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 Capita Asset Services. 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 access other rating information supplied by other providers.

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 its own monies: all lending is Fund money.

3.7 The borrowers dealt with from April 2015 to February 2016 are shown in Appendix IV.

3.8 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. The lending limit for specified investments with a short term credit rating of F1 or better is £15m. However, subject to obtaining prior approval from the Chair and Vice-Chair, the limit can be extended to £20m. A unit limit of £10m applies to non-specified investments i.e. the Authority can lend to the top twenty Prudential Regulatory Authority (or equivalent FATF regulator) regulated building societies, or those with assets in excess of £1bn. These restrictions apply to the Authority's principal bankers (i.e. Lloyds and HSBC). Officers regularly review the credit rating criteria the Authority uses and have concluded that the present approach is fit for purpose.

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 should the facility be used for sums over £20m such use be reported to the next available meeting of the 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 The current overdraft limit of £250,000 is with the Authority's clearing bank, Lloyds, and is available until 31 August 2016. 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 and is subject to immediate termination.

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. Accordingly, it is intended to seek renewal of the facility from 1 September 2016.

5) Delegated powers

5.1 The Authority's Standing Orders and Financial Regulations have delegated to the Treasurer the responsibility for all aspects of the operation of the Authority's bank accounts. This includes the opening and closing of accounts. She is also authorised to invest any monies belonging to or under the control of the Authority subject to the Authority's general directives. The Treasurer may delegate this power to members of her 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 Treasurer's responsibility to implement and monitor the Strategy and Limit once set. The Treasurer should consider revising and resubmitting it as and when required, draft a strategy report for annual consideration by the Authority and monitor and report upon any material divergence from the strategy and recommend revisions if and when required.

B Implementation

6) 2016/17 Immediate Considerations

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

	£M	%
Borrowing Requirement 2016/2017	None	
Current Bank of England Bank Rate (Feb 16)		0.5%
Current Investment Rates estimated range (overnight) for £10m deposit size		0.35-0.45%

7) Prospects for Interest Rates

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 (the MPC meets today) and the Bank of England has indicated it is not likely to rise in the foreseeable future and that when it does so it will be gradual. The economic and investment environment does not appear to have great impetus and remains below trend. It is very dependent upon consumer spending though the latest manufacturing indicators are a bit more encouraging. The labour market remains robust though wage growth is still subdued. Inflation has been influenced by fuel and food price falls but by not as much as they were last year which will eventually dissipate over the year on base effects. Growing inflationary pressures are not evident in the economy and, thus, inflation should remain below the 2% target for the rest of this year.

The preface to the EU Referendum will add to the uncertain mix that has dogged the year to date.

b) Longer Term Interest Rates

Given the nature of the Authority's portfolio and liquidity requirements forecasting longer term interest rates is a low priority for this function. However, the Bank of England's view appears to be that risks are a little skewed to the downside in the medium term and expects inflation to exceed the 2% target within two years and then rise further above it. It judges that Bank Rate will increase over that period. However, the rise will be gradual and to a lower level than in recent cycles. But that view is an expectation only and policy will be determined by actual economic circumstances.

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

8.1 Capital Finance

The Authority may have a requirement to finance capital expenditure in relation to the acquisition of new software licences or similar. Such expenditure will ultimately be financed from the Fund.

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 had deposits with Icelandic banks or their UK subsidiaries in 2008 at the time of their collapse. Both capital and interest due on these deposits was written off within its 2008/09 accounts.

8.5.2 The Authority's ISK account has a balance of c4,600,000 ISK which is valued at roughly £25,500. This sum remains in an interest earning escrow account and is subject to capital controls. The timing of the control release and the prevailing exchange rate at that time cannot be predicted.

8.5.3 The anticipated recovery rates and distribution periods for the monies deposited with the UK subsidiary banks vary even though both KSF and Heritable are UK E&Y run administrations. The latest KSF creditor report disappointed. The next payment, expected to be not less than a 1p dividend, is due later this month. The E&Y forecast of ongoing recovery was below market expectations though the administrator is still indicating a total recovery in the range of 85 – 86.5 p/£. KSF Distributions to date equate to 82.5p/£. Opportunities to sell the debt are being explored. So far 95.75p/£ has been recovered from Heritable. The deposits were £5m with KSF and £2.5m with Heritable (two shapes). It is not possible to predict either the totality or timing of the recovery from those deposits.