

Local Members Interest	
NIL	

PENSIONS PANEL – 3 MARCH 2015

Report of the Director of Finance and Resources

Annual Investment Strategy for Pension Fund Cash 2015/16

Recommendation of the Chairman

1. That the Pensions Panel approves the proposed Annual Investment Strategy (AIS) for the Staffordshire Pension Fund, for the investment of internally managed Pension Fund cash.

Reasons for Recommendations

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 require the administering authority to formulate a policy for the management of Pension Fund cash. The Government also provides specific guidance to local authorities under the Local Government Act 2003 in completing an AIS; the relevant principles of which have been used to structure this AIS for the Staffordshire Pension Fund.

Background

3. The Pension Fund has a small strategic asset allocation to cash of 1%, recognising that cash balances are needed for the day to day management of the Fund. This cash is managed by Officers in the County Council's Treasury and Pension Fund Team; mainly in the short-term to provide liquidity to pay bills as they arise. It is not invested solely to seek a return and is not, therefore, usually considered as a major asset allocation decision.
4. The cash does increase from time to time, pending investment in other major asset classes e.g. property. The proposed AIS will therefore need to allow for such situations occurring. Also, the Pensions Panel will need to agree these temporary increases as part of its quarterly review of the strategic asset allocation benchmark, together with any associated ranges.
5. The proposed AIS will not deal with the segregated, relatively small working cash balances held by the custodian (Northern Trust) under the control of the investment managers or with cash arising from occasional transitional activity. Overnight, Northern Trust sweep funds into their "AAA" rated Money Market Funds (MMFs).

AIS for Pension Fund Cash 2015/16

Objectives of investment

6. The proposed main objectives for the AIS are to:
 - a) provide security of capital (i.e. ensure the return of the money and interest);
 - b) provide liquidity (i.e. pay the bills as they fall due and ensure funds are available for reinvestment when needed); and
 - c) earn interest (i.e. obtain a reasonable return within the constraints outlined at a) and b)).

7. The 1% allocation to cash will by its nature need to be kept short-term. Where balances exceed this allocation, say pending investment in other asset classes, then investments will be needed that recognise their longer-term nature. It is anticipated that initially, any longer term requirements will be fulfilled through the use of 'cash plus or short bond funds' (see paragraph 17). Outside of this, the Pensions Panel will need to assess any specific requirements and consider any changes that may be required to the AIS.

Credit Rating Criteria and the Approved Lending List (the List)

8. Government regulations state that local authorities have to decide how they define a 'high credit rated' counterparty (i.e. a bank or a building society). In the past, the Pension Fund has relied on advice and creditworthiness services from Treasury Management Advisors, such as those appointed by the County Council.

9. However, once fully invested in property, there is forecast to be a low level of cash for the Pension Fund in 2015/16 and it is considered highly unlikely that the Pension Fund will need to enter into a large number of term deposits with financial institutions. Indeed, given recent changes in the Government's attitude and their treatment of banks that fail, the risk that depositors such as the Pension Fund could lose a proportion of their investments (known as 'bail-in risk') has been heightened. As such, therefore, it is not considered necessary for the Pension Fund to adopt a full creditworthiness service approach. Instead, a simplified AIS, consisting of three elements, yet still acknowledging the 'high credit rating' concept is proposed.
 - (i) Regulation Investments

10. Government Regulations specify the type of financial instruments that can be used and they divide them into 'specified' and 'non-specified' investments.

Specified investments are investments made in sterling for a period of less than a year that are invested with:

- the UK Government;
- a local authority;
- a parish or community council (unlikely to be used by the Pension Fund);
- a body, or in an investment instrument, that has a 'high credit rating'.

11. The first three named investments can be used by the Pension Fund by virtue of their inclusion within the guidance; these are referred to as Regulation Investments in the remainder of this report. It is important to note that these classes of investment are not subject to "bail-in" risk as mentioned earlier in this report.

(ii) Money Market Funds (MMF's)

12. MMF's are pooled investment vehicles consisting of money market deposits and similar instruments. MMF's have been used for some time by the Pension Fund and by Northern Trust as stated earlier. They are also widely used by other public and private sector bodies.
13. MMF's proposed for use by the Pension Fund would be 'AAA' rated, the highest possible credit rating and they would have the following attributes:
- Diversified – MMF's are diversified across many different investments, far more than the Pension Fund could hope to achieve on its own account.
 - Same day liquidity – this means that funds can be accessed on a daily basis.
 - Ring-fenced assets – the investments are owned by the investors and not the fund management company.
 - Custodian – the investments are also managed by an independent custodian, who operates at arms-length from the fund management company.
14. All treasury activity carries an element of risk and MMF's are no different. In the event of a further financial crisis, the failure of one or more of an MMF's investments could lead to a run on the MMF as investors rush to redeem their investment. This could then spread to other MMF's as investors take flight from this asset class.
15. The very low interest rate environment also threatens the ongoing continuity of MMF's. Each MMF charges a fee and this could mean that interest earned became negative after its deduction. If this problem arose then it would be a matter of moving funds to an alternative class of investment.
16. MMF's as described in these paragraphs are therefore judged to meet the criteria of an instrument that meets the definition of a 'high credit rating'. Providing daily liquidity, the Pension Fund currently has accounts open with 5 MMF's.

17. Additionally, the Pension Fund invests in a 'cash plus' fund. 'Cash plus and short bond' funds provide a useful longer term option to investments in MMF's. Whilst they are considered to be slightly higher risk, it is anticipated that they will provide a higher return. An investment period of at least six months is generally recommended and they also provide some diversification away from other short term investments. It is proposed to delegate the decision on the further use of 'cash plus and short bond' funds to the Director of Finance and Resources, after taking appropriate advice.

(iii) The Pension Fund's Banker

18. The new banker for the Pension Fund, Lloyds Bank has been transitioned in successfully and is now fully operational.
19. Under the new arrangements relatively low levels of cash will be retained with Lloyds Bank each night earning interest at a market rate. It is important to note that funds are available daily, they are not committed for any period of time.

Investment Diversification

20. In order to ensure diversification, it is proposed that the maximum investment limit for AAA rated diversified MMF's which are, by default, already invested across a larger number of counterparties, is the lower of 50% of total cash or £25m, per MMF. Cash plus and short bond funds will also be subject to these limits. This approach is considered reasonable for the Pension Fund's risk profile; taking into account that cash is only one asset class and the Fund already has diversification across other asset classes.
21. To allow the practical management of the treasury transactions each day, it is proposed that the choice over the investments made is delegated to the Director of Finance and Resources.

Investment duration

22. The investment arrangements set-out in this report are of short duration; with the exception of cash plus or short bond funds, investments in an MMF or with the Pension Fund's banker are liquid and available at one days notice. Other regulation investments may be invested for up to 12 months but more typically will be for a month or two.
23. The Pension Fund's Approved Lending List is shown at **Appendix 2**. The maximum recommended investment duration for 2015/16 works within the definition of a specified investment which is to not invest for more than a year.

Risk

24. Cash is only a small part of the overall investments of the Pension Fund and the wider aspects of risk are taken into account in the strategic asset allocation where cash forms part of a diversified portfolio.

25. Looking at cash in isolation, then treasury management usually recognises that the two prime risk areas are security and liquidity. It is considered that focussing primarily on these two risks is appropriate for the Fund's relatively low 1% allocation to cash, for day to day cash management purposes; although the AIS has the flexibility to consider yield in the use of higher risk funds.
26. Should the Pensions Panel decide at some point in the future to make a higher strategic allocation to cash, where seeking a higher return would become more important, the balance of risk and reward would need to be revisited.

Review of Strategy

27. The main circumstances where a revised strategy would be prepared include a change in:
- the Fund's strategic asset allocation;
 - the economic environment;
 - the financial risk environment; and
 - the regulatory environment.
28. Whilst the Pensions Panel will be responsible for approving any revised strategy, it may be necessary for action to be taken quickly. It is proposed, therefore, that the responsibility for assessing the circumstances above will rest with the Director of Finance and Resources.

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Appendix 1

Equalities implications: There are no equalities implications arising directly from this report.

Legal implications: There are no direct legal implications arising from this report.

Resource and Value for money implications: All resource and value for money implications are covered in the body of this report.

Risk implications: Risk is inherent in an AIS and is dealt with throughout the report.

Climate Change implications: There are no direct climate change implications arising from this report.

Health Impact Assessment Screening: There are no direct implications arising from this report

PENSIONS PANEL – 3 MARCH 2015

Staffordshire Pension Fund
Approved Lending List

Lending List – March 2015	
	Time Limit
Regulation Investments <i>(no maximum investment limit)</i>	
UK Government T-bills	6 months
UK Government Gilts	12 months
UK Local Authority	12 months
Banks	
Lloyds Group (£5m maximum investment limit)	call only
Money Market Funds (MMFs) <i>(maximum investment limit in each individual MMF is the lower of 50% of total cash or £25m)</i>	
Goldman Sachs	call only
J P Morgan	call only
Deutsche Bank	call only
Morgan Stanley	call only
Federated	call only
Ignis Short Duration Cash Fund	3 day notice