MEETING	**PENSIONS COMMITTEE**
DATE	**22 MARCH 2013**
PURPOSE	**TO ASK THE PENSIONS COMMITTEE TO ADOPT THE STRATEGIES**
TITLE	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2013/14**
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1. THE PENSION FUND'S INVESTMENT STRATEGY

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 2013/14, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's TMSS for 2013/14 was approved by the Full Council on 28 February 2013.

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 counterparties currently meeting investment criteria **(Appendix C)** have been updated to reflect the latest recommendations. The maximum length of loans to all institutions has been increased from 1 year to 2 years to reflect these recommendations. The maximum limit and length of investments are listed, although they are currently restricted to 1 year or less, depending on the status of each institution.

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 2013/14, as amended for the Gwynedd Pension Fund (Appendix A), and to note the current 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 2013 onwards.

APPENDIX A

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2013/14 TO 2015/16

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Welsh Government's Investment Guidance.

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

1.3 The purpose of this Treasury Management Strategy Statement is, therefore, to approve:

- Treasury Management Strategy for 2013/14;
- Annual Investment Strategy for 2013/14;

1.4 The Council has borrowed and/or invested substantial sums of money and therefore has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.

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

3. Interest Rate Forecast

3.1 The Arlingclose interest rate forecast continues its theme of the last few years, that is, that interest rates will remain low for even longer. Indeed, the forecast is for official UK interest rates to remain at 0.5% until 2016 given the moribund outlook for economic growth and the extension of austerity measures announced in the Chancellor's Autumn Statement. Until there is a credible resolution of the problems that stalk the Eurozone – and that resolution requires full-scale fiscal union which faces many significant political hurdles – then the UK's safe haven status and minimal prospect of increases in official interest rates will continue to combine and support the theme within the forecast.

3.2 The economic and interest rate forecast shown below is provided by the Council's treasury management advisor, Arlingclose Ltd. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events.

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Official Bank Rate													
Upside risk			0.25	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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
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
3-month LIBID													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.50	0.55	0.55	0.55	0.60	0.60
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
1-yr LIBID													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75
Central case	0.85	0.90	0.95	0.95	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.10	1.10
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	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	0.95	0.95	0.95	0.95	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.20	1.20
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	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Central case	2.00	2.00	2.05	2.05	2.05	2.05	2.10	2.10	2.10	2.20	2.20	2.20	2.20
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	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
Central case	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.00	3.10	3.10	3.10	3.10	3.10
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	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00
Central case	3.35	3.35	3.35	3.40	3.40	3.40	3.50	3.50	3.50	3.50	3.60	3.60	3.60
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

Underlying Assumptions:

- UK growth is unlikely to return to above trend for the foreseeable future. Q3 GDP was strong at 0.9% but this momentum is unlikely to be sustained in Q4 or in 2013. The rebalancing from public-sector driven consumption to private sector demand and investment is yet to manifest, and there is little sign of productivity growth. Further contraction in the Eurozone, including Germany's powerful economy, and slower forecast growth in the emerging economies (Brazil/Mexico/India) are exacerbating the weakness.

- Consumer Price Inflation has fallen to 2.7 % from a peak of 5.2%. Near term CPI is likely to be affected by volatility in commodity prices and its decrease towards the 2% target is expected to be slower than previously estimated. Real wage growth (i.e. after inflation) is forecast to remain weak.

- The fiscal outlook for bringing down the structural deficit and stabilising debt levels remains very challenging. Weakened credibility of the UK reining in its levels of debt poses a risk to the AAA status, but recent history (US, France) suggests this may not automatically result in a sell-off in gilts.

- In the absence of large, unexpected decline in growth, QE is likely to remain on hold at £375bn for now. The availability of cheaper bank borrowing and subsequently for corporates through the Funding for Lending Scheme (FLS) is a supporting factor.

- The US Federal Reserve's shift in its rate guidance from a date-based indication to economic thresholds (6.5% unemployment, inflation 1 – 2 years out projected to remain below 2.5%, longer term inflation expectations remain well anchored) is likely to increase market uncertainty around the highly volatile US employment data releases.

- The Eurozone is making slow headway which has curtailed some of the immediate risks, although peripheral countries continue to struggle. Fully-fledged banking and fiscal union is still some years away.

- In the US, the issues of spending cuts, reducing the budget deficit and raising the country's debt ceiling remain unresolved. A failure to address these by March 2013 could lead to another showdown and risks a downgrade to the US sovereign credit rating by one or more agencies.
- A reversal in market risk sentiment from current "risk on" to "risk off" could be triggered by economic and/or political events – impending Italian and German elections, US debt ceiling impasse, difficulty surrounding Cyprus' bailout, and contagion returning the haunt the European peripheral nations – and could inject renewed volatility into gilts and sovereign bonds.

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 Council's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Council's investments is secondary, followed by the yield earned on investments which is a tertiary consideration.

7.2 The Council and its advisors remain on a heightened state of alert for signs of credit or market distress that might adversely affect the Council.

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 Council 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 Council 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	✓	✓
Commercial Paper	✓	✗
Investments with Registered Providers	✓	✓
Investments with other organisations which do not meet the specified investment criteria (subject to an external credit assessment)	✗	✓
Business Loans to Local Companies (as agreed by the Local Loans Fund scheme)*	✗	✓

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

7.5 Registered Providers have been included within specified and non-specified investments for 2013/14. Investments with Registered Providers will be analysed on an individual basis and discussed with Arlingclose prior to investing.

7.6 Investments with other organisations have been included as a non-specified investment category for 2013/14. This would include investment opportunities with small and medium sized enterprises (SMEs) and other businesses across the UK. Because of the higher perceived credit risk of SMEs, such investments may provide considerably higher rates of return. An external credit assessment will be undertaken and advice from the Council's TM adviser will be sought (where available) before any investment decision is made.

7.7 The minimum credit rating for non-UK sovereigns is AA+ (or equivalent). For specified investments the minimum long term rating for counterparties is A- (or equivalent). As detailed in non-specified investments in Appendix C, the Head of Finance will have discretion to make investments with counterparties that do not meet the specified criteria on advice from Arlingclose.

The other credit characteristics, in addition to credit ratings, that the Council monitors are listed in the Prudential Indicator on Credit Risk (PI 11, page 16).

Any institution will be suspended or removed should any of the factors identified above give rise to concern. Specifically credit ratings are monitored by the Council at least monthly, although any rating changes to institutions on the Council's counterparty list are communicated by its Treasury Advisors as they occur. When Arlingclose advises the Council on ratings changes and appropriate action to be taken this is implemented. The counterparties currently meeting the criteria are shown in **Appendix C**.

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 period of 10 years. The total value of the fund for such investments is £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.

7.8 **Council's Banker –** The Council banks with Barclays Bank plc. At the current time, it does meet the Council's minimum credit criteria. Even if the credit rating falls below the Council'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 some time, 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 a portfolio largely invested in cash, investments will be placed with approved counterparties over a range of maturity periods. 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 Council will also seek to mitigate operational risk by utilising at least two MMFs. The Council 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. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund.

9. Policy on Use of Financial Derivatives

9.1 The Localism Act 2011 includes a general power competence that removes the uncertain legal position over English local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). Although this change does not apply to Wales, the latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

9.2 In the absence of any legislative power, the Council's policy is not to enter into standalone financial derivatives transactions such as swaps, forwards, futures and options. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall risk management strategy.

10. 2013/14 MRP Statement – Not Applicable to the Pension Fund

11. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

11.1 The Head of Finance will report to the Audit Committee on treasury management activity/performance and Performance Indicators every six months 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.

The Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

12. Other Items

12.1 Training

In accordance with CIPFA's Code of Practice, the Head of Finance shall ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs, and that they understand their roles and responsibilities.

12.2 Treasury Management Advisors

The Council uses Arlingclose as Treasury Management Advisors and receives the following services:

- Credit advice
- Investment advice
- Technical advice
- Economic & interest rate forecasts
- Workshops and training events

The Council maintains the quality of the service with its advisors by holding quarterly meetings and tendering periodically.

APPENDIX B

Prudential Indicators 2013/14 – 2015/16 – Not Applicable to the Pension Fund

APPENDIX C

COUNTERPARTIES CURRENTLY MEETING INVESTMENT CRITERIA

Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
UK	DMADF, DMO	No Limit	No Limit
UK	UK Local Authorities	£30m (£30m)	2 years
UK	Santander UK Plc (Banco Santander Group)	£12m (£18m)	2 years
UK	Bank of Scotland (Lloyds Banking Group)	£12m (£18m)	2 years
UK	Lloyds TSB (Lloyds Banking Group)	£12m (£18m)	2 years
UK	Barclays Bank Plc	£12m (£18m)	2 years
UK	Clydesdale Bank (National Australia Bank Group)	£12m (£18m)	2 years
UK	HSBC Bank Plc	£12m (£18m)	2 years
UK	Nationwide Building Society	£12m (£18m)	2 years
UK	NatWest (RBS Group)	£12m (£18m)	2 years
UK	Royal Bank of Scotland (RBS Group)	£12m (£18m)	2 years
UK	Standard Chartered Bank	£12m (£18m)	2 years
Australia	Australia and NZ Banking Group	£12m (£18m)	2 years
Australia	Commonwealth Bank of Australia	£12m (£18m)	2 years
Australia	National Australia Bank Ltd (National Australia Bank Group)	£12m (£18m)	2 years
Australia	Westpac Banking Corp	£12m (£18m)	2 years
Canada	Bank of Montreal	£12m (£18m)	2 years
Canada	Bank of Nova Scotia	£12m (£18m)	2 years
Canada	Canadian Imperial Bank of Commerce	£12m (£18m)	2 years
Canada	Royal Bank of Canada	£12m (£18m)	2 years
Canada	Toronto-Dominion Bank	£12m (£18m)	2 years
Finland	Nordea Bank Finland	£12m (£18m)	2 years
Finland	Pohjola	£12m (£18m)	2 years
France	BNP Paribas	£12m (£18m)	2 years
France	Credit Agricole CIB (Credit Agricole Group)	£12m (£18m)	2 years
France	Credit Agricole SA (Credit Agricole Group)	£12m (£18m)	2 years
France	Société Générale	£12m (£18m)	2 years
Germany	Deutsche Bank AG	£12m (£18m)	2 years
Netherlands	ING Bank NV	£12m (£18m)	2 years
Netherlands	Rabobank	£12m (£18m)	2 years
Netherlands	Bank Nederlandse Gemeenten	£12m (£18m)	2 years
Singapore	DBS Bank Ltd	£12m (£18m)	2 years
Singapore	Oversea-Chinese Banking Corporation (OCBC)	£12m (£18m)	2 years
Singapore	United Overseas Bank (UOB)	£12m (£18m)	2 years
Sweden	Svenska Handelsbanken	£12m (£18m)	2 years
Switzerland	Credit Suisse	£12m (£18m)	2 years
US	JP Morgan	£12m (£18m)	2 years

1. There is a limit of £18m on banks within the same banking group.
2. The time limits in the above list relate to term deposits. Negotiable/tradable instruments such as CD’s are subject to a 5 year limit. Current recommended duration limits are considerably lower than this, but the limits outlined above provide flexibility to react to the possiblity of continued stabilisation or improvement in credit and economic conditions in 2013/14.
3. 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.

Non-Specified Investments

Instrument	**Maximum maturity**	**Max £m of portfolio**	**Capital expenditure?**	***Examples***
Term deposits with banks and building societies which meet the specified investment criteria	2 years	£12m per counterparty	No	
Term deposits with local authorities	2 years	£12m per counterparty	No	
CD's and negotiable instruments with banks and building societies which meet the specified investment criteria*	5 years	£12m per counterparty	No	
Investments with banks, building societies and other organisations which do not meet the specified investment criteria* (subject to and external credit assessment) (with authority of s151 officer)	3 months	£5m per counterparty	No	*Bank falling below criteria specified e.g. Co-op* *Small and medium enterprises (SME's)*
	1 year	£1m per counterparty	No	
	5 years	£100k per counterparty	Yes / No	
		Subject to a maximum of £20m overall		
Deposits with registered providers	5 years	£5m	No	*Housing Associations, Registered Social Landlords*
Gilts	6 years	No limit	No	*DMO*
Bonds issued by multilateral development banks	6 years	£12m	No	*EIB Bonds, Council of Europe Bonds etc.*
Sterling denominated bonds by non-UK sovereign governments	6 years	£12m	No	
Money Market Funds and Collective Investment Schemes	Daily liquidity	£8m per name £37.5m in total.	Yes	*Ignis Sterling Liquidity Fund, Federated Prime Rate Sterling Liquidity Fund, RBS Global Treasury Funds etc.* *Investec Target Return Fund; Elite Charteris Premium Income Fund; LAMIT; M&G Global Dividend Fund*
Corporate and debt instruments issued by corporate bodies purchased from 01/04/12 onwards	2 years	£5m	No	
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in WSI 2004 No 1010 (W.107) or WSI 2007 No 1051 (W.108)	These funds do not have a defined maturity date	£5m	Yes / No	*Way Charteris Gold Portfolio Fund; Lime Fund*
Deposits with other organisations in relation to mortgage deposit schemes (with authority of s151 officer in consulation with the Council's treasury advisor).	7 years	£1m	No	*LAMS*
Business loans to local companies **	10 years	£3m	Yes / No	

* 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 the final paragraph of part 7.7 of Appendix A. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.

The Council will have a maximum of 75% of its investment portfolio in non-specified investments.