MEETING:	**PENSIONS COMMITTEE**
DATE:	**25 NOVEMBER 2011**
TITLE:	**TREASURY MANAGEMENT 2011/12 – MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Pension Fund's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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1. BACKGROUND

The Treasury Management Strategy for Gwynedd Pension Fund has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely investment activity for the forthcoming financial year.

The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

Treasury management is defined as: "The management of the local authority'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."

2. ECONOMIC BACKGROUND

Global growth prospects deteriorated considerably over the six months to September, moving from an expectation of modest expansion to the risk of a double-dip recession. Q1 2011 GDP in the UK was 0.5% but was just 0.2% in Q2.

Inflation remained stubbornly high. The annual consumer price inflation (CPI) for August was 4.5%. CPI had remained above the Monetary Policy Committee's (MPC) 3% upper limit for 20 consecutive months and required the Bank of England's Governor to write his seventh open letter to the Chancellor. The Bank believed the elevated rate of inflation reflected the temporary impact of several factors: the increase in the VAT rate to 20%, past increases in global energy prices and import prices.

Weakness persisted in the labour market. High inflation trumping average earnings growth of only 2.9%, scarce availability of credit, stagnant house prices, all combined to lower disposable income, squeeze household spending power and leave consumer confidence fragile.

Central bankers' policies were driven by the feeble growth outlook rather than the upward trend in inflation. The Bank of England's August Inflation Report downgraded the growth forecast even as it acknowledged energy price rises could push CPI to 5% before inflation falls back to the 2% target over the medium-term. The UK's strategy of combining loose monetary policy (the Bank Rate had remained at 0.5% for 2½ years and Quantitative Easing at £200bn) with tight fiscal policy supported the rebalancing of the economy and also commanded support in the markets.

A lack of both political governance and measures to address the high debt burden (put off until after the 2012 presidential election), ultimately led Standard & Poor's to downgrade the US Sovereign from AAA to AA+. The country's weak economic and fiscal situation and an unemployment rate of 9.1% left the Federal Reserve little option but to commit to "exceptionally low" interest rates until mid 2013.

The European sovereign debt crisis deepened. The agreement in July to address Greece's fiscal problems and broaden the mandate for the European Financial Stability Facility (EFSF) only bought time for the Eurozone as market pressure increased on Italy and Spain, but did little to address the issue of overburdened sovereign balance sheets.

The European Banking Authority released the results of the second of its stress tests in July. 8 banks (two Greek, one Austrian and five small domestic Spanish banks) out of 91 banks failed the tests. All of the UK and non-UK banks tested by the EBA and which are on the Council's lending list met the 'stressed' Core Tier 1 Ratio of 5%, none were adjudged as 'near-failed'(i.e. having ratios between 5% and 6%).

The economic uncertainty resulted in analysts postponing the likelihood of an increase in the UK Bank Rate until mid 2012. Gilts were considered a safe haven and benefited from market turmoil. Gilt yields fell to their lowest levels in five years. 5-year gilt yields fell to 1.25%, 10-year yields to 2.2% and 20-year yields to 3.05%. PWLB borrowing rates fell commensurately.

3. INVESTMENT ACTIVITY

The Pension Fund's surplus cash is invested with the Council's surplus cash for maximum efficiency and effectivenes.

The Guidance on Local Government Investments in Wales gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Investments

	Balance on 01/04/2011 £000s	Investments Made £000s	Investments Repaid £000s	Balance on 30/09/2011 £000s	Increase/ Decrease in Investments £000s
Short Term Investments in Banks & Building Societies	58,115	151,375	165,705	43,785	-14,330
Long Term Investments in Banks & Building Societies	-	5,000	-	5,000	5,000
Investments in Money Market Funds	5,000	62,000	52,000	15,000	10,000
Investments in other Local Authorities	5,000	5,000	-	10,000	5,000
TOTAL INVESTMENTS	**68,115**	**223,375**	**217,705**	**73,785**	**5,670**

Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2011/12. New investments can be made with the following institutions:

- Debt Management Office;
- Other Local Authorities;
- AAA-rated Stable Net Asset Value Money Market Funds;
- Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Sweden, Switzerland and the USA);
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.

Counterparty credit quality is assessed and monitored with reference to:Credit Ratings (the Council's minimum long-term counterparty rating of A+ (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms /potential support from a well-resourced parent institution; share price.

Credit Risk

Counterparty credit quality has progressively strengthened/been maintained through the first half of the year, as can be demonstrated by the Credit Score Analysis summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2011	3.53	AA-	2.70	AA
30/06/2011	3.51	AA-	2.70	AA
30/09/2011	3.07	AA	2.50	AA+

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 15
The aim = A+ or higher credit rating, with a score of 5 or lower, to reflect current investment approach with main focus on security.

Counterparty Update

The lack of real progress in resolving the sovereign debt crisis in Europe began to affect even the stronger Eurozone nations and their banking systems. Market volatility spiked sharply in August, banks' share prices fell sharply. Having reviewed all credit indicators the Council, advised by Arlingclose, believed that there were no solvency issues with the banks on the recommended lending list. Nevertheless the share price moves were too sharp to ignore and a prudent response to the tensions and negativity in the markets was required.

The Council responded to the growing stress by scaling back maturities for new investments on the advice of the Council's treasury advisors. Limits for UK banks, Nationwide BS and Australian, Canadian and US banks have now been temporarily reduced to 6 months (Santander UK plc to is restricted to 3 months). Limits for European banks have been temporarily reduced to 1 month. French institutions have been suspended for new investments in response to concerns over funding and their sovereign exposure to peripheral European nations.

On 28th September Clydesdale Bank was suspended from the lending list following the bank's downgrade to A2 by Moody's, which falls below the Council's minimum criteria of A+ or equivalent.

During the first quarter Moody's placed the ratings of a number of UK institutions on review for possible downgrade. The review is likely to be completed sometime in October and may lead to downgrades of some counterparties on the Council's lending list. The implications of any downgrades will be discussed with Arlingclose and could result in a review of the Council's minimum credit criteria, as set out in its Treasury Management Strategy Statement.

The Council has no current investments with non-uk banks.

The Council's counterparty list as at 30 September 2011 is attached as information in Appendix A.

Budgeted Income and Outturn
The Pension Fund's budgeted investment income for the year has been estimated at £82,600. The average cash balances representing the Council's reserves, working balances and the Pension Fund's surplus cash were £81.9m during the period.

The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until the middle of 2012. Short-term money market rates have remained at very low levels. New deposits were made at an average rate of 1.25%. The Pension Fund anticipates an investment outturn of £117,700 for the whole year.

Icelandic Bank Investment Update
Following the latest guidance issued by CIPFA in September 2011 (LAAP Bulletin 82 Update 5), the following is now known.

- ***Heritable*** – It is expected that 86p-90p/£ will be recovered overall. At the time the LAAP Bulletin 82 Update 5 was issued, interim payments totalling 60.42% of the claim had been made. 6.25% was received in April 2011 and 4.05% in July 2011. A further 4.50% is expected in October 2011.

4. OUTLOOK FOR QUARTER 3 - QUARTER 4

At the time of writing this activity report in November 2011, given the precarious outlook for growth it is believed the Bank of England would only raise rates after there was firm evidence that the economy had survived the fiscal consolidation. Therefore, the outlook is for official interest rates to remain low for an extended period, at least until late 2012.

	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
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**	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.25**	**1.50**	**1.75**	**2.00**	**2.25**
Downside risk						-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

5. SUMMARY

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2011/12. As indicated in this report a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

GWYNEDD COUNCIL'S LIST OF AUTHORISED COUNTERPARTIES (as updated 30/09/11)

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	1 year
UK	Santander UK Plc (Banco Santander Group)	£20m	3 MONTHS ~~2 years~~
UK	Bank of Scotland (Lloyds Banking Group)	£20m	keep to 6 months ~~2 years~~
UK	Lloyds TSB (Lloyds Banking Group)	£20m	keep to 6 months ~~2 years~~
UK	Barclays Bank Plc	£20m	keep to 6 months ~~2 years~~
UK	Clydesdale (National Australia Bank Group) **SUSPENDED 28/09/11**	£20m	2 years
UK	HSBC Bank Plc	£20m	keep to 6 months ~~2 years~~
UK	Nationwide Building Society	£20m	keep to 6 months ~~2 years~~
UK	Nat West (RBS Group)	£20m	keep to 6 months ~~2 years~~
UK	Royal Bank of Scotland (RBS Group)	£20m	keep to 6 months ~~2 years~~
UK	Standard Chartered Bank	£20m	keep to 6 months ~~2 years~~
Australia	Australia and NZ Banking Group	£5m	keep to 6 months ~~1 year~~
Australia	Commonwealth Bank of Australia	£5m	keep to 6 months ~~1 year~~
Australia	National Australia Bank Ltd (National Australia Bank Group)	£5m	keep to 6 months ~~1 year~~
Australia	Westpac Banking Corp	£5m	keep to 6 months ~~1 year~~
Canada	Bank of Montreal	£5m	keep to 6 months ~~1 year~~
Canada	Bank of Nova Scotia	£5m	keep to 6 months ~~1 year~~
Canada	Canadian Imperial Bank of Commerce	£5m	keep to 6 months ~~1 year~~
Canada	Royal Bank of Canada	£5m	keep to 6 months ~~1 year~~
Canada	Toronto-Dominion Bank	£5m	keep to 6 months ~~1 year~~
Finland	Nordea Bank Finland	£5m	keep to 1 month ~~1 year~~
France	BNP Paribas *SUSPENDED 13/09/11 *	£5m	1 year
France	Credit Agricole CIB (Credit Agricole Group) *SUSPENDED 13/09/11*	£5m	1 year
France	Credit Agricole SA *SUSPENDED 13/09/11*	£5m	1 year
France	Societe Generale *SUSPENDED 11/08/11*	~~£5m~~	~~1 year~~
Germany	Deutsche Bank AG	£5m	keep to 1 month ~~1 year~~
Netherlands	ING Bank NV	£5m	keep to 1 month ~~1 year~~
Netherlands	Rabobank	£5m	keep to 1 month ~~1 year~~
Sweden	Svenska Handelsbanken	£5m	keep to 1 month ~~1 year~~
Switzerland	Credit Suisse	£5m	keep to 1 month ~~1 year~~
US	JP Morgan	£5m	keep to 6 months ~~1 year~~

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
Business loans to local companies**	UK	As agreed by the Local Loans Fund Scheme	£1m	10 years

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

** Advancement of these loans will be approved by the procedure detailed in Appendix Ch, Paragraph 6. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.