minutes of the Monetary Policy Committee's December meeting suggested a movement away from further Quantitative Easing. Despite Money Supply being weak and growth prospects remaining subdued the MPC have gravitated towards increasing rates in the new year as global inflation continues to rise along with household inflation.
- Consumer Price Inflation is stubbornly above 3% and is likely to spike above 4% in January as VAT, Utilities and Rail Fares are increased.
- Unemployment remains near a 16 year high, at just over 2.5 million, and is set to increase as the Public Sector shrinks.
- Recently announced Basel III capital/liquidity rules and extended timescales are positive for banks. Restructuring of UK banks' balance sheets is ongoing and expected to take a long time to complete. This will be a pre-condition for normalisation of credit conditions and bank lending.
- Mortgage repayment, a reduction in net consumer credit and weak consumer confidence are consistent with lower consumption and therefore future trend rates of growth, despite Q3's fairly strong performance.

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.

<u>Specified Investments:</u>

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
Gilts (DMO)*	High Security – issued by Government	In-house	1 year
Treasury bills *	High Security – issued by Government	In-house	1 year
Local Authority bills *	High Security although Local Authorities are not credit rated.	In-house	1 year
Bonds issued by multilateral development banks. *	EIB, Council of Europe, Inter American Investment Bank	In-house	1 year

* These are new additions to the list and investment in these instruments will be on advice from the Council's treasury advisor. They are only likely to be used to ensure a safe haven at any future time of banking stress.

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 A+ 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.
Gilts (DMO)*	High Security – issued by Government	In-house	6 years	No limit
Bonds issued by financial institutions guaranteed by the UK government *	High Security –guaranteed by Government	In-house	6 years	50% of all the Council's portfolio.
Sterling denominated bonds by non-UK sovereign governments *	Minimum AA+ credit rating.	In-house	3 years	50% of all the Council's portfolio.
Bonds issued by multilateral development banks. *	EIB, Council of Europe, Inter American Investment Bank	In-house	6 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.

* These are new additions to the list and investment in these instruments will be on advice from the Council's treasury advisor. They are only likely to be used to ensure a safe haven at any future time of banking stress.

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 Dd). 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+ for counterparties; AA+ for countries);
- credit default swaps (where available);
- 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;
- its share price (where available);
- macro-economic indicators; and
- corporate developments, news and articles, market sentiment.

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. 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.

In order to diversify the counterparty list (Appendix C) the use of comparable non-UK Banks for investments was introduced in 2010/11. Amendments have been made to the list for 2011/12 to include Sweden as an approved sovereign state. Spain has been removed and 6 banks have been added to the list. 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. MRP Statement 2011/12 - Not applicable to the Pension Fund

9. Reporting on the Treasury Outturn

The Head of Finance will report to 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 30th 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

APPENDIX C

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	**Santander UK Plc** (Banco Santander Group)	£20m (£20m)	2 years*
UK	Bank of Scotland (Lloyds Banking Group)	£20m (£20m)	2 years
UK	**Lloyds TSB (Lloyds Banking Group)**	**£20m (£0m)**	**2 years**
UK	Barclays Bank Plc	£20m (£20m)	2 years
UK	Clydesdale Bank (National Australia Group)	£20m (£20m)	2 years
UK	HSBC Bank Plc	£20m (£20m)	2 years
UK	Nationwide Building Society	£20m (£20m)	2 years
UK	**Nat West (RBS Group)**	**£20m (£0m)**	**2 years**
UK	Royal Bank of Scotland (RBS Group)	£20m (£15m)	2 years
UK	**Standard Chartered Bank**	**£20m (£0m)**	**2 years**
Australia	Australia and NZ Banking Group	£5m (£5m)	1 year
Australia	Commonwealth Bank of Australia	£5m (£5m)	1 year
Australia	National Australia Bank Ltd	£5m (£5m)	1 year
Australia	Westpac Banking Corp	£5m (£5m)	1 year
Canada	Bank of Montreal	£5m (£5m)	1 year
Canada	Bank of Nova Scotia	£5m (£5m)	1 year
Canada	Canadian Imperial Bank of Commerce	£5m (£5m)	1 year
Canada	Royal Bank of Canada	£5m (£5m)	1 year
Canada	Toronto-Dominion Bank	£5m (£5m)	1 year
Finland	Nordea Bank Finland	£5m (£5m)	1 year
France	BNP Paribas	£5m (£5m)	1 year
France	**Credit Agrigcole CIB** (Credit Agricole Group)	£5m (£5m)	1 year
France	Credit Agricole SA (Credit Agricole Group)	£5m (£5m)	1 year
France	**Société Générale**	**£5m (£0m)**	**1 year**
Germany	Deutsche Bank AG	£5m (£5m)	1 year
Netherlands	**ING Bank NV**	**£5m (£0m)**	**1 year**
Netherlands	Rabobank	£5m (£5m)	1 year
Sweden	**Svenska Handelsbanken**	**£5m (£0m)**	**1 year**
Switzerland	Credit Suisse	£5m (£5m)	1 year
US	JP Morgan	£5m (£5m)	1 year

* Arlingclose has currently imposed a restriction to 6 months for this bank.

1. There is a limit of £20m on banks within the same banking group.
2. Investments in Non-UK banks will be restricted to a maximum limit of 40% of the portfolio, with a £10m country limit **to a maximum of 30% of the portfolio per country**.
3. **Minimum Credit Criteria** - long term A+ for counterparties; AA+ for countries.

Instrument	**Country**	**Counterparty**	**Maximum Limit of Investments £m**	**Maximum Length of Loans**
Gilts*	UK	DMO	No limit	6 years
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
Treasury bills*	**UK**	**DMO**	**No limit**	**1 year**
Local Authority bills*	**UK**	**UK Local Authorities**	**£10m**	**1 year**
Bonds issued by multilateral development banks.*	**Europe/ America**	**EIB, Council of Europe, Inter American Investment Bank**	**£5m**	**6 years**
Bonds issued by financial institutions guaranteed by the UK government.*	**UK**	**Guaranteed financial institutions**	**£5m**	**6 years**
Sterling denominated bonds by non-UK sovereign governments.*	**Non-UK**	**Non-UK Sovereign Governments**	**£5m**	**3 years**

* Investment in these instruments will be on advice from the Council's treasury advisor.