Pension Fund Committee
Thursday, 10 March 2022
Treasury Management Strategy 2022-23

For Decision

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Recommendation:

That the Committee approve the Treasury Management Strategy for 2022-23.

Reason for Recommendation:

To ensure that officers manage the pension fund's cashflows and invests surplus cash balances appropriately.

1. Executive Summary

This report revises the previously approved Treasury Management Strategy for 2021-22, approved by the Pension Fund Committee in March 2021.

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.

2. Financial Implications

The Local Government Pension Scheme (LGPS) is a national pension scheme administered locally. Dorset Council is the administering authority for the LGPS in

Dorset which provides pensions and other benefits for employees of the Council, other councils and a range of other organisations within the county.

The LGPS is a ‘defined benefit’ scheme which means that benefits for scheme members are calculated based on factors such as age, length of membership and salary. Member benefits are not calculated on the basis of investment performance as they would be in a ‘defined contribution’ scheme.

Administering authorities are required to maintain a pension fund for the payment of benefits to scheme members funded by contributions from scheme members and their employers, and from returns on contributions invested prior to benefits becoming payable.

Contribution levels for scheme members are set nationally, and contribution levels for scheme employers are set locally by actuaries engaged by administering authorities.

As scheme member rates cannot be changed locally and benefits are defined, the risk of investment underperformance is effectively borne by scheme employers.

3. Wellbeing and Health Implications

No wellbeing and health implications arising from this report have been identified.

4. Climate implications

No climate implications arising from this report have been identified.

5. Other Implications

No other implications arising from this report have been identified.

6. Risk Assessment

The risks associated with the pension fund’s cash and treasury investments are assessed in detail and considered as part of the treasury management strategy.

7. Equalities Impact Assessment

There are no equalities implications arising from this report.

8. Appendices

None.

9. Background Papers

Dorset Council Budget Report Appendix 5 Treasury Management Strategy

10. Background

10.1 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, property rental income, and investments and disinvestments. For example, in 2020-21 total contributions paid into the pension fund from scheme employers and scheme members were approximately £135m, and total benefits of approximately £130m were paid out.

10.2 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.

10.3 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.

10.4 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.

10.5 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 2021-22, approved by the Pension Fund Committee in March 2021.

11. Treasury Management Advisers

11.1 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.

11.2 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.

12. Treasury Investments and Borrowing

12.1 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.

12.2 Treasury management decisions must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates.

12.3 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) and the time limits shown.

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	2 years	Unlimited	n/a
Local authorities & other government entities	2 years	£30m	Unlimited
Secured investments *	2 years	£30m	Unlimited
Banks (unsecured) *	12 months	£15m	Unlimited
Building societies (unsecured) *	12 months	£15m	£30m
Registered providers (unsecured) *	2 years	£15m	£30m
Money market funds *	n/a	£30m	Unlimited

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

12.5 ***Minimum Credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long term credit rating is no lower than A-. 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. For entities without published credit ratings, investments may be made either where external advice indicates the entity to be of similar credit quality.

12.6 **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.

12.7 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

12.8 **Banks and building societies (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.

12.9 **Registered providers (unsecured):** 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 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.

12.10 **Money market funds:** Pooled 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 in return for a small fee. Although no sector limit applies to money market funds, officers will take care to diversify the pension fund's liquid investments over a variety of providers to ensure access to cash at all times.

23.11 **Operational bank accounts:** The pension fund may incur operational exposures, for example though current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. 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 £15m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the pension fund maintaining operational continuity.

12.12 **Risk assessment and credit ratings:** 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.

12.13 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.

12.14 **Other information on the security of investments:** 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.

12.15 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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.

12.16 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 or with other local authorities. This may investment returns to fall but will protect the principal sum invested.

12.17 **Liquidity management:** 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 pension fund's liquid cash will be spread over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

12.18 Officers will aim for a minimum of £20m 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.

Footnote:
Issues relating to financial, legal, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.