SOUTH YORKSHIRE PENSIONS AUTHORITY

16 FEBRUARY 2012

Report of the Clerk and Treasurer

TREASURY POLICY AND STRATEGY STATEMENT 2012/2013

1) Purpose of the report

To seek Members' approval of the treasury management procedures and strategy followed by the Authority.

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2) **Recommendation**

It is recommended that the Authority:-

a) **adopts the Annual Investment Strategy and recommendations set out in Appendix I; and**

b) **in accordance with Section 3(1) of the Local Government Act 2003 approves an Affordable Borrowing Limit, on a rolling basis for the forthcoming year and two successive years as outlined in Appendix II, of £250,000 being the maximum amount the Authority can afford to borrow; and**

c) **keeps the above under review.**

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3) Background information

3.1 Local authority treasury management activities are governed by Section 12 of Part I, Chapter I of the Local Government Act 2003 ("the Act") which provides that a local authority may invest "for any purposes relevant to its functions under any enactment, or "for the purposes of the prudent management of its financial affairs". Pursuant to section 15 of the Act, in carrying out its functions, a local authority is required to have regard to relevant guidance and regulations issued by the Secretary of State. Under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ("the Regulations"), Regulation 24 requires local authorities to have regard to the Chartered Institute of Public Finance and Accounting (CIPFA) publication "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" ("the Code") issued in November 2009. The Code covers the whole range of treasury management issues, including the fundamental principles for making and managing investment and requires local authorities to prepare an annual treasury management strategy ("the Annual Strategy"). Under the Code treasury management is defined as:

"the management of the Authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of the optimum performance consistent with those risks".

3.2 Amongst the primary requirements of the Code are the need to establish and maintain a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities and sets out how they will be achieved; approval of the Annual Investment Strategy; regular reporting on activities during the year and establishment of the delegation by the Authority of its responsibilities to other bodies and its officers. For this Authority the delegated scrutinising body is the Corporate Planning and Governance Board.

3.3 The Authority manages its cash itself. The customised benchmark allocation for cash has not changed during the year (it remains at 0%) nor has the tactical range (0%-10%). Some cash is always held in order to service creditors etc and the pension payroll. Even though in absolute terms the amount of cash held at any one time might run to tens of millions of pounds it is normally going to form a relatively small percentage of total Fund assets. This is one reason why the CIPFA Code has not been universally adopted by Local Government Pension Scheme ("LGPS") administering authorities for local authority pension funds. The specialised nature of pension fund monies does not lend itself easily to the Code: this is especially so since the funds themselves have no borrowing powers.

3.4 The Authority has never utilised its borrowing powers other than for temporary overdraft purposes. The borrowing powers (i.e. in its own right and not on behalf of the Fund) have always been reviewed annually and resolved upon separately by the Authority. The current governing legislation is the Act and the requirements are more fully referred to in section 4 below. Please note that the Act does not apply to pension funds, being controlled by a separate regulatory regime which is administered by the Department for Communities and Local Government (CLG).

3.5 Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009: SI 2009/3093 ("the 2009 Regulations") the administering authority has a power to borrow on behalf of the LGPS fund it administers in certain circumstances.

3.6 The management of the Fund itself is conducted in accordance with the Authority's Statement of Investment Principles which has been drawn up in accordance with extant Regulations.

3.7 This report embodies the principles of the CIPFA Code and the Act. There are two appendices: Appendix I, referring to the Annual Investment Strategy and Appendix II referring to the Affordable Borrowing Limit.

4) <u>The Local Government Act 2003</u>

4.1 Although pension fund monies are specifically excluded from the investment regulations [The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003] made under the Local Government Act 2003 Members should note that the Authority is subject to the capital expenditure requirements (Part 8, section 32). CLG will issue guidance under the Act from time to time and local authorities must have regard to the guidance.

4.2 Present guidance stresses the need for strategies to be prudent and defines a prudent investment policy as one having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). The generation of investment income is distinct from these prudential objectives. In other words, it is reasonable to seek the highest yield consistent with the two priorities but only after they have been met.

4.3 Section 3 (1) of the Act requires the Authority to set and keep under review an 'Affordable Borrowing Limit' (ie how much money it can afford to borrow) and to do so by reference to the CIPFA Prudential Code. The Limit is to be set, on a rolling basis, for the forthcoming year and two successive financial years. The Clerk and Treasurer can confirm that the Limit has been kept under review.

4.4 Subsection (8) provides that a local authority's function under subsection (1) shall be discharged only by the authority; i.e. Members only can determine the affordable borrowing limit.

4.5 Part 1 of the Act introduced a prudential capital finance system called the prudential code for capital finance in local authorities. The key objectives of the "Prudential Code" are to ensure within a clear framework that:-

- capital investment plans of local authorities are affordable, prudent and sustainable
- treasury management decisions (notably borrowing for capital expenditure) are taken in a manner which supports affordability, prudence and sustainability

Affordability is implied in relation to the council tax. Prudence and sustainability is implied in relation to external borrowing.

4.6 To demonstrate that authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used and factors to be taken into account. The Code does not include suggested limits or ratios as these are for the local authority to set. The prudential indicators for the forthcoming year and following years must be set before the beginning of the year. They may be revised at any time, following due process, and must be reviewed and revised, if appropriate, for the current year when the prudential indicators are set for the following year.

4.7 Section 5 of the LGA 2003 contains the power for an authority to borrow temporarily against future income yet to be received by it provided the delayed receipt of such future income was not taken into account in the setting of the affordable borrowing limit. This power is thought to apply to the Authority by virtue of Regulation 32 of the Local Government (Capital Finance and Accounting) (England) Regulations 2003.

4.8 The Authority must have regard to both the guidance issued by CLG and the CIPFA Treasury Management Code when preparing its Annual Investment Strategy (AIS). CLG recommends that the AIS be approved at the equivalent level of full council and should be approved before the start of the financial year. Under the current cycle of Authority meetings this meeting is the appropriate one. The AIS is included within the attached Statement.

4.9 Other than the statutory obligation to set an Affordable Borrowing Limit the Authority is not materially affected by the Practice or Prudential Code though if it had a capital expenditure programme it would be different. The Authority's levy, issued in accordance with The Levying Bodies (General) Regulations 1992, finances the payment of statutory compensation and is not a function of capital financing decisions. The Authority does not borrow to fund either annual running costs or capital investment.

4.10 Whilst the Authority has no need to undertake external borrowing the Act still appears to impose a duty to set an Affordable Borrowing Limit. Last year's ABL was set at £250,000 and there is not thought to be any need to amend that limit.

4.11 In terms of delegation the Authority receives this report and approves policy and strategy. The Corporate Planning and Governance Board receives quarterly updates upon the implementation of the policy and strategy. Day to day management is entrusted to the Clerk and Treasurer.

4.12 The Clerk and Treasurer, as s151 Officer, has overall responsibility for the execution and administration of treasury management decisions and is responsible for:

recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;

submitting regular treasury management policy reports;

receiving and reviewing management information reports;

reviewing the performance of the treasury management function;

ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;

ensuring the adequacy of internal audit, and liaising with external audit;

the appointment of external service providers.

4.13 In summary, therefore, the Authority employs a treasury management strategy in which investments are managed broadly in accordance with the Code of Practice for Treasury Management in Public Services published by CIPFA.

5) <u>Retail banking services</u>

I reported in 2010 that the South Yorkshire Joint Secretariat, acting on behalf of all four South Yorkshire joint authorities, had embarked upon a review of the authorities' banking arrangements and this might lead to a formal tender exercise being undertaken. In fact, the exercise has been put on hold pending further clarification of the position regarding the future requirements of the Police and Crime Commissioner. The contract with Co-op Bank was extended to cover 2011-12 and it is expected to be further extended to cover 2012-13. At the moment the present “pooling” arrangements for the other three joint authorities are assumed to continue. If that should change it is probable that separate tenders would then need to be initiated.

6) Implications

6.1 Financial

There are no implications not otherwise mentioned within the report.

6.2 Legal

It is not thought that there are any legal implications.

6.3 Diversity

There are no diversity implications.

6.4 Risk

This Authority is the formal decision-making body for treasury management matters and has responsibility to ensure that adequate risk management processes are in place. This it discharges by establishing a treasury management policy and ensuring that it is regularly monitored by the Corporate Planning and Governance Board. There are potential reputational and financial risks that could arise from non-compliance with the Act and Regulations. It should also be noted that the ratings issued by credit rating agencies are only a means of assessing creditworthiness and are open to error and interpretation.

W. J. Wilkinson
Clerk and Treasurer

Officer responsible:
John Hattersley, Fund Director.

Contact telephone: 01226 772873

Background papers used in the preparation of this report are available for inspection at the offices of the South Yorkshire Pensions Authority in Barnsley

Other sources and references: Bevan Brittan**;** CIPFA; CLG; Sector Treasury Services

APPENDIX I

SOUTH YORKSHIRE PENSIONS AUTHORITY

TREASURY MANAGEMENT: ANNUAL INVESTMENT STRATEGY

A) Policy Statement

1) Introduction

1.1 Treasury management can be defined as the management of the Authority's cash flow, its borrowings and its investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks.

1.2 The Authority's treasury management operation is relatively simple compared to that of a conventional local authority. It essentially revolves around the depositing of surplus monies (ie pending permanent investment) with approved institutions.

1.3 This Strategy is constantly monitored and if deemed necessary may be replaced by a revised strategy. The circumstances warranting a revised strategy may vary but likely triggers could be changes in legislation, changes to interest rate expectations or changes to underlying investment market conditions and money market liquidity. However, the Strategy should not be formally reviewed just because of changes to purely technical circumstances. It is to be treated as a flexible document with sufficient delegations to allow officers to effectively manage the cash balances of the Authority and Fund.

2) Treasury Management Operation and Objectives

2.1 The activities of the treasury management operation cover:-

- Lending
- Cash flow forecasting and management
- Managing the underlying risk associated with the Fund's cash balances
- Consideration, approval and use of new financial instruments and treasury management techniques
- Liaison with brokers, the Authority's bankers, and other financial institutions

2.2 The overall objectives of the Authority are to achieve the optimum return consistent with minimising risk, with the overriding principle being to maintain the Authority's and Fund's capital.

2.3 Currently, investments are restricted to a limited number of organisations which enjoy a credit rating of F1 or better for short term debt (see 3.4 below).

2.4 Under the CIPFA Code procedures for the formulation of treasury management strategy are to be set and approved each year. This involves, inter alia, forecasting sums available for investment determined annually in advance and periods of investments, determined by the forecast interest rate movements, and the need to hold cash to meet contingencies. However, because of the short term nature of the Fund's cash balances (the allocation in the benchmark presumes that the Fund will normally be fully invested in the stock markets etc.) these decisions are taken as part of the greater asset allocation exercise which considers the Fund's overall disposition. This is under constant review within the constraints laid down by the customised benchmark. Therefore, most deposits under normal circumstances are fixed for periods of not more than three months. The majority of monies are invested on call, weekly or monthly terms. If market conditions suggest that it would be beneficial for the Authority to lend longer, such loans are directly related to account settlement, real estate or payroll requirements or liabilities i.e. are determined by overall Fund requirements rather than money market considerations. The maximum length of temporary investments will not, in any case, exceed 364 days. The borrowing of monies purely to invest or on-lend and make a return is unlawful and will not be engaged in.

2.5 Officers employed in treasury management activities have proper working relationships with external advisors and brokers and have the appropriate level of experience. Members involved in the scrutiny of treasury management issues are encouraged to avail themselves of relevant training wherever possible.

2.6 Quarterly updates on treasury management matters are presented to the Corporate Planning and Governance Board. If this Strategy is approved at today's meeting it will be published on the Authority's website.

3) Approved Instruments and Organisations for Investment

3.1 The Authority manages its monies in compliance with the statutory requirements. Within the CLG guidance there are definitions of "local authority", "investment", "long-term investment" and "specified investment".

3.2 Under Government guidance, specified investments are categorised as those offering both high security and high liquidity and must be sterling dominated, maturing in less than one year and be made either with UK Government, local authorities or institutions with high credit ratings as determined by the Authority.

3.3 A non-specified investment is one not covered by the previous definition and is subject to greater potential risk. CLG has confirmed that building societies and similar investments are covered by this paragraph and has stated that there is no intention to discourage authorities from using non-specified investments. The aim is simply to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies that are not highly credit-rated.

3.4 The Authority uses the creditworthiness service provided by Sector Treasury Services. 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. The service does not only rely on the current credit ratings of counterparties but also uses the following as overlays:-

- Credit watches and credit outlooks from credit rating agencies

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings

- Sovereign ratings to select counterparties from only the most creditworthy countries.

This is a service which the Authority would not be able to replicate using in-house resources.

3.5 This service provides an independent assessment by professionals of the overall credit quality of an institution. Weekly reviews of the credit ratings ensure that the Authority's criteria are maintained and the Authority is alerted to changes on a daily basis. Officers also utilise other rating information provided by other providers when appropriate and available and are constantly reviewing other potential sources of information. Officers are aware of and monitor the position regarding the UK banking system support package and the credit ratings attached to the banks that are covered.

3.6 The Authority can currently utilise the following instruments:-

- Deposits with banks, building societies, Debt Management Office or local authorities (and certain other bodies) for up to 364 days

- Certificates of deposits (CDs) with banks and building societies for up to 364 days

- Money market funds.

The Authority itself does not lend: all lending is Fund money.

3.7 The borrowers dealt with during the last ten months (to end January 2012) are shown in Appendix III. The amount invested with any one institution is limited. All loans must take due cognisance of the amount involved and the quality of the borrower in both absolute and relative terms to the whole lending book.

3.8 The lending limit for specified investments with a short term credit rating of F1 or better was increased from £10m to £15m in October 2011. At the same time it was agreed that, subject to obtaining prior approval from the Chair and Vice-Chair, the limit could be extended to £20m. The same limits apply to non-specified investments i.e. the Authority can lend to the top twenty Financial Services Authority (or equivalent FATF regulator) regulated building societies, or those with assets in excess of £1bn, up to a unit limit of £10m. These restrictions, therefore, apply to the Authority's principal bankers (i.e. Co-operative Bank and HSBC). Officers regularly review the credit rating criteria the Authority uses and have concluded that in the circumstances the current approach is appropriate.

3.9 The Authority has a deposit facility with the UK Debt Management Office which is an executive agency of HM Treasury. This facility has no limit on deposit size but internal procedures require that the use of the facility over a £20m limit be reported to the next available meeting of the appropriate Board.

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3.10 The Local Authorities (Capital Finance and Accounting) (Amendment)(England) Regulations 2004 [SI No 534] clarified the use of money market funds and CLG has confirmed that this Authority is eligible to utilise them. The Authority has approved investment in such funds up to a maximum limit of £10m into any one fund and up to a maximum of 50% of total lent monies at any one time.

3.11 Under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009: SI 2009/3093 the administering authority has a power to borrow on behalf of the LGPS fund it administers in certain circumstances.

4) <u>Overdraft</u>

4.1 It is proposed that an overdraft limit of £250,000 is agreed with the Authority's clearing bank, the Co-operative Bank plc with effect from 1 April 2012: this is the same as last year. The current interest rate on authorised overdrafts is officially 2% above the base rate. This facility is very rarely used. It is a contingency for unexpected events or to facilitate short term allocations.

4.2 I can report that the Authority has had no difficulty in terms of overdraft limits formerly set, nor, are any difficulties envisaged for current or future years. This view takes into account current commitments, existing plans and proposals in the approved budget.

5) <u>Delegated powers</u>

5.1 The Authority's Standing Orders and Financial Regulations have delegated to the Clerk and Treasurer the responsibility for all aspects of the operation of the Authority's bank accounts. He is also authorised to invest any monies belonging to or under the control of the Authority subject to the Authority's general directives. The Clerk and Treasurer may delegate his power to invest to members of his staff.

5.2 The Authority should approve the Annual Investment Strategy annually and before the start of the financial year.

5.3 The Affordable Borrowing Limit must be approved for each financial year and must be determined by the Authority. It should not be delegated to a committee and cannot be delegated to officers. It has to be kept under review.

5.4 It is the Clerk and Treasurer's responsibility to implement and monitor the Strategy and Limit once set. The Clerk and Treasurer should consider revising and resubmitting it as and when required; draft a strategy report for annual consideration by the Authority and to monitor and report upon any material divergence from the strategy and recommend revisions if and when required.

B Implementation

6) <u>2012/13 Immediate Considerations</u>

6.1 The factors expected to affect treasury matters during the forthcoming year are:-

	£M	%
Borrowing Requirement 2012/2013	None	
Current Bank of England Bank Rate (Feb 12)		0.5%
Current Investment Rates estimated range (overnight) for £10m deposit size		0.43-0.55%

7) <u>Prospects for Interest Rates</u>

The prospects for interest rates in the UK are expected to be as follows:-

a) Short Term Interest Rates

Bank Rate has been held at 0.5% since March 2009 and is not likely to rise in the foreseeable future. The Bank of England is unlikely to increase rates whilst the economic situation remains fragile.

b) Longer Term Interest Rates

The ongoing sovereign debt crisis is but one factor which has caused forecasters to delay their anticipated increase in interest rates. This time last year saw some commentators predicting an increase in interest rates to 0.75% by now. Those same forecasters are now contemplating an increase by the end of the third quarter this year. There is still no consensus over the speed of global economic recovery or the degree to which western government austerity programmes will dampen consumer confidence or hinder employment prospects. There is growing speculation that Greece might default on its loans during this quarter but it is not clear what the ramifications will be for the Eurozone or for those economies that trade with the Eurozone if she does. The Bank of England continues to believe that inflation will be back to near target within a year to two time horizon.

8) <u>Short term considerations</u>

8.1 Capital Finance

The Authority is not expected to have a requirement for financing new capital expenditure.

8.2 Debt Rescheduling

The Authority has no debt.

8.3 Temporary Investments

Cash flow requirements and changes in base rates will be closely monitored and investments made accordingly:

a) kept short if it is anticipated that interest rates will rise, enabling returns to be compounded more frequently

b) weighted to longer periods, with a view to enabling returns to be maintained, in a falling market.

Investments will be restricted to those funds and institutions which meet the criteria laid down in the Annual Investment Strategy.

8.4 Utilisation of Amounts Set Aside for Debt Redemption

The Authority has no debt.

8.5 Other issues

8.5.1 The Authority has deposits with certain Icelandic banks or their subsidiaries and determined to write-off both capital and interest due within the 2008/09 accounts. Following the decision of the Icelandic Supreme Court in October 2011 that UK local authority deposits enjoyed priority creditor status the winding-up boards of Glitnir and Landsbanki have proceeded on that basis. Both the anticipated recovery rates and distribution periods are different for the two banks and in the case of Glitnir still subject to potential legal objections. The timing of recoveries remains uncertain. The advice received from the lawyers acting on behalf of the Authority, via the LGA litigation group, is not to make any public statement but to rely upon information released by the winding-up boards into the public domain.

8.5.2 Members are reminded that the Authority is a member of the LGA organised litigation group and that the Clerk and Treasurer has been authorised to take all necessary steps to participate in and progress the group claims to maximise the Authority's potential for recovery of the deposits. The Clerk and Treasurer is basing his decisions on a balanced range of success factors, including legal merits, financial implications and reputational risks and monitors the costs of the litigation process in the context of those factors. The options are reassessed throughout the process. Members are aware that this process involves information in respect of which a claim to legal privilege could be maintained in legal proceedings.

APPENDIX II

SOUTH YORKSHIRE PENSIONS AUTHORITY

DETERMINATION OF AFFORDABLE BORROWING LIMIT 2012/2013

1) Background Information

1.1 Under Section 3(1) of the Local Government Act 2003, those local authorities covered by the Act, must determine on a rolling basis, for the following financial year and two successive years, an affordable borrowing limit which is the amount of money which the Authority can afford to borrow.

1.2 This limit must be determined by the Authority and cannot be delegated to committees or officers.

2) Proposed Limit for 2012/2013

2.1 In accordance with the Act, the following determinations are proposed for 2012/2013:

a) an overall borrowing limit of £250,000
b) the proportion of interest payable at variable rates should be set at 100%

2.2 It should be noted that it is open to the Authority to vary the above limits at any time during the year.

APPENDIX III

BORROWING INSTITUTIONS

MARCH 2011 to JANUARY 2012

DMO was used on one occasion. The maximum amount lent on a single occasion was £10m.

Banking institutions rated F1 or above as per Fitch Ratings Ltd

SANTANDER UK CORP BANKING	F1
BANK OF NOVIA SCOTIA	F1+
BARCLAYS BANK PLC	F1+
COMMONWEALTH BANK OF AUSTRALIA	F1+
COVENTRY BUILDING SOCIETY	F1
LANDESBANK BADEN-WUERTTEMBERG	F1+
LANDESBANK BERLIN AG	F1+
NATIONAL BANK OF CANADA	F1
NATIONAL WESTMINSTER BANK	F1
NATIONWIDE BUILDING SOCIETY	F1+
NORDDEUTSCHE LANDESBANK	F1
OVERSEAS CHINESE BANKING CORP	F1+