Dorset Council

Pension Fund Committee

Treasury Management Strategy 2020-21

Date of Meeting: 12 March 2020

Director: Aidan Dunn, Executive Director Corporate Development

Executive Summary: This report revises the previously approved Treasury Management Strategy for 2019-20, approved by the Pension Fund Committee in February 2019. Although the pension fund has no strategic allocation to cash, cashflows need to be managed to ensure there is sufficient liquidity to meet liabilities as they fall due and to invest any surplus balances appropriately. The Treasury Management Strategy (TMS) provides the framework within which officers must manage these cashflows and 'treasury' investments. The TMS for the pension fund broadly follows the TMS of Dorset Council, the administering authority for the pension fund, where applicable. In relation to counterparty risks and limits, this strategy continues to be consistent with that of the administering authority.
Equalities Impact Assessment: This report does not deal with any new strategies or polices that would trigger an impact assessment.
Budget: Not applicable.
Risk Assessment: Details of the expected risks of implementing the project are included in the report.
Climate Implications: The Fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks arising from environmental issues, including those associated with climate change.
Other Implications: None.
Recommendation: That the Committee approve the Treasury Management Strategy for 2020-21.

Reason for Recommendation: To ensure that officers manage the pension fund's cashflows and invests surplus cash balances appropriately.
Appendices:
Background Papers: Dorset Council Budget Report Appendix 5 Treasury Management Strategy
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1. Background

1.1 The pension fund has no strategic allocation to cash, but it does have a number of cashflows in and out of the fund, including member and employer contributions, pensions and other benefits, dividend and rental income, and investments and disinvestments. The role of treasury management is to ensure that these cashflows are adequately planned so that there is sufficient liquidity to meet liabilities as they fall due, with any surplus monies invested in low risk counterparties, providing adequate liquidity before considering optimising returns.

1.2 The Treasury Management Strategy (TMS) provides the framework within which officers must manage these cashflows and investments, and follows broadly the strategy of Dorset Council, the administering authority for the pension fund, where applicable.

1.3 The strategy set limits on the amount and length of time that cash can be invested with specific counterparties, to a maximum of two years. This is to reflect the fact that there is not a strategic allocation to cash and investing cash sums for more than this period would be contrary to the pension fund's investment strategy.

1.4 In relation to counterparty risks and limits, this strategy continues to be consistent with that of the administering authority and revises the previously approved Treasury Management Strategy for 2019-20, approved by the Pension Fund Committee in February 2019.

2. Treasury Management Advisers

2.1 The administering authority employs professionally qualified and experienced staff with responsibility for making treasury management decisions. Officers are supported by specialist external advisers. Dorset Council currently employs Arlingclose Limited as its treasury management advisers.

2.2 This approach ensures that the administering authority has access to a wide pool of relevant market intelligence, knowledge and skills, that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the administering authority.

3. External Context (Economic Background and Outlook)

3.1 Treasury management decisions must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates. In February 2020, Arlingclose were forecasting that Bank Rate will remain at 0.75% until the end of 2022.

4. Treasury Investments and Borrowing

4.1 Cash balances are invested on a daily basis using call accounts, pooled money market funds and by making deposits with the pension fund's bank, NatWest. Longer term investments can also be made for up to two years but in practice it is unlikely that treasury investments will be made for longer than six months.

4.2 The pension fund's cash balances can be invested with any of the counterparty types in the table below, subject to the cash limits (per counterparty) shown.

Category	Minimum Credit Rating	Limit
Banks & Building Societies (unsecured)	A-	£15m
Banks & Building Societies (secured)	A-	£20m
UK Government including gilts and the Debt Management Account Deposit Facility (DMADF)	n/a	no limit
Local Authorities	n/a	£20m
Corporates	A-	£10m
Registered Providers	A-	£10m
Money Market Funds (Low Volatility)	AAA	£20m
Money Market Funds (Notice Accounts)	AAA	£20m

4.3 This table should be read in conjunction with the following notes:

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank’s assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 2 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money Market Funds: These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term money market funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.

4.4 The pension fund may incur operational exposures, for example though current accounts, to a bank with a credit rating lower than A-. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5m per bank.

4.5 Credit ratings are obtained and monitored by the treasury management advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

4.6 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.7 Credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the treasury management advisers. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

4.8 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the pension fund will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its treasury investments to maintain the required level of security.

4.9 The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the pension fund’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This may cause a reduction in the level of investment income earned but will protect the principal sum invested.

4.10 The maximum that will be lent to any one organisation (other than the UK Government) will be £20 million.

4.11 Officers monitor the pension fund's cash flow forecasting on a daily basis to determine the maximum period for which funds may prudently be committed. The forecast aims for a minimum of £10m to be readily available in same day access bank accounts and/or money market funds. This is to minimise the risk of needing to borrow funds or sell assets at short notice to meet the pension fund's liabilities and commitments. Any borrowing should be short term (less than 12 months) and for cashflow purposes only.