Bath & North East Somerset Council		
MEETING: **AVON PENSION FUND COMMITTEE** MEETING DATE: **16 MARCH 2012**	**AGENDA ITEM NUMBER**	
TITLE: **TREASURY MANAGEMENT POLICY**		
WARD: **'ALL'**		
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Appendix 1** Current Treasury Management policy approved in December 2009. **Appendix 2** Proposed Treasury Management policy. **Appendix 3** Graph illustrating the Fund's cash accumulation since April 2010 **Appendix 4** Graph illustrating the forecast increase in retirements		

1 THE ISSUE

1.1 The Fund's Treasury Management Policy sets out how the Fund's cash is invested to meet its day to-day requirements. The short term cash managed within the Treasury Management policy at any one time is c. £25m. This represents less than 1% of the Fund's total value. The Treasury Management policy should therefore be considered as a risk management policy that is applicable to this small proportion of the overall assets.

1.2 The current policy approved in December 2009 was based on the Council's Treasury Management framework. Since 2009 significant downgrades of credit ratings of UK banks has made it increasingly difficult to invest the Fund's cash balance in line with this policy. Officers reported to the December Committee that following reductions in counterparty limits as a result of credit rating down-grades, the Fund had lent to some counterparties amounts up to previous limits. This was due to a lack of alternative approved counterparties. There have been no further issues of counterparty limits since those reported in December.

1.3 This report sets out the revised Treasury Management policy that provides flexibility to ensure the efficient management and investment of short term cash.

1.4 In addition, the report notes that the cash flow profile of the Fund is approaching a time of transition. Contributions are constrained by the pay freeze and reductions in Local Government expenditure and the value of pensions paid out is increasing. The net effect is to bring the Fund closer to the point of maturity when cash outflows (mainly pensions & lump sums) are no longer exceeded by cash inflows (mainly contributions i.e. excluding investment income).

2. RECOMMENDATION

2.1 That the Committee approves the revised Treasury Management policy as set out in Appendix 2

2.2 That the Committee notes the forecast change in the Fund's cash flow profile and the policy decisions that will be required as a consequence.

3 FINANCIAL IMPLICATIONS

3.1 The Fund requires accessibility to short term cash to meet its day to day operating requirements. Cash received in contributions needs to be invested for periods from a few days to less than three weeks before being used to meet the payment of pensions. This short term investment earns interest and incurs transfer costs. However, the significance of an efficient means of short term investment is to ensure that the payment of pensions can be achieved on time and without incurring unplanned borrowing costs.

4 CURRENT TREASURY MANAGEMENT POLICY

4.1 The current policy is set out in Appendix 1. The Fund's Treasury Management is administered by the Council's Treasury Management team. The Fund uses the Council's approved Counterparty list but in recognition of the Fund's lower level of short term cash, its limits have been set below those of the Council. The lower limits were designed to ensure diversity in the use of counterparties. They did not reflect the fact that the amount of cash being invested represented a small proportion of the Fund's invested assets (around 1%) whereas the Council's cash represents all its invested assets.

4.2 Counterparty risk is reduced by limiting the amount of cash permitted to be invested with a counterparty and limiting the maximum period for which it can be invested. As explained above, the Fund's cash limits were not based on the size of the Fund or the proportion of the Fund being invested. The limits on the period for which cash could be invested ranged from a maximum of three months to a maximum of six months, whereas in practice the Fund normally requires the cash to be on call and never normally needs to invest for more than a month.

4.3 The policy originally provided a capacity to invest £25m across five instant access call accounts (that met the credit rating criteria) and through lending in the money markets to AAA rated banks and other Local Authorities. In addition, unlimited funds can be placed with the Government's Debt Management Office although its interest rates are very low and it only takes fixed term money.

5 THE AFFECT OF THE BANKING CRISIS

5.1 The banking crisis has resulted in two of the call accounts no longer being available as the banks' credit ratings have fallen below the minimum acceptable. The remaining three accounts have had their maximum lending limits reduced from £5m to £3m following credit rating downgrades and the Council's maximum limits being reduced. In addition there is now very little demand in the money markets from approved counterparties for the very short term money that the Fund has to lend. The Debt Management Office interest rates are very low and its requirement for fixed term investments makes it unsuitable for depositing the day to day cash that the Fund needs to invest.

5.2 The Council is reviewing its Treasury Management policy in the light of the same developments. Because the Fund's existing Treasury Management policy is specifically linked to the Council's current Treasury Management policy these limits will no longer be appropriate once the Council's existing policy is replaced.

6 THE AFFECT OF THE MATURITY OF THE FUND

6.1 In the past the Fund has experienced positive monthly cash flow as contributions and other (non-investment) cash income have exceeded the payments of pensions c. £1m per month. The accumulated cash has been transferred to Investment

Managers in tranches of c. £5m. The Fund's current policy is for investment income to be retained by Investment Managers for reinvestment as it has not been required to meet pension payments. In the normal life cycle of a Pension Fund a point is reached at which the amounts paid out as pensions starts to exceed the contributions being paid in. At this point the Fund becomes "mature".

6.2 As a result of the Local Government pay freeze and reductions staff numbers, the level of contributions has begun to decline and is forecast to decline further. At the same time pension payments are forecast to rise due to (i) inflation indexation and (ii) the number of active members reaching retirement age increasing each year. In common with other LGPS funds, in the past year, these factors have accelerated the Fund's maturity and negative cash flow profile. The graph at Appendix 3 shows the accumulation of cash since April 2010 illustrating the recent slow-down in the accumulation of cash. The graph at Appendix 4 shows the forecast continued increase in the number of retirements based on the Actuaries assumptions.

6.3 Further work on the forecasting of future cash flows is required. It is proposed that the result of this research and the implications of the use of investment income and divestments to fund pension payments will be presented at June Committee in order that the options can be considered.

6.4 The requirements of a Treasury Management policy are very similar regardless of whether the Fund is in a cash flow positive or cash flow negative position. Transfers to or from the Investment Managers have normally been of a minimum of £5m. Where the Fund is cash flow positive this amount will be accumulated before transfer to the Investment Managers. Where the Fund is cash flow negative this amount will be transferred to the bank account and used over a period. In both cases the capacity for holding £5m cash in the short term is in addition to the cash flow investment requirements surrounding the efficient use of contributions and payment of pensions. This element of the Fund's cash investment capacity could be reduced through more frequent and consequently smaller transfers.

7 THE REVISED TREASURY MANAGEMENT POLICY

7.1 For its day to day operations the Fund requires the capacity to invest c. £25m of readily accessible short term cash. Currently the monthly cycle of the Fund's cash flow includes the receipt of contributions and other income amounting to c. £13m and the payment of a similar amount in benefits. Because contributions are received before pensions are paid, there is the need to invest c. £13m between the receipt and payment. In addition, as mentioned earlier, cash is accumulated up to £5m before being transferred to Investment Managers or tranches of £5m are received from managers to top up the cash balance. The Fund also has a policy of retaining a £5m balance in short term cash to meet any unexpected circumstances. These three amounts total £23m, hence the £25m capacity requirement. It is possible that the £5m transfer figure could in future be reduced by more frequent transfers to and from Investment Managers. The £5m balance held for unexpected circumstances could also be reduced. Taken together these changes could reduce the total required capacity to £20m.

7.2 Currently there is not a need to invest for periods of more than a month. A sustainable policy should build in the potential for higher levels and longer periods for investment to provide greater flexibility in the management of cash. A revised policy should not increase risk, but should exclude limits that are inappropriately cautious within the context of the overall Fund. The policy should be established in the knowledge that short term cash investment is necessary for the efficient operation of the Fund, bridging the period between the receipt of contributions and other cash and the payment of pensions.

7.2 The proposed revised Treasury Management Policy is set out in Appendix 2. The policy is designed to include the capacity for continued cash investment following adverse changes in counterparty ratings. Although the normal requirement is for cash to be invested for less than one month, the policy includes longer term limits designed to accommodate unforeseen changes in Treasury Management requirements such as the possible investment of investment income in excess of short-term cash requirements. This is also the reason that UK Local Authorities and Building Societies have been included even though at present it is not expected that they would be used.

7.3 The proposed revised Treasury Management policy closely mirrors the policy set out in the Councils' Annual Investment Strategy (approved at Council meeting 14th February 2012). As the Fund's Treasury Management is managed by the Council's Treasury Management Team, the use of similarly formatted policies will reduce the risk of error. The Pension Fund and Council also have a similar attitude to Treasury Management risk. Where the policy limits differ, it is a reflection of the different cash flow requirements and the amounts of cash (as a proportion of overall Fund assets) that need to be invested.

8. RISK MANAGEMENT

8.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has appropriate investment and treasury management strategies in place which are regularly monitored. In addition it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations.

9. EQUALITIES

9.1 An equalities impact assessment is not required.

10. CONSULTATION

10.1 None appropriate.

11. ISSUES TO CONSIDER IN REACHING THE DECISION

11.1 The issues are detailed in the report.

12. ADVICE SOUGHT

12.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

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Background papers	Various Accounting and Statistical Records Treasury Management Strategy Statement and Annual Investment Strategy 2012/13 (Council 14th February 2012)