

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel
Date of Decision:	15 December 2010
Decision Title:	Pension Fund cash – Annual Investment Strategy 2011/12
Decision Reference:	2385
Report From:	County Treasurer

Contact name: Anthony Dodridge

Tel: 01962 847407

Email: anthony.dodridge@hants.gov.uk

1. Executive Summary

- 1.1. This report provides an Annual Investment Strategy for 2011/12 (although this would also be adopted for the rest of 2010/11) for approval, which is covered in Section 3.
- 1.2. The policy for managing the Hampshire Pension Fund's cash balance is covered in Section 4.

2. Background

- 2.1. As reported to the Panel on 18 June 2010, the Government has required administrative authorities, such as the County Council, to maintain a separate bank account for the Pension Fund from 1 April 2011. This was set up well in advance of this statutory deadline, and has been fully operational since October 2010.
- 2.2. For transparency, the Pension Fund's cash balance has been separately invested from that of the County Council's own cash balance since that time.
- 2.3. The Pension Fund receives cash each month from contributions by employees and employers, and from investment income. 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.

- 2.4. The Pension Fund requires a cash balance to meet the outgoings on pensions and benefits, existing commitments to invest in property and to fund drawdowns by the private equity funds, as well as covering day-to-day cash flow.
- 2.5. Whilst 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, the Pension Fund's cash flow will be managed on the basis that the need for borrowing for the Fund is avoided.

3. Annual Investment Strategy

- 3.1. The following Annual Investment Strategy has been prepared with the advice of the County Council's recently appointed Treasury Advisers, Arlingclose.
- 3.2. The policy for managing the Pension Fund's cash fully complies with the requirements of the revised CIPFA Code of Practice for Treasury Management in the Public Services (2009).
- 3.3. Treasury management in the context of this report is defined as:

"The management of the organisation'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 optimum performance consistent with those risks." (CIPFA Code of Practice).
- 3.4. The investment priorities are:
 - security of the invested capital;
 - liquidity of the invested capital;
 - an optimum yield which is commensurate with security and liquidity.
- 3.5. The Investment Strategy will provide flexibility to invest cash for periods of up to two years in order to access higher investment returns in the current low interest rate environment.
- 3.6. Cash investments with longer than 364 days to maturity will be restricted to a maximum of £20m, with a maximum investment being placed with one institution of £10m. Such limits are considered appropriate given that the Pension Fund's Statement of Investment Principles does not include a strategic allocation in cash as an asset class.
- 3.7. The Investment Strategy will provide flexibility to hold a certain amount of the Pension Fund's cash in US dollars pending dollar denominated private equity drawdowns to manage changes in exchange rate levels. For example, this would allow for US dollars to be bought at a point where their cost is perceived to be attractively priced against sterling at, say, \$1.65.

- 3.8. The Pension Fund's cash investments are made with reference to the outlook for the UK Official Bank Rate and money market rates. The UK Bank Rate has been maintained at 0.5% since March 2009, and is anticipated to remain at low levels throughout 2011/12. Short-term money market rates are likely to remain at very low levels for an extended period which will have a significant impact on investment income.
- 3.9. Arlingclose's latest economic forecast indicates a UK Official Bank Rate as follows:

Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
0.50	0.50	0.75	1.00	1.25

- 3.10. The Pension Fund's cash investment holding was £122m as at 30 November 2010, a breakdown of which is provided in the exempt appendix.
- 3.11. Countries and the institutions within them are selected for the counterparty list after analysis and careful monitoring of:
- Credit Ratings (minimum long-term A+ for counterparties; AA+ for countries), using all three Government recognised credit rating agencies
 - Credit Default Swaps
 - Net Debt as a Percentage of GDP
 - Sovereign Support Mechanisms/potential support from a well-resourced parent institution
 - Share Prices
 - Macro-economic indicators
 - Corporate developments, news and articles, market sentiment.
- 3.12. The County Treasurer and Arlingclose will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.
- 3.13. The Fund's surplus cash will either be invested in:-
- UK and non-UK banks and building societies listed in Appendix 1 for periods of up to two years (although this will be shortened in respect of those institutions with a higher perceived credit risk, based on the creditworthiness criteria outlined in paragraph 3.11), which are rated at least A+ which denotes a high credit quality and expectations of low credit risk and a strong capacity to meet its financial commitments;

- fixed-term deposits with the Government's Debt Management Office will only be used as a default position during a period of significant stress in the markets given the low returns. This would be considered as an acceptable trade-off for the guarantee that the Pension Fund's capital is secure, and there would be no limit on the amount placed with the Debt Management Office;
- fixed-term deposits with other local authorities; and
- same-day liquidity deposits with managed AAA-rated money market funds, which are currently listed as follows (although other AAA-rated money market funds may also be used if deemed necessary):
 - RBS Global Treasury Sterling Fund;
 - Standard Life Sterling Fund;
 - Henderson Sterling Fund;
 - Ignis Sterling Fund; and
 - Prime Rate Sterling Fund.

No more than £10m should be placed with any one money market fund, and the overall exposure to money market funds should not exceed £50m.

- 3.14. Same-day liquidity deposits may be recalled at any time. The Pension Fund's cash flow position will be monitored on a daily basis and adjustments made as necessary to the funds placed on instant access.
- 3.15. To provide scope for a greater degree of geographical diversification, a number of non-UK banks are included on the approved lending list. This is a change in the policy of not investing with overseas banks which was introduced in response to the Icelandic banking collapse in October 2008, and is a reflection of more stable credit conditions. These non-UK banks are appraised on the same basis as their UK counterparts. One of the considerations in assessing creditworthiness is the capacity and willingness of sovereigns to put in place support mechanisms as well as banks' access to liquidity facilities such as those made available by the European Central Bank, the Federal Reserve, and the Bank of England.
- 3.16. The Pension Fund Panel delegates responsibility for the execution and administration of treasury management investment decisions to the County Treasurer, who will act in accordance with this Annual Investment Strategy.
- 3.17. Changes to the lending list and the limits on investments will be subject to the approval of the County Treasurer and will be reported to the Pension Fund Panel at the first available opportunity.
- 3.18. The County Treasurer will continue to manage cash balances on a cautious basis with the emphasis on capital preservation at the expense, where necessary to avoid unjustifiable risks, of additional interest returns.

4. Policy for managing the Pension Fund's cash

- 4.1. The £122m of cash held by the Pension Fund at 30 November 2010 will be required for:-

	£m
Future purchases of UK property to bring the portfolio managed by CB Richard Ellis up to the target of £228m	52
Future drawdowns for the European property funds managed by Aberdeen Property Investors	9
Drawdowns (net of distributions) for the private equity portfolio	31
Final investments in the hedge fund portfolio managed by Aberdeen	10
Day-to-day cash flow management	20
Total	122

- 4.2. Work is continuing to establish whether these balances should be invested in the market instruments which reflect the movement in the underlying markets in which the cash will eventually be invested. One possibility might be a UK property market derivative as a temporary investment pending purchases of properties by CBRE. That may not be sufficiently flexible and liquid and another option being considered is to use an index tracking fund for UK equities such as that offered by State Street. However, this will reflect the movement in markets and is much more likely to result in a loss of capital than the security-conscious policy for holding cash on deposit. On the other hand, it would ensure that the Pension Fund benefits from any upward movement in investment markets.
- 4.3. The current cash balance is forecast to reduce from £122m to about £90m over the next year and then rise thereafter. There will be scope to allocate part of this balance for new permanent investments as part of the forthcoming review of investment management arrangements.

5. Recommendations

- 5.1. That the Annual Investment Strategy for 2011/12 (although this would also be adopted for the rest of 2010/11) be approved.
- 5.2. That the County Treasurer be authorised to manage the Fund's cash balance in accordance with the policy set out in this report.
- 5.3. That the County Treasurer be authorised to invest the Pension Fund's cash balance in market-related investments as appropriate.

CORPORATE OR LEGAL INFORMATION:

Links to the Corporate Strategy

This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision because the management of the Pension Fund's cash balance needs to be decided.

Other Significant Links

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

<u>Document</u>	<u>Location</u>
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.

List of UK and non-UK banks and building societies

Country/ Domicile	Counterparty	Maximum Counterparty Limit £m
UK	Santander UK Plc	30
UK	Lloyds TSB	30
UK	Barclays Bank Plc	30
UK	Clydesdale Bank	30
UK	HSBC Bank Plc	30
UK	Nationwide Building Society	30
UK	NatWest	30
Australia	Australia and NZ Banking Group	10
Australia	Commonwealth Bank of Australia	10
Australia	Westpac Banking Corp	10
Canada	Bank of Montreal	10
Canada	Bank of Nova Scotia	10
Canada	Canadian Imperial Bank of Commerce	10
Canada	Royal Bank of Canada	10
Canada	Toronto-Dominion Bank	10
Finland	Nordea Bank Finland	10
France	BNP Paribas	10
France	Credit Agricole CIB	10
France	Société Générale	10
Germany	Deutsche Bank AG	10
Netherlands	ING Bank NV	10
Netherlands	Rabobank	10
Sweden	Svenska Handelsbanken	10
Switzerland	Credit Suisse	10
US	JP Morgan	10

* Please note that additional counterparties could be added to this list if, for example, a counterparty/country is upgraded. Alternatively if a counterparty is downgraded, this list may be shortened.