

## **TREASURY MANAGEMENT STRATEGY**

### **Purpose of the Report**

1. The purpose of this report is to seek Members' approval for the first Treasury Management Strategy prepared for the Wiltshire Pension Fund.

### **Background**

2. As the Committee is aware, the Fund has its own bank account, entirely separate from Wiltshire Council's bank accounts. This was implemented in April 2009, at the same time as the Fund gained its own accounting entity with the introduction of the SAP system. Separate bank accounts will become a requirement of the Local Government Pension Scheme Regulations from 1 April 2011.
3. Following concerns about so-called "co-mingling" of local authority and pension fund cash balances, and the associated risk of cross-subsidy, the same Regulations require that the two sets of cash investments are also managed separately.

### **Considerations for the Committee**

4. Wiltshire has never engaged in "co-mingling" in its true sense - the two pots of cash have always been separately identified and accounted for on a monthly basis and an appropriate rate of interest paid to the Pension Fund, commensurate with the risk being taken. This rate of interest has been the Local Authority 7 Day Rate, which is lower than a true "market rate", but this reflects the fact that the investment is on a "no risk" basis. For example, the Fund did not share in Wiltshire Council's losses in the Icelandic banks in 2008.
5. However, in accordance with the Regulations and best practice, the Fund's treasury management arrangements need to be completely separated from those of Wiltshire Council. This will involve the setting up of suitable money market funds and/or call accounts to invest the cash held in Trowbridge ("Trowbridge Cash"). It has also involved the determination of a separate Treasury Management Strategy for the Fund.
6. The Committee must be aware that by adopting this best practice of complete separation, the interest earned on Trowbridge Cash may improve, but as the Fund will be "standing on its own", it will also involve increased risk. This confirms the need for a prudent Treasury Management Strategy that balances risk and return.
7. 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. The surplus cash accumulated (Trowbridge Cash) is sent to one of the Fund's investment managers on a monthly basis, although a float of approximately one month's cash requirement (£1.5 - £2 million) is held for cashflow purposes. This is necessary to avoid the Fund having to borrow short-term within the month.

### The key points of the Treasury Management Strategy

8. The key points of the Strategy (see attached) are:
- a) The Fund will aim to achieve the optimum return on investments commensurate with high levels of security and liquidity.
  - b) The monies will be invested separately from the Council's and the Fund will receive the actual interest earned.
  - c) The Pension Fund will use the same criteria for maximum limits and terms with individual counterparties as approved by Wiltshire Council on an annual basis in its own Treasury Management Strategy, subject to:
    - i. A maximum of £5 million with any single counterparty.
    - ii. No investment will be made in the money market funds / cash vehicles used by the Custodian to invest any cash it holds on behalf of the Fund's investment managers.
  - d) Given the nature of Trowbridge Cash (ie. short-term working capital nature), the investments will only be made either in:
    - i. Call Accounts provided by an approved deposit-taker that complies with the Counterparty Policy set out in the Strategy; or
    - ii. Money Market Funds managed by an approved investment manager.
  - e) The providers of the Call Accounts, and the Money Market Fund vehicles, must have a "high credit rating" as prescribed in the minimum requirements for "high credit rating" set out in Wiltshire Council's annual Treasury Management Strategy.
  - f) The Fund will not borrow except by way of temporary loan or overdraft from a bank or otherwise, and then only in exceptional circumstances where it is for the purpose of:
    - i. Paying benefits due under the Scheme; or
    - ii. Meeting investment commitments arising from the implementation of a decision by the Committee to change the balance between the different types of investment.
  - g) The management of Wiltshire Pension Fund's cash will be carried out by Wiltshire Council's Treasury Management team under a Service Level Agreement.

### Environmental Impact of the Proposal

9. There is no known environmental impact of this proposal.

### Financial Considerations & Risk Assessment

10. This has been adequately dealt with in the whole paper.

## **Reasons for Proposals**

11. It is best practice, as well as being desirable operationally, to have a separate Treasury Management Strategy for the Wiltshire Pension Fund, so that there is no question of cross-subsidy or co-mingling.

## **Proposals**

12. The Committee is asked to approve the attached Treasury Management Strategy.

MARTIN DONOVAN  
Chief Finance Officer

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Unpublished documents relied upon in the production of this report: NONE

**WILTSHIRE PENSION FUND**  
**TREASURY MANAGEMENT STRATEGY**

**Operational Context**

1. 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.
2. The surplus cash accumulated (“Trowbridge Cash”) is allocated to one (or more) of the Fund’s investment managers on a monthly basis. It is sent to the Fund’s custodian BNY Mellon, who invest the cash held on behalf of each investment manager in Money Market Funds, under the terms of the Custody Agreement. These investments are not within the scope of this Strategy.
3. However, approximately one month’s net inflow (£1.5 - £2 million) is held back as a float for cashflow purposes. This is necessary to avoid the Fund having to borrow from Wiltshire Council or elsewhere for short-term cashflow purposes within the month.

**Regulatory Context**

4. The Fund will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1 January 2010, and from 1 April 2010 will not pool pension fund cash with Wiltshire Council’s own cash balances for investment purposes. Any investments made by the pension fund directly with Wiltshire Council after 1 April 2010 will comply with the requirements of SI 2009 No 393 (ie. will be treated in the same way as any other external investment).
5. The Fund will also have regard to:
  - a) The Department for Communities and Local Government’s (DCLG’s) Guidance on Local Government Investments (“the Guidance”) issued in March 2004 and any revisions to that Guidance;
  - b) The Audit Commission’s report on Icelandic investments;
  - c) The 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”);
  - d) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 more widely.

**Investment Policy**

6. The general investment policy of the Fund is the prudent investment of any surplus cash balances, the priorities of which are:
  - a) The security of capital; and
  - b) The liquidity of investments.

7. The Fund will also aim to achieve the optimum return on investments commensurate with high levels of security and liquidity.
8. All cash investments will be in sterling.
9. The monies will be invested separately from the Council's and the Fund will receive the actual interest earned. Monies will be paid out of and received back into the Pension Fund bank account.
10. Trowbridge Cash will target a range of £1.5 - £7 million, with the highest balances held between the 19<sup>th</sup> of the month (ie. when all contributions have to be paid over by employers) and 25<sup>th</sup> of the month (pensions payroll). The float held in-month for cashflow purposes will target £1.5 - £2 million. For the avoidance of doubt, these are indicative amounts, not absolute limits.
11. The Pension Fund will use the same criteria for maximum limits and terms with individual counterparties as approved by Wiltshire Council on an annual basis in its own Treasury Management Strategy, subject to:
  - a) A maximum of £5 million with any single counterparty.
  - b) No investment will be made in the same money market funds / cash vehicles used by the Custodian to invest any cash it holds on behalf of the Fund's investment managers.
  - c) For the avoidance of doubt, the Pension Fund's limits are in addition to Wiltshire Council's own limit in any single counterparty.
12. Given the nature of Trowbridge Cash (ie. short-term working capital nature), the investments will only be made either in:
  - a) Call Accounts provided by an approved deposit-taker that complies with the Counterparty Policy set out below; or
  - b) Money Market Funds managed by an approved investment manager.
13. For the avoidance of doubt, direct investments with counterparties are not permitted (eg. direct deals with banks or other local authorities for fixed time periods).
14. The providers of the Call Accounts, and the Money Market Fund vehicles, must have a "high credit rating" as prescribed in the minimum requirements for "high credit rating" set out in Wiltshire Council's annual Treasury Management Strategy.
15. An extract of the appropriate parts from Wiltshire Council's latest Treasury Management Strategy (2010-11) is given in the Annex for information.

### **Borrowing Policy**

16. The Fund will not borrow except by way of temporary loan or overdraft from a bank or otherwise, and then only in exceptional circumstances where it is for the purpose of (overleaf):

- a) Paying benefits due under the Scheme; or
- b) Meeting investment commitments arising from the implementation of a decision by the Committee to change the balance between the different types of investment.

**Management Arrangements**

- 17. The management of Wiltshire Pension Fund's cash will be carried out by Wiltshire Council's Treasury Management team under a Service Level Agreement. All treasury management activity related to the Pension Fund will be reported to the Head of Pensions on a monthly basis.
- 18. The Treasury Management Team will inform the Head of Pensions of any change in the criteria for the counterparty list.

*Approved by Wiltshire Pension Fund Committee on 25 February 2010*

**EXTRACT FROM WILTSHIRE COUNCIL'S TREASURY MANAGEMENT STRATEGY FOR 2010-11**

11. The Council uses the creditworthiness service provided by Sector. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach, with credit ratings from all three rating agencies (Fitch, Moodys and Standard and Poors), forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:
  - a) credit watches and credit outlooks from credit rating agencies;
  - b) CDS spreads to give early warning of likely changes in credit ratings; and
  - c) sovereign ratings to select counterparties from only the most creditworthy countries
12. This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.
13. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council, where it is considered appropriate and in line with its whole investment strategy, will therefore use counterparties within the following durational bands:
  - a) Purple – 2 years;
  - b) Blue – 1 year (only applies to nationalised or semi nationalised UK Banks and their subsidiaries);
  - c) Orange – 1 year;
  - d) Red – 6 months;
  - e) Green – 3 months; and
  - f) No Colour – not to be used.
14. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys are currently very much more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Sector creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue prevalence to just one agency's ratings.
15. All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service. Following receipt of this information from Sector:

- a) any financial institutions meeting the criteria are updated on the list of authorised lenders and investments may then be placed with “qualifying” institutions immediately;
- b) if a downgrade results in the counterparty/investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately;
- c) if funds are held by an institution that subsequently falls outside the current credit rating criteria and CDS overlay, all funds will be withdrawn from that institution at the earliest opportunity. This will normally be on the maturity of that deposit. If the fall is significant and there are more than three months before the maturity date and in any other extreme circumstances, negotiations for premature repayment will be pursued;
- d) whenever there is a change in the list of authorised lenders, a revised list will be provided to those authorised to deal in investments on behalf of the Council, including its authorised brokers.
- e) in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council’s lending list.

16. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

#### **The Minimum requirements for “high credit rating”**

17. In accordance with the DCLG Guidance on Local Government Investments in respect of selection of counterparties with whom investments are placed, Wiltshire Council will comply with the minimum requirements below.

18. Credit ratings will be those issued by Fitch Ratings Ltd in respect of individual financial institutions (as shown below, where F1+ is the highest short term rating and AAA the highest long term rating). An exception is made in respect of money market funds, as shown below, where a different overall AAA rating is the highest.

19. The minimum requirements for high credit rating, by type of institution, are as follows:

- **Banks incorporated inside the United Kingdom with a short term credit rating of at least F1 or Government backed and their subsidiaries;**
- **Banks incorporated outside the United Kingdom with a short term credit rating of at least F1+ and a long term rating of A+;**
- **United Kingdom building societies with a short term credit rating of at least F1 or Government backed;**
- **All local authorities and public bodies (as defined in S23 of the Local Authorities Act 2003) (ratings are not issued for these bodies);**
- **Multilateral development banks (as defined in Statutory Instrument 2004 No. 534) with a short term credit rating of at least F1 and long term credit rating of AAA;**



- **All banks & building societies must have an individual rating of at least C;**
- **In addition, all banks and building societies to which the Authority may lend funds must have a support rating of no more than 3 (1 being the highest support rating);**
- **Money market funds, which have been awarded the highest possible rating (AAA) from at least one of the following credit rating agencies, Standard and Poor's, Moody's Investor Services Ltd or Fitch Ratings Ltd.; and**
- **Deposits must only be placed in money market funds subject to individual signed management agreements.**

20. In addition to the above criteria, the following limits will be applied to the total cumulative investments placed with an individual institution (or group of institutions where there is common ownership):

**a) Up to £15 million:**

- **UK incorporated banks with a long term credit rating of at least AA;**
- **Overseas banks that have a long term credit rating of at least AA;**
- **Multilateral development banks;**
- **Local authorities and other public bodies; and**
- **Money market funds.**

**b) Up to £8 million:**

- **Other UK incorporated banks (that have a long term credit rating of less than AA but which also satisfy the credit rating conditions within this Strategy);**
- **Other overseas banks (that have a long term credit rating of less than AA but which also satisfy the credit rating conditions within this Strategy);**
- **UK Building societies with long term credit rating of at least A; and**
- **Government backed UK and overseas banks and UK building societies and their subsidiaries.**

21. The following investment duration matrix shows the maximum duration for which an investment can be placed, depending on the combination of the individual institution's long term, short term, individual and support ratings (e.g. up to five years where an institution is classified as F1+ (short term rating), AAA (long term rating), A (individual rating) and 1 (support rating) or up to one year where an institution is classified as F1, A+, A, 2)

**Investment Duration Matrix**

Ratings					
Short Term	Long Term	Individual	Support		
			1	2	3
F1+	AAA	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA+	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA-	A	1-2yrs	1-2yrs	1 yr
A/B		1-2yrs	1-2yrs	3 mths	
B		1-2yrs	1-2yrs	3 mths	
B/C		1-2yrs	1-2yrs	3 mths	
C		1 yr	1 yr	3 mths	
F1	A+	A	1 yr	1 yr	3 mths
		A/B	1 yr	1 yr	3 mths
		B	1 yr	1 yr	3 mths
		B/C	3 mths	3 mths	n/a
		C	3 mths	3 mths	n/a
	A	A	1 yr	1 yr	3 mths
		A/B	1 yr	1 yr	3 mths
		B	1 yr	1 yr	3 mths
		B/C	3 mths	3 mths	n/a
		C	3 mths	3 mths	n/a