Section 4: Treasury Management Strategy, Investment Strategy, Prudential Indicators and Minimum Revenue Provision Policy 2014/15

Appendix E – Annual Investment Strategy 2014/15

1. The Annual Investment Strategy details our approach to identifying counterparties deemed sufficiently secure to place our investments. In setting our Strategy the council has regard to the revised Government Guidance on Local Government Investments which came into effect from April 2010 and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. This council will only invest in institutions with the highest security and / or backing from the Government.

2. The monies available for investing are primarily cash flow derived, and are only available temporarily pending expenditure. The council does not currently have funds available for long-term investments. Hence our investment priorities are:-

a) the security of capital and

b) the liquidity of our investments.

3. The council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this council will not engage in such activity.

4. Investment Instruments

Investment instruments identified are categorised as either 'Specified' or 'Non-Specified' Investments.

4.1 **'Specified' Investments**

'Specified' investments are identified by Government Guidance. All such investments will be sterling denominated, with maturities up to a maximum of one year, meeting the minimum 'high' rating criteria where applicable. These include deposits with the Government's Debt Management Office, deposits with local authorities and deposits with banks and building societies with 'high' credit ratings. The criteria for 'high' credit ratings are in Table 1. The council defines a body of high credit quality as having the highest short term ratings with all three credit rating agencies (Fitch, Moodys, and Standard and Poors) plus a long term rating of a minimum of A. Since the credit crunch there have been a number of developments which require separate consideration:-

4.1.1 **Partially nationalised banks in the UK**

RBS has received substantial support from the UK Government, with a majority share of the bank being owned by the Government (81%). The Lloyds Banking Group has also received support from the Government. Some of this holding has been sold in 2013, but the Government still holds a substantial stake (33%).

4.1.2 **Country blanket guarantees on all deposits**

Some countries, such as Ireland, supported their banking system by giving a blanket guarantee on *all* deposits. However, in determining lending policy the sovereign rating of the country needs to be considered as well as the individual credit ratings of the banks covered by that guarantee. This council will only invest in the UK and in AAA rated countries. Ireland is now only BBB+ rated so its guarantee would not be secure enough for us.

4.1.3 **Other categories of 'specified' investments**
These include Certificates of Deposit issued by banks and building societies either covered by UK Government guarantee or with 'high' credit ratings, Treasury Bills and AAA rated Money Market Funds.

4.2 '**Non specified' investments**
'Non specified' investments carry a higher risk than specified investments, but potentially have a higher yield. These include deposits with maturities in excess of one year. The council will only invest in those investments where there is minimal risk to capital, and where the rate of return justifies their use. It is proposed that a maximum of £100m could be held in aggregate in 'non-specified' investments, for a maximum period of up to two years. These investments are only being held with the Government backed banks, RBS and Lloyds, and local authority/similar[1] bodies, to take advantage of attractive rates of interest.

5. Creditworthiness policy

5.1 The council uses the creditworthiness service provided by Capita Asset Services. This service has been progressively enhanced over recent years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys, and Standard and Poors - forming the core element. By using a scoring system undue reliance is not given to any one agency's ratings. The service does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies
- Credit default swap spreads to give early warning of likely changes in credit rating
- Sovereign ratings to select counterparties from only the most creditworthy countries.

5.2 This modelling approach combines credit ratings, credit watches, credit outlooks and credit default swap spreads in a weighted scoring system for which the end product is a series of bands that indicate the relative creditworthiness of counterparties. These bands are used by the council to determine the duration time periods for investments and are therefore referred to as durational bands. The council is satisfied that this service now gives a much improved level of security for its investments. It is also a service that the council would not be able to replicate using in house resources.

5.3 All credit ratings are monitored weekly. The council is alerted immediately to changes to ratings of all three agencies through its use of the Capita creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the council's minimum criteria its further use as a new investment is withdrawn immediately.

5.4 Sole reliance is not placed on the use of this external service. The council also uses market data and market information, and information on government support for banks.

5.5 The council has determined that it will only use approved counterparties from the UK, and from other countries which have a sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

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[1] E.g Mayor's Office for Policing

6. External Fund Managers

6.1 The council's policy has been not to appoint external investment fund managers apart from for managing specific earmarked sums of money. The reason has been that the monies the council has for investing are primarily cash-flow derived, and are only available temporarily pending expenditure. However, the Assistant Director – Strategic Finance is authorised to review and appoint at the appropriate time external cash fund managers when of benefit to the council.

7. Investment Strategy - UK Institutions

7.1 Interest Rate Outlook**:** Bank Rate has stayed at 0.50% since March 2009. It is expected to stay at 0.50% until the middle of 2016 when it is projected to rise to 0.75%, and then reaching 1.00% by late 2016.

7.2 The council's in-house managed funds are mainly cash flow derived. Investments will accordingly be made with reference to the cash flow requirements and the outlook for short –term interest rates (i.e. rates for investments up to 24 months).

7.3 The council will make deposits to identified banks and building societies which meet the high creditworthiness criteria in Table 1 below.

Table 1: Creditworthiness Criteria

Type	**Minimum Rating**			**Definition**
	Fitch	**Moodys**	**S&P**	
Short term - Maturities of less than 1 year	F1	P-1	A-1	Highest credit quality. Indicates the strongest capability for timely payment of financial commitments.
Long term **-** Maturities up to 5 years	A	A2	A	High credit quality. Low credit risk; capacity for payment of financial commitments is considered strong but may be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
Viability **-** intrinsic safety and soundness on a stand- alone basis	a	C-		Adequate bank. Characteristics rated are profitability and balance sheet integrity, franchise, management, operating environment and prospects.
Support - presence of lender of last resort, either government or parent	1			Extremely high probability of external support.

Standard and Poors (S&P) only have short term and long term ratings; Fitch is the only agency that has a support rating

7.4 In addition the council will also make deposits to UK nationalised banks and banks receiving support from the UK Government, where the long term rating is lower than A and the viability rating is lower than a, but the support rating is 1. Royal Bank of Scotland and Lloyds Banking Group fall into this category.

7.5 The council will also make deposits to the Government's Debt Management Office, local authorities and AAA rated Money Market Funds.

7.6 To minimise risk a limit of £100m is set for investments over one year but less than two years. No investments are allowed for periods exceeding two years.

8. Investment Strategy - non UK Institutions

8.1 To give extra flexibility the authority has on its lending list a small number of foreign banks with very high credit ratings (as in Table 1 above), whose home countries have a AAA rating. They are banks based in Australia, Canada, Finland, Germany, Singapore and Sweden. They will only remain on the lending list as long as their home countries retain their AAA status and the banks retain their individual high ratings.

9. Approved List of Counter-Parties at 30 November 2013

9.1 The current lending list as at 30 November 2013 was discussed at Audit Committee on the 16 December 2013 and is attached at paragraph 9.4 below. The list is monitored by officers on a weekly basis. Daily emails are sent by Capita, enabling immediate action to be taken if a downgrading warning is issued. Changes to counterparty list and other relevant market activity are included in the regular monitoring reports to Cabinet.

9.2 The Assistant Director – Strategic Finance is delegated to monitor credit ratings and other market information and make additions, deletions and amendments to the Approved Lending List in the light of changing circumstances.

9.3 To minimise risk absolute limits are set for institutional categories.

- No limit is set for the Debt Management Office as this is backed by the UK Government.
- A limit of £100m per institution has been set for banks that are partially owned by the UK government i.e. Royal Bank of Scotland / National Westminster Bank and Lloyds Banking Group.
- Local authorities are underwritten by the local taxpayers, hence their risk of default is negligible. A limit of £30m is set for each local authority.
- A limit of £30m per institution has also been set for other appropriately rated banks.
- A limit of £20m has been set for individual AAA money market funds.

9.4 Approved list of Counter-Parties

a. No limit: - Debt Management Office

b. £100m limit
   - Royal Bank of Scotland/National Westminster Bank
     Lloyds TSB/Bank of Scotland

c. £30m limit
   - All local authorities

d. £30m limit
   - Banks and Building Societies
     - Barclays Bank
     - HSBC Bank
     - Nationwide Building Society
     - Santander UK
     - Standard Chartered Bank

   - Foreign Banks

- Australia	Australia and New Zealand Banking Group Commonwealth Bank of Australia
- Canada	Bank of Montreal Bank of Nova Scotia Canadian Imperial Bank of Commerce Royal Bank of Canada Toronto Dominion
- Finland	Nordea Bank Finland plc
- Germany	Deutsche Bank Landwirtschaftliche Rentenbank
- Singapore	Overseas Chinese Banking Corp United Overseas Bank DBS Bank
- Sweden	Nordea Bank AB Svenska Handelsbanken

e. £20m limit
   - Money Market Funds AAA
     - AIM STIC Global Sterling
     - Fidelity Institutional
     - HSBC Sterling Liquidity
     - Insight
     - Scottish Widows
     - IGNIS
     - Goldman Sachs
     - BNP Paribas
     - Federated Prime Rate
     - Legal and General