Complete Agenda

Democratic Service
Swyddfa'r Cyngor
CAERNARFON
Gwynedd
LL55 1SH

Meeting

PENSIONS COMMITTEE

Date and Time

2.00 pm, THURSDAY, 14TH MARCH, 2019

Location

Ystafell Gwyrfai, Council Offices, Caernarfon, Gwynedd. LL55 1SH

Contact Point

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(DISTRIBUTED 06/03/19)

PENSIONS COMMITTEE

MEMBERSHIP (7)

Plaid Cymru (4)

Councillors

Aled Wyn Jones
Peter Read
Simon Glyn
Peredur Jenkins

Independent (2)

Councillors

John Brynmor Hughes
John Pughe Roberts

Individual Member (1)

Councillor
Stephen W. Churchman

Co-opted Members

Councillor David Cowans Conwy Borough Council
Councillor Robin Wyn Williams Anglesey

Ex-officio Members

Chair and Vice-Chair of the Council

A G E N D A

1. APOLOGIES

To receive any apologies for absence

2. DECLARATION OF PERSONAL INTEREST

To receive any declaration of personal interest

3. URGENT ITEMS

To note any items which are urgent business in the opinion of the Chairman so that they may be considered

4. MINUTES 4 - 7

The Chairman shall propose that the minutes of the meeting of this committee held on 21.01.2019 to be signed as a true record

5. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2019/20 8 - 23

To consider the report of the Head of Finance

6. WALES PENSIONS PARTNERSHIP: EQUITY INVESTMENTS 24

To consider the Investment Managers report

PENSIONS COMMITTEE 21/01/19

Present:

Councillors: Stephen W. Churchman, John Pughe Roberts, Aled Wyn Jones, Simon Glyn, Peredur Jenkins, Peter Read and Councillor Robin Wyn Williams

OFFICERS: Dafydd L. Edwards (Head of Finance), Lowri Haf Evans (Members and Scrutiny Support Officer) and Caroline Lesley Roberts (Investment Manager)

1. APOLOGIES

Apologies were received from Councillors David Cowans (Conwy Borough Council) and John Brynmor Hughes.

2. DECLARATION OF PERSONAL INTEREST

None to note.

3. URGENT ITEMS

None to note.

4. MINUTES

The Chair signed the minutes of the meeting of this committee, held on 8th November 2018, as a true record.

5. FIXED INCOME SUB-FUNDS

Submitted - a report requesting the Committee to consider sub-funds for 'fixed income' assets as options for the Gwynedd Pension Fund to invest via the Wales Pensions Partnership. As a contingency measure it was explained that the Gwynedd Pension Fund had access to passive 'fixed income' assets via the passive investments agreement.

It was noted in a meeting of the Investments Panel on 15/11/2018, that information and guidance had been presented to members of the Pensions Committee regarding the Wales Pensions Partnership sub-funds for 'fixed income' assets and the possible options were discussed. It was suggested that it would be an opportunity to transfer assets to the Partnership's active portfolios at the beginning of Summer 2019.

With a possible option of distributing the assets between four types of fixed income sub-funds, the conclusion of the Investment Panel was that the Absolute Returns Fund and the Multi Asset Credit Fund was of interest to Gwynedd at the time of launching the Wales Pensions Partnership sub-funds.

A summary of the possible options was submitted as an exempt appendix to the report and therefore, in order for the Members to discuss them in detail, it was resolved, **TO EXCLUDE THE PRESS AND PUBLIC as there was an acknowledged public interest in openness in relation to the use of public resources and related financial issues.** However, it is also acknowledged that there are occasions, in order to protect the financial interests of public authorities, when matters related to commercial information need to be discussed without being publicised. The appendix related to investment arrangements that are commercially sensitive and confidential for the company in question. Publishing commercially sensitive information of this type could undermine the provider's confidence in submitting prices to the Council and, therefore, the Council's ability to invest successfully. This would be contrary to the wider public interest of securing value for money and the best overall outcome.

Observations arising from the discussion;

- Committee Members appreciated the views of the officers and the experts from Hymans and Russell in this field, and wanted to follow the suggestion presented.
- Committee members valued the opportunity to work with new managers, together with the possibility of retaining assets with one of the current managers of the Gwynedd Fund.
- Although there was no intention for the Gwynedd Fund to transfer assets to the Worldwide Credit Fund, the Chair was asked to highlight the principles of relative responsible investment at the next meeting of the Wales Pensions Partnership Joint Committee.

RESOLVED -

a) **In accordance with the proposal, to generally reinvest the current fixed income assets of the Gwynedd Fund in the sub-fund of the Absolute Returns Fund of the Wales Pensions Partnership and to reinvest the equity assets set aside for now in order to reduce the risk in the sub-fund of the Multi Asset Credit Sub-fund of the Wales Pensions Partnership.**
b) **Since all the investment managers of the Wales Pensions Partnership had not yet been finally confirmed, to delegate the power to the Head of Finance Department, in consultation with the Chair of the Committee, to determine the final allocations between the sub-funds, following the opinion and further guidance from experts, as required.**

The press and public were invited back into the meeting.

6. SECURITY LENDING

Submitted – a report requesting the Committee to agree for the Wales Pensions Partnership to agree to a loan guarantee as an opportunity to increase income from equity in the funds.

It was highlighted that all Welsh funds that are part of the Wales Pensions Partnership would have to agree to the proposal before implementation.

Reference was made to a document by Hymans Robertson attached to the report giving an overview and explanation of the process, why investors would loan stock and the risks linked to this.

The members noted that the proposal was an interesting opportunity with a low risk, was a means of receiving some gains to the fund whilst mitigating the risk through a guarantee.

In response to a question regarding limiting the relevant investment sum of the Fund, and if a maximum had been set, it was noted that it would be possible to ask the question at the next meeting of the Wales Pensions Partnership Joint Committee.

RESOLVED that the Gwynedd Pensions Fund agrees for the Wales Pensions Partnership to loan stocks from the sub-funds.

7. SCHEME ADVISORY BOARD COST MANAGEMENT

Submitted for information a report summarising the proposed recommendations of the Scheme's Advisory Board that would return the total cost of the scheme to its target cost of 19.5% (it is estimated that 19.0% is the current actual cost of the scheme). It was noted that changes had to be made to benefits if they wanted to reach 19.5% and a package of recommendations were submitted to the Secretary of State in November 2018. It was added that legal counsel and the views of the Government's Actuary had been considered by the national Board.

The following main points were highlighted and attention was drawn to the financial impacts of the package. The final decision on the package of improvements would be made by the Ministry of Housing, Communities and Local Government with a brief consultation likely to take place at the beginning of Spring, in order for the improvements to take effect by April 2019.

In response to a question regarding the target set at 19.5%, it was noted that the target had been set by the Westminster Government via a national agreement with relevant Trade Unions.

Observations arising from the discussion;

- Despite the cost to the fund and to employers, the modifications would benefit contributors.
- Concern about the impact on small employers.
- Concern that small employers cannot afford the amendments and would therefore be placed under pressure to find a different scheme.
- Concern that the fund would lose members.
- Accept that this was national guidance, however, everything must be weighed up carefully.

RESOLVED to request that the Head of Finance Department and the Chair present observations on the members' concerns to the Ministry of Housing, Communities and Local Government in Westminster and the National Advisory Board for the Local Government Pension Scheme, when there is a consultation

8. PENSION ADMINISTRATION UNIT STAFFING

Meirion Jones (Senior Communications Officer (Pensions) left the room during the following discussion.

Submitted – a report requesting the Committee to approve additional resources to enable the Finance Unit to establish a resilient staffing structure for the Pensions Unit in

response to the increasing demands to administer the Local Government Pension Scheme. It was added that the proposed structure corresponded to the Council's management structure and that the posts had been evaluated. It was noted that the staff percentage in the Unit were older and that a continuation scheme should be established.

Observations arising from the discussion;

- That the salary scales in the Unit were lower than other funds.
- The team was smaller than in other funds.
- The existing structure was historical.
- In terms of risk management, continuation had to be planned for.

RESOLVED:

- **To approve the increase in expenditure financed to enable the Finance Department to establish a more resilient staffing structure for the Pensions Unit at an additional cost of £121,120.**
- **To request that the Head of Finance implements an appropriate amended staffing structure for the Pensions Unit as soon as practically possible, in order to manage business risks and work pressure.**

The meeting commenced at 2.00 pm and concluded at 3.00 pm

CHAIRMAN

MEETING:	**PENSIONS COMMITTEE**
DATE:	**14 MARCH 2019**
TITLE:	**TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2019/20**
PURPOSE:	**To ask the pensions committee to adopt the strategies**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
AUTHOR:	**DAFYDD L EDWARDS, HEAD OF FINANCE**

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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 2019/20, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's TMSS for 2019/20 was approved by the Full Council on 7 March 2019.

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. The report approved by the Full Council on 7th March 2019 included agreement to continue the pooling arrangement with the Pension Fund following any request from Pensions Committee.

5. COUNTERPARTIES

The Council Treasury Management Policy Statement and practice papers include a risk matrix which will be used to define the instruments and counterparties to be used for investment purposes rather than a defined list each year.

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 2019/20, as amended for the Gwynedd Pension Fund (Appendix A).

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 2019 onwards.

APPENDIX A

Treasury Management Strategy Statement 2019/20

1. Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

1.3 In accordance with the WG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

2. External Context

2.1 Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019/20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2% - 2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

2.2 Credit outlook

The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring fencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

2.3 Interest rate forecast

Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in mid December). As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix 1.**

2.4 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.88%, and that the Council will not need any new long-term loans will be required in 2019/20

3. Local Context (Net Borrowing Position) – Not applicable to the Pension Fund

4. Liability benchmark – Not applicable to the Pension Fund

5. Borrowing Strategy – Not applicable to the Pension Fund

6. Investment Strategy

6.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £79.4 and £17.6 million, and similar levels are expected to be maintained in the forthcoming year.

This includes the cash balances of Gwynedd Pension Fund which are pooled with the Council's funds for investment purposes. The Pension Fund requests this annually as the returns received are improved and the risks reduced by combining the cash with the Council's funds. The Pensions Committee will approve the relevant elements of this Strategy Statement and request the continuation of the pooling arrangements for 2019/20 at its meeting on 14 March 2019.

6.2 Objectives

Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

6.3 Negative interest rates

If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

6.4 Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £10m that is available for longer-term investment. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will represent a continuation of the strategy adopted in 2015/16.

6.5 Business models

Under the IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

6.6 Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	5% / £4m 5 years	10% / £8m 20 years	10% / £8m 50 years	5% / £4m 20 years	5% / £4m 20 years
AA+	5% / £4m 5 years	10% / £8m 10 years	10% / £8m 25 years	5% / £4m 10 years	5% / £4m 10 years
AA	5% / £4m 4 years	10% / £8m 5 years	10% / £8m 15 years	5% / £4m 5 years	5% / £4m 10 years
AA-	5% / £4m 3 years	10% / £8m 4 years	10% / £8m 10 years	5% / £4m 4 years	5% / £4m 10 years
A+	5% / £4m 2 years	10% / £8m 3 years	10% / £8m 5 years	5% / £4m 3 years	5% / £4m 5 years
A	5% / £4m 13 months	10% / £8m 2 years	10% / £8m 5 years	5% / £4m 2 years	5% / £4m 5 years
A-	5% / £4m 6 months	10% / £8m 13 months	10% / £8m 5 years	5% / £4m 13 months	5% / £4m 5 years
None	£1m 6 months	n/a	10% / £8m 25 years	£0.5m 5 years	5% / £4m 5 years
Pooled funds and real estate investment trusts		10% / £8m per fund or trust			

This table must be read in conjunction with the notes below.

6.7 Credit rating

Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

6.8 Banks unsecured

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

6.9 Banks secured

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

6.10 Government

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

6.11 Corporates

Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1 million per company as part of a diversified pool in order to spread the risk widely.

6.12 Registered providers

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

6.13 Pooled funds

Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

6.14 Operational bank accounts

The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £900,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

6.15 Risk assessment and credit ratings

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

6.16 Other information on the security of investments

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

6.17 Specified investments

The Welsh Government Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

6.18 Non-specified investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies nor any defined as capital expenditure. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£30m
Total investments without credit ratings or rated below A- (except the UK Government and UK local authorities)	£8m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£4m
Total non-specified investments	£24m

6.19 Investment limits

The Council's revenue reserves available to cover investment losses are forecast to be £41 million on 31st March 2019. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £8 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£8m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£8m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£40m per broker
Foreign countries	£8m per country
Registered providers and registered social landlords	£20m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£8m in total
Money market funds	£40m in total
Real estate investment trusts	£20m in total

6.20 Liquidity management

The Council uses prudent cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on the basis that short-term borrowing is used to cover its financial commitments if required. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

7. Treasury Management Indicators – Not applicable to the Pension Fund

8. Related Matters

8.1 The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.

8.2 Financial Derivatives

In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

8.3 Markets in Financial Instruments Directive

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Head of Finance believes this to be the most appropriate status.

9. Welsh Government Guidance

9.1 Investment training

The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

9.2 Investment advisers

The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The

quality of this service is monitored by the Head of Finance and the Investment Manager on a regular basis.

9.3 Investment of money borrowed in advance of need

The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £190 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

10. Financial Implications

10.1 The budget for investment income in 2019/20 is £0.2 million based on an average investment portfolio of £22 million at an interest rate of 0.88%. The budget for debt interest paid in 2019/20 is £6.0 million, based on an average debt portfolio of £106.6 million at an average interest rate of 5.62%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

The Pension Fund receives interest on the percentage of cash it has invested each day.

11. Other Options Considered

11.1 The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix 1 – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.17**
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.65**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.80**	**1.00**	**1.10**	**1.20**	**1.30**	**1.30**	**1.25**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.17**
Downside risk	0.20	0.50	0.60	0.70	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.68**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.05**	**1.25**	**1.35**	**1.40**	**1.50**	**1.45**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.37**
Downside risk	0.35	0.50	0.60	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.69**
5-yr gilt yield														
Upside risk	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.15**	**1.20**	**1.25**	**1.35**	**1.40**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**
Downside risk	0.30	0.35	0.45	0.50	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.54**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.60**	**1.65**	**1.65**	**1.70**	**1.75**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	0.30	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.55**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.90**	**1.95**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.98**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.80**	**1.85**	**1.85**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.88**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

MEETING:	**PENSIONS COMMITTEE**
DATE:	**14 MARCH 2019**
TITLE:	**WALES PENSIONS PARTNERSHIP: EQUITY INVESTMENTS**
PURPOSE:	**To inform the members of the Committee a transfer of the Gwynedd Fund's equity portfolio into the new funds in the Wales Pool**
AUTHOR:	**CAROLINE ROBERTS, INVESTMENT MANAGER**

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1. Introduction

In January 2019 the global equity funds of the Wales Pensions Partnership were activated and seven of the pension funds in Wales transferred their relevant equity holdings into the investment pool.

2. Equity Investments

The Gwynedd Fund transferred equal amounts into two funds provided by the Wales Partnership as follows:

- LF Wales PP Global Growth Fund (Class A Income)
  (Baillie Gifford, Veritas and Pzena)

- LF Wales PP global Opportunities Equity Fund (Class A Income)
  (Morgan Stanley, Numeric, Sanders, Jacobs Levy, SW Mitchell, NWG and Oaktree)

The next transfers for equities will be for specific regions of the world (the UK and Europe) and Gwynedd Pension Fund does not have any of hold any of these investments.

The next transfer for Gwynedd will be the fixed income category in 2019/20. This will include a transfer of our current investments with Insight into pools provided by the Wales Partnership.

3. Conclusion

The transfer in January went smoothly and the investments in both funds have kept their value through the transition.