MEETING	**PENSIONS COMMITTEE**
DATE	**23 MARCH 2012**
PURPOSE	**TO ASK THE PENSIONS COMMITTEE TO ADOPT THE STRATEGIES**
TITLE	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2012/13**
AUTHOR	**DAFYDD L EDWARDS – HEAD OF FINANCE**

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 2012/13, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's TMSS for 2012/13 was approved by the Full Council on 1 March 2012.

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 maximum length of loans to UK Institutions have been lowered from 2 years to 1 year to reflect these recommendations. 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 1 March 2012, and the new list will be operational from 1 April 2012 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 2012/13, 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 2012 onwards.

APPENDIX A

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2012/13 TO 2014/15

1. Background

1.1 The CIPFA Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”) and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Welsh Government’s (WG’s) Investment Guidance.

1.2 The purpose of this TMSS is, therefore, to approve:

- Treasury Management Strategy for 2012/13
- Annual Investment Strategy for 2012/13

1.3 Treasury Management is about the management of risk. The Authority is responsible for its treasury decisions and activity. No treasury management activity is without risk.

1.4 As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management Code at a meeting of its Full Council on 3rd March 2011.

1.5 All treasury activity will comply with relevant statute, guidance and accounting standards.

2. Capital Financing Requirement – Not applicable to the Pension Fund

3. Interest Rate Forecast

3.1 The economic and interest rate forecast as at December 2011, is provided by the Authority’s treasury management advisor, Arlingclose Ltd, and is shown below. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Official Bank Rate													
Upside risk					0.25	0.50	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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk													
1-yr LIBID													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	1.75	1.75	1.75	1.75	1.80	1.85	1.95	2.00	2.10	2.20	2.30	2.40	2.40
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
5-yr gilt													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	1.30	1.35	1.40	1.50	1.60	1.70	1.80	2.00	2.10	2.30	2.40	2.50	2.50
Downside risk	-0.25	-0.25	-0.25	-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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	2.30	2.40	2.45	2.50	2.55	2.60	2.70	2.75	2.80	2.85	2.90	3.00	3.00
Downside risk	-0.25	-0.25	-0.25	-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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	3.05	3.05	3.10	3.20	3.25	3.30	3.35	3.40	3.45	3.50	3.60	3.75	3.75
Downside risk	-0.25	-0.25	-0.25	-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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.00	4.00	4.10	4.20	4.25	4.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Their economic forecast at December 2011 is as follows:

- Conventional monetary policy has become largely redundant; the Bank of England and the US Federal Reserve have signalled their respective official interest rates will be on hold through to the end of 2012. We think that it could be 2016 before official UK interest rates rise.
- The UK's safe haven status, the direct effect of QE and minimal prospect of an increase in policy rates are expected to keep gilt yields at their lows in the near term.
- A disorderly outcome to the Eurozone sovereign crisis remains a key economic, credit and political risk.

Their underlying assumptions are as follows:

- Financial market stress is expected to remain a feature of 2012. Rates within Interbank markets (where banks fund the majority of their day to day operations) have continued to climb. This dynamic was a characteristic of the 2008 banking crisis and whilst the authorities have flooded the markets with liquidity, it is still a strong indicator of market risk.
- Inflation has moderated back to 4.8% in November. CPI is expected to drop gradually back towards the 2% target as the January 2011 VAT increase, the surge in oil prices and the large energy price hikes fall out of the twelve month comparison.
- Recent data and surveys suggest that since the summer the UK economy has lost the admittedly fragile momentum. Business and consumer surveys point to continued weakness in coming months. Public spending cuts, austerity measures, credit constraints, low business and consumer confidence could result in the economy stalling (Q3 excepted, when the 2012 Olympics will provide a temporary boost) and most likely pressure the Bank of England to provide further QE.
- Faltering global growth will not be helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone and gridlock in the US going into an election year. The knock-on effects could in turn weigh on growth in China and emerging market countries.
- Gilt supply is expected to be higher in 2012-13 than earlier forecast by the Treasury. However, over the short-term, gilts will retain their safe-haven status as euro area contagion risks grow.

- Sizeable European bond redemptions and refinancing (Italy in particular) in the first half of 2012 remain significant challenges. Headwinds to fiscal convergence and treaty changes could intensify downgrade pressures on the AAA core nations as well as peripheral countries. The effectiveness of the European Financial Stability Fund (EFSF) may prove limited, increasing the possibility of a sovereign failure or the break-up of the euro area.

4. Borrowing Strategy – Not applicable to the Pension Fund

5. Sources of Borrowing and Portfolio implications – Not applicable to the Pension Fund

6. Debt Rescheduling - Not applicable to the Pension Fund

7. Annual Investment Strategy

7.1 In accordance with Investment Guidance issued by the Welsh Government and best practice this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yields earned on investments are important but are secondary considerations.

7.2 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt it has built up have lead to a sovereign debt crisis and a banking crisis with the outcome still largely unknown. It is against this backdrop of uncertainty that the Authority's investment strategy is framed.

7.3 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the Welsh Government. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

7.4 The types of investments that will be used by the Authority and whether they are specified or non-specified are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Debt Management Account Deposit Facility	✓	×
AAA rated Money Market Funds	✓	×
Treasury Bills (T-Bills)	✓	×
Local Authority Bills	✓	×
Term deposits with other UK local authorities	✓	✓
Term deposits with banks and building societies	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Bonds issued by Multilateral Development Banks	✓	✓
Corporate Bonds	✓	✓
Other Money Market and Collective Investment Schemes	✓	✓
Business Loans to Local Companies (as agreed by the Local Loans Fund scheme)*	×	✓

**Advancement of these loans will be approved by the procedure detailed below. Evaluation of the Business Loans is not part of the advice or services from the Authority's treasury advisor.*

7.5 A number of changes have been implemented to the investment strategy for 2012/13 in response to evolving conditions in financial markets. The credit crisis has refocused attention on the treasury management priority of security of the capital invested. The authority uses credit ratings to derive its list of counterparties. The authority and its treasury advisors, Arlinclose Ltd, will continue to maintain a counterparty list and will assess and update the credit standing of the institutions on a regular basis. The authority and its treasury advisors, select countries and financial institutions after analysis and ongoing monitoring of:

- Published credit ratings for financial institutions (minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns) – this is lower than the A+ minimum adopted in 2011/12 and is in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the financial system.
- Credit Default Swaps (where quoted)
- Economic fundamentals (for example Net Debt as a percentage of GDP)
- Sovereign support mechanisms
- Share Prices
- Corporate developments, news, articles, markets sentiment and momentum
- Subjective overlay – or, put more simply, common sense.

Any institution can be suspended or removed should any of the factors identified above give rise to concern. The council's counterparty list is shown in Appendix CH.

It remains the Authority's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

The Council has set up a Local Loans Fund which will make loans to local businesses. These investments are included in the Non-Specific Investments table above and will be for a maximum of 10 years. The total value of the fund for such investments will be £3million. Applications for loans under this scheme will not be part of the usual credit assessment for treasury management investment purposes but will be assessed by appointed consultants and any decision to lend will be made by the Investment Panel for the scheme.

7.6 Authority's Banker – The Authority banks with Barclays Bank plc. At the current time, it does meet the minimum credit criteria of A- (or equivalent) long term. Even if the credit rating falls below the Authority's minimum criteria it will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

8. Investment Strategy

8.1 With short term interest rates low for even longer, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

8.2 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.

8.3 Money market funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF.

9. The Use of Financial Instruments for the Management of Risks

9.1 Currently, Local Authorities' legal power to use derivative instruments remains unclear. Consequently, the Authority does not intend to use derivatives.

9.2 Should this position change, the Authority may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

10. Balanced Budget Requirement – Not applicable to the Pension Fund

11. 2012/13 MRP Statement – Not applicable to the Pension Fund

12. Reporting on the Treasury Outturn

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

- Mid year and year end review against the strategy approved for the year.
- The Council will produce an outturn report on its treasury activity no later than 30th September after the financial year end.

13. Other Items

13.1 Training

CIPFA's Code of Practice requires the Head of Finance to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Formal training, possibly sourced externally may be provided for relevant members during 2012/13.

APPENDIX B

Prudential Indicators 2012/13 – 2014/15 – Not applicable to the Pension Fund

GWYNEDD COUNCIL'S LIST OF AUTHORISED COUNTERPARTIES

Country	**Counterparty**	**Maximum Limit of Investments £m**	**Maximum Length of Loans**
UK	DMADF, DMO	No Limit	No Limit
UK	UK Local Authorities	£25m (£25m)	1 year
UK	**Santander UK Plc (Banco Santander Group)**	£20m (£20m)	**1 year** (2years)
UK	**Bank of Scotland (Lloyds Banking Group)**	£20m (£20m)	**1 year** (2years)
UK	**Lloyds TSB (Lloyds Banking Group)**	£20m (£20m)	**1 year** (2years)
UK	**Barclays Bank Plc**	£20m (£20m)	**1 year** (2years)
UK	**Clydesdale Bank (National Australia Bank Group)**	£20m (£20m)	**1 year** (2years)
UK	**HSBC Bank Plc**	£20m (£20m)	**1 year** (2years)
UK	**Nationwide Building Society**	£20m (£20m)	**1 year** (2years)
UK	**NatWest (RBS Group)**	£20m (£20m)	**1 year** (2years)
UK	**Royal Bank of Scotland (RBS Group)**	£20m (£20m)	**1 year** (2years)
UK	**Standard Chartered Bank**	£20m (£20m)	**1 year** (2years)
Australia	Australia and NZ Banking Group	£5m (£5m)	1 year
Australia	Commonwealth Bank of Australia	£5m (£5m)	1 year
Australia	National Australia Bank Ltd (National Australia Bank Group)	£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 Agricole CIB (Credit Agricole Group)	£5m (£5m)	1 year
France	Credit Agricole SA (Credit Agricole Group)	£5m (£5m)	1 year
France	Société Générale	£5m (£5m)	1 year
Germany	Deutsche Bank AG	£5m (£5m)	1 year
Netherlands	ING Bank NV	£5m (£5m)	1 year
Netherlands	Rabobank	£5m (£5m)	1 year
Netherlands	Bank Nederlandse Gemeenten	£5m (£5m)	1 year
Sweden	Svenska Handelsbanken	£5m (£5m)	1 year
Switzerland	Credit Suisse	£5m (£5m)	1 year
US	JP Morgan	£5m (£5m)	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.

Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively, if a counterparty is downgraded, this list may be shortened.

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	£25m	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 A, Paragraph 7. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.