

## HAMPSHIRE COUNTY COUNCIL

### Decision Report

<b>Decision Maker:</b>	Pension Fund Panel
<b>Decision:</b>	7 June 2013
<b>Title:</b>	Pension Fund Cash – Annual Report 2012/13
<b>Reference:</b>	4860
<b>Report From:</b>	Director of Corporate Resources – Corporate Services

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#### 1. Executive Summary

- 1.1. This report provides an annual review of the policy for managing the Hampshire Pension Fund's cash balance. The Pension Fund adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

#### 2. Background

- 2.1. The Pension Fund receives cash each month from contributions by employees and employers, and from investment income. The Pension Fund requires a cash balance to be able to pay pensions and other costs. Cash is also required if the UK property manager CBRE Global Investors purchases additional properties, to finance drawdowns by the indirect property and alternative investment funds, and the purchase of new and top-up hedge fund investments as recommended by Aberdeen Asset Management, who are the advisers for the alternative investment portfolio.
- 2.2. Dividends from shares and interest receipts from bonds are retained by the external investment managers for reinvestment, but rent income from the Pension Fund's direct property portfolio is credited to the Fund's cash balance. Distributions from the Fund's alternative investments and indirect property funds are also paid to the Fund's balance.
- 2.3. The Pension Fund's investment managers aim to be fully invested in equities and bonds, and do not plan to hold cash as a matter of investment policy. However, they will have some cash balances as a result of trading between stocks and from dividend and interest income pending investment. These relatively small cash balances are held by the Pension Fund's

Custodian bank and are 'swept' on a daily basis into their money market funds in which interest is earned.

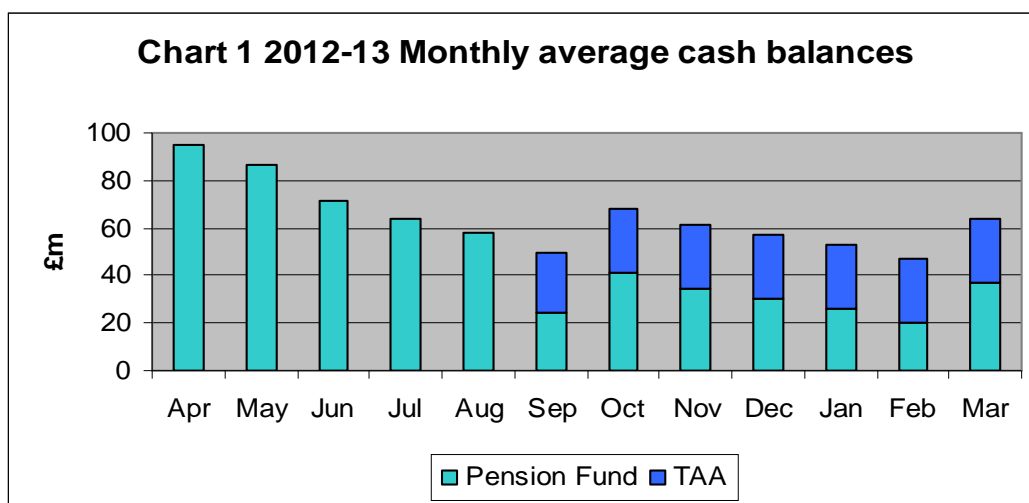
- 2.4. There are rigorous procedures in place to ensure the security of all cash deposits which are held by the County Council in separate bank accounts for the Pension Fund. These include criteria for the quality of counterparties and limits on the amount that can be placed with any one counterparty as set out in the Pension Fund's Annual Investment Strategy for 2012/13 for cash, which was approved by the Panel on 16 December 2011. In addition the County Council's treasury advisers, Arlingclose, provide support to the Director of Corporate Resources in undertaking treasury management activities.
- 2.5. The next report to the Panel on cash management will be the Annual Investment Strategy for cash for 2014/15 including a mid year monitoring statement for 2013/14 at the Panel's meeting in November 2013. The Annual Investment Strategy for cash for 2013/14 reported to the Panel at its meeting on 7 December 2012, is attached to this report as Appendix 1 as background information for the Panel.

### **3. Investment activity**

- 3.1. Security of capital remains the Fund's main investment objective for the management of the cash balance. This was maintained during 2012/13 by following the Fund's counterparty policy as set out in its Annual Investment Strategy. Investments during the year included:
  - Investments in AAA-rated Money Market Funds
  - Call accounts and deposits with banks and building societies systemically important to the UK's banking system.
- 3.2. Counterparty credit quality was assessed and monitored with reference to:
  - credit ratings
  - credit default swaps
  - any potential support mechanisms
  - share prices.
- 3.3. Based on these factors and advice from the Treasury Management advisers, Arlingclose, the Director of Corporate Resources on behalf of the Pension Fund has varied investment duration limits for new investments according to the assessment of credit risk and will suspend investing with individual counterparties at any time if this is felt to be necessary to protect the Pension Fund's capital.
- 3.4. The UK base rate has been maintained at 0.5% throughout 2012/13 and short term money market rates have continued to fall to very low levels which have had a significant impact on cash investment income. The Fund's average cash investment balance was £70.04m during 2012/13, and interest earned was £714,000, leading to an average yield of 1.02%.

**4. Cash inflows and outflows**

- 4.1. The Pension Fund's cash investment holding was £51.2m as at 31 March 2013. This includes £27.0m held as cash that is part of the Tactical Asset Allocation, which is invested according to advice received from Aon Hewitt.
- 4.2. The chart below shows that the Pension Fund's cash balance declined throughout 2012-13 as cash was used to increase the investments in the property and alternative investment portfolios towards their target investment levels. The cash balance increased in March 2013 as it was necessary to take a total of £20m from the three equity managers, Aberdeen, Newton and Schroders, to ensure that the Pension Fund had sufficient cash balances to meet its ongoing commitments.



- 4.3. As a result of the reduction in the Pension Fund's cash balances it has been necessary to invest cash on an instant access basis to maintain liquidity. This is shown in all but one of the Pension Fund's accounts being instant access bank accounts or money market funds, as shown in Appendix 2. The exception is a term deposit for two years that was placed in May 2011, when cash balances were higher.
- 4.4. It is being reported that for the first time some LGPS funds are experiencing annual cash deficits; income from employer and employee contributions are being exceeded by the outgoings on pensions and other costs. In finalising the financial accounts for 2012/13 the Pension Fund's annual surplus or deficit from its dealing with members and employers will be produced and any significant movement, and the proposed necessary action, will be reported to the Panel at its meeting on 27 September 2013.
- 4.5. The Pension Fund's cash balance will continue to be carefully managed to ensure that there are funds to meet the obligations to members and investment commitments. In accordance with the Pension Fund's Annual Investment Strategy for cash for 2012/13 the cash flow was managed to avoid the need to borrow (although regulations provide an explicit power for pension funds to borrow for a period of up to 90 days for cash flow purposes, such as allowing scheme benefits to be paid and during a transition period when the investment of the Fund's assets is being

changed). Avoiding the need to borrow continues to be a key element of the Pension Fund's Investment Strategy for cash for 2013/14.

**5. Recommendation**

- 5.1. That the outturn report on the Pension Fund's cash management in 2012/13 be approved.

**CORPORATE OR LEGAL INFORMATION:****Links to the Corporate Strategy**

<b>This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision by the Pension Fund Panel to approve the annual report on Pension Fund cash for 2012/13.</b>
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**Other Significant Links**

<b>Links to previous Member decisions:</b>		
<u>Title</u>	<u>Reference</u>	<u>Date</u>
<b>Direct links to specific legislation or Government Directives</b>		
<u>Title</u>	<u>Date</u>	

**Section 100 D - Local Government Act 1972 – background documents**

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

DocumentLocation

None

## **IMPACT ASSESSMENTS:**

### **1. Equalities Impact Assessment:**

- 1.1. Equality objectives are not considered to be adversely affected by the proposals in this report.

### **2. Impact on Crime and Disorder:**

- 2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

### **3. Climate Change:**

- a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

- b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.

## 1. Annual Investment Strategy 2013/14

- 1.1. The following Annual Investment Strategy, for the period to 31 March 2014, has been prepared with the advice of the County Council's treasury advisers, Arlingclose.
- 1.2. The primary objective in relation to the investment of Pension Fund cash remains the security of capital. The liquidity or accessibility of the Fund's cash investments followed by the yields earned on these investments are important but secondary considerations.
- 1.3. There are three Government-recognised credit rating agencies, and their credit rating equivalents and definitions are provided in the following table. All the credit ratings listed are referred to as 'Investment Grade'.

**Table 2 – Description of credit rating agencies' ratings**

<b>Fitch</b> Long-term	<b>S&amp;P</b> Long-term	<b>Moody's</b> Long-term	
AAA	AAA	Aaa	Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk.
AA+ AA AA-	AA+ AA AA-	Aa1 Aa2 Aa3	High credit quality. 'AA' ratings are subject to very low credit risk.
A+ A A-	A+ A A-	A1 A2 A3	'A' ratings are upper-medium investment grade and are subject to low credit risk.

- 1.4. The security risk of countries and the institutions within them is assessed using the following range of factors:
- Credit Ratings (minimum long-term A- or equivalent for counterparties)
  - Credit default swaps (the premium paid to a third party to insure against the risk that a country or institution will default on the repayment of a loan)
  - Economic fundamentals, such as a country's net debt as a percentage of its GDP
  - Sovereign support mechanisms
  - Share prices
  - Corporate developments, news, articles, market sentiment and trends.
- 1.5. In order to diversify the cash investment portfolio, new investments will be placed with a range of approved investment counterparties, investment periods and rates of return as follows.

**Table 3 – Investment strategy counterparty limits**

Counterparty	Maximum term	Maximum deposit
Approved UK banks and building societies	2 years	£30m per counterparty
Approved foreign banks	2 years	£10m per counterparty
AAA rated Money Market Funds	Overnight	£10m per fund £50m in total
Treasury Bills	6 months	Unlimited
Local authorities	2 years	£10m (maximum per authority for the largest authorities, with reducing banding for smaller authorities)

- 1.6. The Investment Strategy will provide flexibility to invest cash for periods of up to 2 years in order to access higher investment returns in the current low interest rate environment. This will be shortened in respect of those institutions with a higher perceived credit risk, based on the creditworthiness criteria outlined in paragraph 4.4. For example, new investment deposits with banks and building societies are currently restricted a maximum of 12 months at most at the present time.
- 1.7. Local Authorities are able to invest with the Government's Debt Management Office (DMO), which they may make use of during periods of significant stress in the markets given the low returns that are offered. This is considered as an acceptable trade-off for the guarantee that capital is secure, and there would be no limit on the amount placed with the DMO. A separate account cannot be set up with the DMO specifically in the name of the Pension Fund as it is not a legally separate entity from its administering authority. Therefore in order for the Pension Fund to access the DMO the funds would need to be placed via the County Council although the credit risk would remain with the Pension Fund.
- 1.8. Given the Pension Fund's intention to only maintain a small cash balance the duration of investments will be limited to ensure that liquidity is maintained. Cash investments with longer than 364 days to maturity will be restricted to a maximum of £20m in total. The duration that cash is invested as part TAA portfolio will depend on the advice received from Aon Hewitt.
- 1.9. The Director of Corporate Resources and Arlingclose will continue to analyse and monitor the indicators of credit risk and wider economic developments on a regular basis and respond as necessary to ensure security of the capital sums invested. Changes during the duration of this Annual Investment Strategy, to the lending list and the limits on investments (in Table 3) will be subject to the approval of the Director of Corporate Resources and will be reported to the Pension Fund Panel at the first available opportunity.

- 1.10. The Director of Corporate Resources will continue to manage cash balances on a cautious basis with the emphasis on capital preservation at the expense of additional interest returns where necessary to avoid unjustifiable risks.