Pension Fund Committee
Meeting to be held on 15 April 2011

Electoral Division affected:
None

Pension Fund Treasury Management Policy and Strategy 2011/12

Contact for further information:
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Executive Summary

From 1 April 2011, the Pension Fund will be keeping its money in its own bank account separate from that of the County Council. With keeping its money separate, it is best practice for the Pension Fund to have its own Treasury Management and Investment Strategy, recognising the unique features of the Fund.

This report presents the proposed Pension Fund Treasury Management Policy and Strategy for 2011/2012, including the cash management strategy.

While the routine cash balances of the Pension Fund are relatively small, the Pension Fund may have very substantial balances to invest from time to time or may need to borrow on a short term basis, for example, when investment transitions between mandates are taking place.

Recommendation

The Committee is asked to approve the Pension Fund Treasury Management Policy and Strategy for 2011/12.

Background and Advice

The Pension Fund has in the past conducted its treasury management activities within the general policy and strategy approved by Lancashire County Council and the stipulations laid down in CIPFA's Prudential Code for Capital Finance and Treasury Management Code of Practice.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require the Pension Fund to have its own bank account separate from that of the administering authority from 1 April 2011. With its own funds and substantial cash balances from time to time, it is best practice for the Pension Fund to develop its own Treasury Management Policy and Strategy tailored to its specific needs.

1. Pension Fund Treasury Management Policy and Strategy 2011/12

In setting the Treasury Management Strategy, economic forecasts and the forecast level of the cash balances have been taken into account. It covers the following aspects of the treasury management function:

- prudential indicators which provide a controlling framework for the treasury management activities of the Fund
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy; and
- the risk profile.

The following Treasury Management statements and reports will be considered by the Pension Committee and Investment Panel as follows:

Treasury Management	Committee	Frequency
Policy Statement	Pension Committee	Initial adoption in 2011, updated thereafter as needed
Annual Investment Strategy	Pension Committee	Annually before the start of the each financial year
Annual Investment Report	Pension Committee	Mid year
Treasury Management Monitoring Reports	Investment Panel	Quarterly
Scrutiny of treasury management strategy	Investment Panel	Annually
Scrutiny of treasury management performance	Investment Panel	Quarterly

2. Prudential Indicators for 2011/12 to 2013/14 in respect of the Pension Fund's Treasury Management Activities

In accordance with its statutory duty and with the requirements of the Prudential Code for Capital Finance and the CIPFA Code for Treasury Management, the Fund will produce each year a set of prudential indicators which regulate and control its treasury management activities.

The following table sets out the debt and investment-related indicators which provide the framework for the Fund's borrowing and lending activities over the coming three years:

Pension Fund Treasury Management Prudential Indicators		2011/12 £M	2012/13 £M	2013/14 £M
(i)	**Authorised limit for external debt**			
	A prudent estimate of external debt, which reflects the Fund's potential short term cash-flow needs and allows sufficient headroom for unusual cash movements.			
	Borrowing	200	200	200
(ii)	**Operational boundary for external debt**			
	A prudent estimate of debt, without allowance for extraordinary events.			
	Borrowing	100	100	100
(iii)	**Upper limit for fixed rate debt**			
	This limit reflects the fact that the Fund may wish to have most of its borrowing at fixed rates.	100%	100%	100%
(iv)	**Upper limit for variable rate debt**			
	This limit reflects the potential need to take some variable rate debt if interest rates rise to a point where fixed rate borrowing is not attractive.	50%	50%	50%
(v)	**Limit for Investments over 364 Days**			
	This limit applies for bank deposits and corporate bonds only and does not apply to investments in UK or AAA rated foreign Government or Supra-national Bank Securities.	75%	75%	75%

3. Borrowing Strategy

The Fund has no plans to borrow money, but under the Fund's regulatory regime, it may do so in certain limited circumstances, namely to:

(a) pay benefits due under the scheme; or

(b) meet investment commitments arising from the implementation of a decision by it to change the balance between different types of investment

The Fund may only borrow money if, at the time of borrowing, the Treasurer to the Fund reasonably believes that the sum borrowed and interest charged in respect of such sum can be repaid out of the Fund within 90 days of the date of the borrowing.

If borrowing were necessary, the Treasurer, with the Treasury Management Team, would seek the most cost effective and prudent source of funds appropriate for the purpose. Borrowings would be structured in such a way as to be most suitable for the specific need.

4. Cash Management and Investment Strategy

The Fund will have regard to the Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Fund's Cash investment priorities are:

(a) the security of capital;
(b) the liquidity of its investments; and
(c) investment returns

The Fund will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and the overall objectives of the Investment Strategy.

Under the Pension Fund's previous investment strategy (prior to the 2010 actuarial valuation) the amount of cash held by the Fund with the County Council was limited to monthly cash flow from contributions which was then used to aid regular rebalancing of the Fund and for cash calls from external managers.

The revised investment policy adopted by the Pension Fund Committee in December 2010 will involve the Fund in a number of asset class and manager transitions and the strategic allocation of investment income. These events will involve the Fund holding higher cash balances for short periods than in the recent past. It will be necessary to manage these flows efficiently allowing the fund suitable liquidity, security and returns, commensurate with the overall investment objectives of the Fund. Due to the nature of the Fund's overall global investment strategy, cash may be denominated in a number of currencies, predominately Sterling, US Dollars, and Euros. It is envisaged that the Fund's custodian will deal with most non-sterling cash, and certainly all currencies not listed above.

The proposed investment matrix is outlined below. It is important to note that the changes in strategic investment policy may generate large temporary cash balances during transitions and other events.

Instrument	Credit Rating (using Sector criteria)	Maximum Individual Investment (£m)	Maximum Maturity (not investment period)
Government Bonds and Treasury Bills	AA+	1,000	50 yrs
Supranational Bonds G10 Sovereign Bonds	AA+	1,000	50 yrs
Investment Grade Corporate Bonds	AAA	250	25ys
	AA	150	10yrs
	A	75	5yrs
General collateral reverse repurchase agreements	AA+ or better	1000	1yr
Term Deposits with UK and Overseas Banks (domiciled in UK) and Building Societies	Purple (Highest quality, greatest certainty of support)	200	1 yr
	Orange (Highest quality, slightly less certainty of support)	100	1yr
	Red (Highest quality but lower than orange)	50	3 months
	Green (Quality, but lower than Red and lower certainty of support)	25	1 months
Public Works Loan Board – Debt Management Office Deposit Facility	Government Institution	500	Less than 6mths
Other UK Local Authorities and Pension Funds	AAA (implied currently)	500	50yrs

Instrument	Credit Rating (using Sector criteria)	Maximum Individual Investment (£m)	Maximum Maturity (not investment period)
Money Market Funds	AAA Rated, weighted average maturity 6 months	250	These investments do not have a defined maturity date.
Bond Funds	AAA Rated Weighted average maturity less than 5yrs	200	These investments do not have a defined maturity date.
Certificates of Deposit. Collateralised lending agreements backed by higher quality government or local government and supra national securities.	AA, with AAA for any collateral used	500	5yrs
Non credit rated "nationalised" banks	Blue	250	1yr

The placing of residual overnight deposits will be with either the Fund's custodian or the County Fund.

There is currently still a high degree of turbulence in the financial markets and this matrix would enable the Fund to hold a high proportion of investments with banks holding explicit Government guarantees, support or ownership, or in bonds of similar credit quality.

Money market and Bond funds provide similar security and liquidity opportunities to call accounts. The AAA rated funds that the Fund would look to invest in hold Government securities and high quality corporate bonds as their main assets.

5. Day to Day Investment Management

The total cash investments managed will be variable and dependant on the general investment activity of the Fund. In circumstances where investments are in transition, cash balances can be high when investments have been sold with one manager and purchase by another manager is pending. In such cases, exposure to the relevant investment markets is maintained by the use of derivatives contracts.

With derivatives contracts, the Fund retains the use of the principal amount (less any margin paid). It must pay over interest at Libor (London inter-bank overnight rate) in return for the defined return (e.g. that based on a share index). The Treasurer and the Treasury Management Team will carefully manage the investment of the principal with the objective of out-performing Libor but without taking any additional risk to the Fund over its normal cash investment strategy. The margin achieved over Libor is additional return to the Fund over and above the index-based return of the derivative.

With base rates at exceptionally low levels, cash investment returns are likely to continue to be far lower than has been the case in recent years.

It is anticipated that Fund's cash balances will continue to be managed 'in-house', but if circumstances were appropriate, the Fund may consider the appointment of external providers of treasury management services. The Treasurer and the Treasury Management Team will continually monitor the attractiveness of external funds and report to the Committee if there is any potential value in utilising external investment managers.

In recent times, a wider range of investment instruments within the area of cash deposits has been developed by financial institutions. All of these afford similar security of capital to the basic sterling deposits currently in use, but they also offer the possibility, although never of course the certainty, of increased returns. The Treasurer and the Treasury Management Team will, in liaison with the Fund’s advisers, consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the Fund. The Bloomberg financial system used by the Treasury Management Team allows for detailed analysis and value calculation of such deposits.

6. Investment with the County Fund

While the Fund must maintain a bank account separate from that of the County Council, it may co-mingle its funds in order to invest jointly with the County Council in the County Fund (the County Council's book of cash deposits and bonds), provided that proper tracking and reconciliations are undertaken.

Consultations

The Fund's Independent Advisers have been consulted on this preparation of this strategy

Implications:

This item has the following implications, as indicated:

Risk management

This is covered throughout the report.

Legal

The Treasury Management activities must be in accordance with the "Prudential Code for Treasury Management in Local Authorities".

Financial

The objective of the revised Treasury Management strategy is to improve investment returns while reducing the financial risks to which the Fund is exposed.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Ext
Sector - Recommended Lending Criteria	2010/11	Andy Ormerod – County Treasurer's Department Ext 34740
CIPFA Treasury Management Code of Practice	2009	Andy Ormerod – County Treasurer's Department Ext 34740

Reason for inclusion in Part II, if appropriate

N/A