SOUTH YORKSHIRE PENSIONS AUTHORITY

18 JANUARY 2018

Report of the Treasurer and the Interim Fund Director

TREASURY MANAGEMENT STRATEGY REVISION: Counterparty Limits

1) Purpose of the report

To seek Members' approval of the changes to the treasury management strategy followed by the Authority. These changes are limited to the levels of cash we can deposit with counterparties. They arise from the need to hold higher levels of cash that previously as we effect changes in the benchmark allocation i.e. reducing exposure to equities pending reinvestment in alternative investments and real assets.

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2) **Recommendation**

It is recommended that the Authority:-

a) Agrees the changes to the Annual Investment Strategy: The current limit for counterparties with a short term credit rating of F1 or better be changed to £40m. This £40m limit should also apply to HSBC and Lloyds (the Authority's principal bankers) but with the ability to increase this to £50m in exceptional circumstances. The level at which use of the DMO facility be reported to the Board be increased to £50m.

b) 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 and under the supporting Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 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"). The Code was updated in December 2017 and covers the whole range of treasury management issues, including the fundamental principles for making and managing investments and requires local authorities to prepare an annual Treasury Management Strategy Statement ("TMSS"). 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 Strategy Statement (TMSS) 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 (AIS); regular reporting on activities during the year and establishment of the delegation by the Authority of its responsibilities to other bodies and its officers. This report embodies the principles of the CIPFA Code and the Act and hence there is no separate TMSS published. For this Authority the delegated scrutinising body is the Corporate Planning and Governance Board and relevant monitoring reports are presented thereto.

3.3 As is normal practice the AIS will be presented to Authority at its meeting in March 2018 for adoption along with the Affordable Borrowing limit and the Minimum revenue provision policy statement.

4) <u>Changes to the Annual Investment Strategy</u>

4.1 Regular reporting on Treasury Management activities is provided to the Corporate Planning and Governance Board and the last update was in October 2017.

4.2 The Authority manages its cash itself. The customised benchmark allocation for cash remains at 1.5% with a tactical range of 0%-10%. Some cash needs to be held in order to service creditors etc., pension payroll and potential currency hedging requirements. In absolute terms the amount of cash held at any one time might run to tens of millions of pounds but it is normally going to represent 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 the purposes of investing 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.

4.3 As a result of market conditions the Fund remains relatively overweight in equities. There has been a natural reluctance to reduce that exposure and hold large cash balances whilst we endeavour to get money into alternative investments for which we have increased the benchmark allocation.

4.4 The Authority has also agreed to an Equity protection strategy which is based on the lower levels of equity exposure.
At the recent investment board meeting progress towards the new benchmark was questioned. As a result of further discussions with the advisors, officers feel that we should look to reduce the equity exposure to fit more appropriately with the equity protection strategy. Cash will be held until it can move into alternative investments and property which are both underweight.

4.5 This will result in increased cash levels which the current Treasury Management Strategy would struggle to accommodate simply on the number of counterparties that would be required.

4.6 The current cash limits in the strategy have been in place for a number of years and were based around a much smaller overall fund value and a time when the fund didn't hold large cash balances. The average cash balance at the time would have been well below £100m. Added to this is the counterparty appetite for longer term money against the Fund strategy of maintaining higher levels of short term (up to one month) cash deposits which limits the supply of suitable counterparties.

The movement from equities in January will raise approximately £200m increasing cash levels to around £320m by the end of this month, with the potential for this to increase further before the monies can be invested back into the market. Even at these levels the allocation to cash is well within the benchmark allocation which is up to 10% of the Fund (up to £800m at current valuation).

4.7 Currently, investments are restricted to a limited number of organisations which enjoy a credit rating of F1 or better for short term debt. A definition of this credit rating and a list of counterparties used in April to September 2017 is shown at Appendix 1.
The current limit for counterparties with a short term credit rating of F1 or better is £15m, the recommendation is that this be changed to £40m. This £40m limit should also apply to HSBC and Lloyds (the Authority's principal bankers) but with the ability to increase this to £50m in exceptional circumstances. Item 3.9 covers the DMO facility which has no deposit size limit but is subject to any use over £20m being reported to the Board at each update, this too should be increased to £50m.

4.8 All of these limits are to be kept under regular review and to be amended to fit investment strategy and therefore overall cash levels. All loans take account of the quality of the borrower and the level of the loan relative to the whole lending book. Any changes in limits during the year will be reported at the regular updates to the Board.

5) Implications

5.1 Financial
There are no implications not otherwise mentioned within the report.

5.2 Legal
It is not thought that there are any legal implications.

5.3 Diversity
There are no diversity implications.

5.4 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 agreeing a treasury management strategy and ensuring that compliance with 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 one means of assessing creditworthiness and are open to error and interpretation.

Neil Copley Treasurer	Steve Barrett Interim Fund Director

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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: CIPFA; Capita Asset Services, Bank of England, Fitch

APPENDIX 1

CREDIT RATING AGENCY DEFINITIONS

Fitch Short-term Ratings

Rating	
F1	**Highest credit quality.** Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote ant exceptionally strong credit feature.
F2	**Good credit quality.** Good intrinsic capacity for timely payment of financial commitments.
F3	**Fair credit quality.** The intrinsic capacity for timely payment of financial commitments is adequate.

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LIST OF BORROWERS: APRIL 2017 to SEPTEMBER 2017

Banking institutions rated F1 or above as per Fitch Ratings Ltd

AUSTRALIA & NEW ZEALAND BANKING GROUP	F1+
DBS BANK LTD	F1+
DZ BANK AG	F1+
LANDESBANK HESSEN THUERINGEN (HELABA)	F1+
NATIONAL BANK OF CANADA	F1
OVERSEA CHINESE BANKING CORP	F1+
RABOBANK	F1+
SOCIETE GENERALE	F1
SUMITOMO MITSUI BKG CORP EUROPE	F1
UNITED OVERSEAS BANK	F1+