Treasury Management Policy

Approved: June 2023

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Lancashire County Council as administering authority of Lancashire County Pension Fund

Contents

Introduction

1.1 Cash-flow

Cash-flow is an important consideration for the Pension Fund. There is a significant outflow of cash each month as pensions and other expenses are paid. These are offset by contributions and other income. Forecasts for the next four years suggests that there will be a net cash outflow excluding income from investments. Income from investments may cover this shortfall. However, this income is subject to economic conditions and if it failed to materialise could pose a liquidity risk to the Fund. To reduce this risk the Fund has as part of its strategic asset allocation an allocation to cash.

1.2 Scope of policy

This policy is looking at the management of cash. It is based on cash being required for a short time frame to either meet pension payments or investments. Therefore, the aim is to maintain a very liquid cash position with a minimum of five months' worth of net liability outflow[1] (at present, this equates to a £70m holding. However, in certain circumstances, there may be a significantly greater cash holding for a limited time period, for example, following the payment of employer contributions.

1.3 Roles and responsibilities

Roles and responsibilities of the different parties in the treasury management policy are outlined in appendix A.

1.4 Review

This policy will be kept under review and updated as considered appropriate by the LCC Treasury management team, in consultation with the Head of Fund. It will be subject to formal review every three years in line with the actuarial valuation.

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[1] This is in line with the Risk Appetite Statement which states a tolerance of between 5 and 12 months net liability outflow.

Cash Management

The key drivers of the policy are the security of the investment and its liquidity. Cash will be managed with the aim of achieving the optimum return on its investments commensurate with proper levels of security and liquidity. Under this policy, the following will be used for Cash investments:

1. Call accounts and short-term deposits with banks
2. Secured deposits/Reverse Repo's
3. High quality bonds
4. Short term deposits with Local Authorities.
5. Money Market Funds.

In terms of priority, call accounts will be the preferred investment option for Cash. However, use of the other investment options above will depend on the markets available and the overall liquidity. For example if liquidity is low the aim would be to use call accounts and bonds or, if available, very short (7 day) deposits with Local Authorities.

The above investments are defined below and further information on each is provided in appendix B.

2.1 Bank Call Accounts/short term deposits

The Fund will hold call account(s) with UK and Overseas Banks (domiciled in the UK). These are accounts which the money invested can be returned to the Fund immediately.

Arrangements can be made with banks to make investments for a fixed period or to have an undetermined end date, but for the transaction to be ended and the money returned on giving a known notice period, usually 7 days.

However, there is a credit risk to the Fund from investing in unsecured deposits with banks. Under current regulations (referred to as bail-in) if a bank gets into financial difficulties it is expected that equity and deposit holders would cover the losses of the bank rather than the taxpayer. Under the regulations UK Local Authorities and their Pension Funds come very near the bottom for the creditor protections and therefore could potentially face significant loss.

The risk of bail-in is likely to be low. However, it is considered appropriate to spread the monies held on behalf of the Pension Fund across a number of banks and other type of investments while ensuring liquidity.

2.2 Secured deposits/Reverse repurchase agreements (REPO)

A secured bank deposit is similar in many ways to a normal fixed term bank deposit, with a counterparty bank, start date and maturity date agreed in advance. Where it is different is that secured deposits are secured on a basket of collateral held by an agent, which means that (a) they are exempt from bail-in and (b) if the counterparty bank defaults, the agent will sell the collateral and return the proceeds to the investor.

A reverse REPO is when the Fund buys bonds, usually from a bank, on one date and agrees to sell them at an agreed price on an agreed future date.

2.3 Bonds

Bonds are issued by banks or other companies to raise money. The issuer agrees to repay the amount borrowed on a specific date, while interest is paid on agreed dates. Although they are a form of loan agreement there is a market for the sale and purchase of issued bonds. They are highly liquid although the price can vary. Therefore, the type of bonds considered suitable for the policy are:

- **Covered Bonds**- these are long-term secured investments with a bank. They are secured on the bank's residential mortgages and are tradeable.
- **Floating rate notes (FRNs)** - are bonds with a variable interest rate that allows investors to benefit from rising interest rates. FRNs are typically issued for a 3 to 5 year terms.
- **UK Treasury Bills-** these are issued by the UK government and may be issued with a minimum maturity of 1 day and a maximum maturity of 364 days.

2.4 Short Term Deposits with local authorities

There is a market for investments to be made with UK local authorities**.**

2.5 Money Market Funds

These are pooled investment funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager and low fees.

2.6 Currency

The purpose of the cash management is to ensure sufficient liquidity with minimal risk. Therefore, all call accounts and investments should be in sterling. There is no mandate within this policy for holding balances in other currencies for the purpose of trying to make gains on currency movements.

However, in recognition that some transactions are in non-sterling currencies, and in line with LPP's policy, holding some non-GBP currency at Northern Trust is permitted. These balances are generally expected to be limited to US$ 10m and EUR 10m (or equivalent in another foreign currency) although can be higher with the agreement of the Head of Fund or Treasury and Pensions manager.

In line with this policy any foreign currency received should be converted to sterling within 3 working days unless there is a known payment due in the same currency within 10 working days, or if the overall balance is below the thresholds listed previously.

Tolerance

If cash balances fall to below 5 months of peak net liability outflows then LPPI and the Investment Panel will consider whether any action is required. Balances will not fall below 3 months of peak net liability. If they do LPPI will take action to increase the level of cash held.

Borrowing

Borrowing by way of temporary loan or overdraft which is liable to be repaid out of its pension fund can only occur for the purpose of:

(a) paying benefits due under the Scheme; or

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

Borrowing can only occur if, at the time of the borrowing, there is a belief that the sum borrowed, and interest charged in respect of that sum, can be repaid within 90 days of the borrowing.

Appendix A – Roles & Responsibilities

Roles and responsibilities of the different parties in the treasury management policy are outlined below.

Pension Fund Committee	To review ongoing funding updates for potential cash contribution implications. To approve and review on a regular basis an overall Investment Strategy and subsidiary Strategies for such asset classes as the Investment Panel consider appropriate.
Investment Panel	Monitor and review the investment activity.
LPPI	LPPI will review cash balances as part of the overall managements of the Fund's assets and they will take appropriate action if the level of cash balances falls too low. Managing distributions/ call downs and notifying LCC in a timely manner.
Head of Fund	To prepare and submit to Pension Fund Committee an Investment Strategy Statement (to include policy on the management of cash balances). To place any monies not allocated to investments on short term deposit in accordance with arrangements approved by the Pension Fund Committee. Head of Fund will have the ability to agree to exceed the limits referred to in the policy to deal with unusual cash flow.
Treasury Manager/Pensions & Treasury Manager (TM/PTM)	On a daily basis the cash will be managed by Lancashire County Council Treasury Management Team who will report to the Head of Fund. TM/PTM will monitor compliance with this policy and provide quarterly reporting to the Head of Fund and Investment Panel.
Northern Trust	Collect and record cash

Appendix B – Characteristics of Investment Options

Investment option	Risk	Liquidity	Controls to mitigate risk/Other notes
Bank Call Accounts/short term deposits	Risk that the counterparty bank will fail and not be in a position to return the cash invested with the Bank back to the Pension Fund. Bank call accounts and fixed term deposits are subject to bail-in regulations. Under the regulations there is a hierarchy of protection (see Appendix C) should a bank get into financial difficulty. Local authority deposits including Pension Funds are low in the hierarchy and therefore are subject to a risk of loss.	Currently the Fund uses Svenska Handelsbanken and Nat West. In addition, Svenska offer the facility to make deposits with 7 days' notice and Nat West is the operational bank of the Fund. Other accounts will be opened as required within the credit matrix. Fixed term deposits can be arranged with any bank meeting the credit criteria.	Number of bank accounts is to be a minimum of three. Minimum credit rating of Banks used. Credit rating of the bank is taken into consideration and the bank will have a minimum credit rating of: Moody's. P1 S&P A1 Fitch. F1 In a steady state, it is expected that there will be a minimum of £30m held in call accounts. However, this may be higher in certain circumstances, for example due to the prepayment of employer contributions. The maximum balance to be held in any individual Bank is £40M. Fixed term deposits will be limited to a maximum of 1 month in duration. The County Council's treasury management advisers (Arlingclose) monitor credit ratings and issue alerts as appropriate. A monthly credit list is provided, and investments will not be made with banks not on the Arlingclose approved list unless there is approval from the Head of Fund or Director of Finance. In addition, treasury management staff regularly review financial information and credit default swaps (CDS) prices

Investment option	Risk	Liquidity	Controls to mitigate risk/Other notes
			which provide an indication of the risk associated with individual banks.
Secured deposits/Reverse repurchase agreements (REPO)	Risk that the counterparty bank will fail and there will be a reliance on the underlying collateral and agent to ensure cash allocated to the Bank is returned to the Pension Fund. Very low credit risk investments as the Fund actually takes ownership of the bonds and therefore has an asset should the bank default[2]	Duration of the transaction will be limited to 14 days. It is anticipated that most transactions will be for a duration of overnight to 1 week.	In a steady state, it is expected that there will be a minimum of £20m held in secured deposits/REPO. However, this may be higher in certain circumstances the maximum limit is £100m. The limit is higher than for unsecured deposits as the ultimate credit risk is via the collateral held. The collateral will usually be UK Gilts or if not, other bonds will only be used if rated AA- or above as rated by one of the major credit rating agencies (Moody's, S&P or Fitch). The Fund will undertake secured deposits using a nominee[3] and a collateral management agent[4] who will ensure the security is adequate to repay any loss in the event of a counter party. Consort 1 Ltd will act as the nominee, Clearstream Banking SA is used as the collateral management agent. (Clearstream are one of only two International Central Securities Depositaries based in Europe). This structure is arranged by Arlingclose for its clients. Arlingclose have confirmed that Consort 1 Ltd have all the regulatory permissions and the technology in place to arrange transactions. Regulators monitor the action of companies involved in these transactions.

[2] It is anticipated that this investment option be used to ensure short term cash is invested securely with the assets being taken as security being government Gilts or other bonds rated as a minimum of AA-.

[3] An entity into whose name security deposits are transferred by the Pension Fund to facilitate transactions.

[4] Financial organisation that holds collateral on behalf of the Pension Fund.

Investment option	Risk	Liquidity	Controls to mitigate risk/Other notes
			Some banks offer a sale and buy back arrangement which replicates a reverse REPO which may be used if the bank's credit rating meets those outlined above. In this instance Northern Trust will hold the collateral in a Lancashire named account.
Bonds	Risk that the Bank or government which issued the bond fails and is not in a position to return cash back to the Pension Fund. FRN price can vary. If sold before maturity there is a small price risk.	In practice FRNs operate as fixed instruments with a maximum of 3 months to maturity and can be liquidated with one or two days' notice Treasury bills are issued with a minimum maturity of 1 day and a maximum maturity of 364 days.	Covered Bonds usually have an AAA credit rating and investments will not be made in any bonds rated below AA- ** As there is a risk that there will be difficulty selling bonds, at a price which equals or exceeds the initial investment then the use of the bonds is subject to limits . In steady state, it is likely that £20m would be invested across bonds/short-term deposits and Money Market Funds. The maximum amount invested in bonds is £70m but only if there is a balance held in the call accounts of £25m or more. There is an active market for treasury bills and therefore they are highly liquid and do not have to be held to maturity. UK Treasury Bills are unconditional obligations of the UK Government and therefore are assumed to have a very low credit risk.
Short Term Deposits (STDs)	Risk that the Local Authority fails and is not in a position	Mandate is to ensure liquidity and any fixed term deposit is generally kept for	Fixed term deposits are permitted, the term of a deposit would not normally be for more than 3 months although up to 6 months will be considered after discussion with LPPI.

Investment option	Risk	Liquidity	Controls to mitigate risk/Other notes
with Local Authorities	to return cash back to the Pension Fund.	short durations (up to 1 month), or the investment will include a call facility which is usually to give 7 days' notice.	It is not anticipated that many local authority loans would be undertaken in a steady state as these loans are the least liquid of the investment options, but they provide a low-risk investment when cash balances are forecast to be high for a sustained period. The maximum invested with any one local authority will be £10m, while the total invested with local authorities at any one time will be restricted to £50m. Local Authority STDs are seen as carrying a low credit risk as local authorities are supported by the government. As deposits are for a fixed term the principal amount is secure. Arlingclose provide regular updates on specific local authorities where there is a risk of the authority getting into financial difficulties. Appropriate professional publications are also reviewed for news on specific authorities to mitigate risk.
Money Market Funds (MMF's)	Risk that the underlying assets fall in value and principal amount is not returned to the Pension Fund, as there is no guarantee of the principal amount.	Highly liquid with funds providing daily liquidity.	The Fund is not invested in any MMF's at present. The limit in any one MMF is £10m and the total investments in MMF's is limited to £40m. Each MMF must be rated at least a AAA-MMF by one of the three major credit agencies. Arlingclose maintain a list of MMFs, who are monitored regularly. Arlingclose initially meet the MMF's staff to discuss their credit and interest rate risk, the types of investment instruments used, diversification policy and any other

Investment option	Risk	Liquidity	Controls to mitigate risk/Other notes
	MMFs often have unsecured bank exposure. MMFs can occasionally have their own liquidity issues.		relevant criteria. Arlingclose maintain regular contact with key staff at each MMF, including frequent meetings to get details of the investment approach and performance. Consideration will be given to using the MMFs on Arlingclose's list. Assets held within the MMF are diversified across many counterparties which limits risk.

Appendix C – Order of Priority (higher in the list the greater the protection)

Fixed charge holders (i.e. security in the form of mortgage, fixed charge, pledge, lien), including:
- Capital market transactions (e.g. covered bonds)
- Trading book creditors (e.g. collateralised positions)

Liquidators (fees and expenses)

Preferential creditors (ordinary), including:
- FSCS, taking the place of all protected depositors for amounts up to £85,000
- Employees with labour-related claims

Preferential creditors (secondary)
- Depositors that are individuals and micro, small or medium-sized businesses for amounts in excess of £85,000

Floating charge holders

Unsecured senior creditors, including:
- Bondholders
- Trading book creditors (e.g. uncollateralised positions)
- Creditors with master netting agreements (net position only)
- Commercial or trade creditors arising from the provision of goods and services
- Depositors that are not individuals or micro, small and medium-sized businesses for amounts in excess of £85,000
- FSCS, taking the place of individuals with funds invested with the insolvent firm (including protected amounts up to £50,000)

Unsecured subordinated creditors (e.g. subordinated bondholders)

Interest incurred post-insolvency

Shareholders (preference shares)

Shareholders (ordinary shares)