Treasury Management and Investment Strategy

The Devon Pension Fund has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. This is one of the Prudential Indicators required by the Code. The CIPFA code also requires the Pension Fund to approve a Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). A revised Code of Practice was published by CIPFA in November 2011 and a revised Policy Statement and TMPs were agreed by the Investment and Pension Fund Committee in February 2012. No changes are proposed to these policies for 2013/14.

This Treasury Management Strategy document sets out:

- The current treasury position and investments;
- Prospects for interest rates; and
- The investment strategy.

Schedule of Investments

The following schedule shows the Devon Pension Fund's fixed and variable rate investments as at 31 March 2012 and 12 February 2013 (current).

Table A – Schedule of Investments

		Maturing in:	Actual 31.03.12 £'m	Interest Rate %	Current 12.02.13 £'m	Interest Rate %
Fixed Rates						
	Term Deposits	< 365 days	99.78	1.53	37.00	2.79
		365 days & >	0.00		0.00	0.00
	Callable Deposits					
Variable Rate						
	Call & Notice Accounts		24.94	0.95	24.61	0.85
	Accounts linked to LIBOR Rates		0.00		0.00	
	Money Market Funds (MMFs)		0.00		0.00	
All Investments			**124.72**	**1.45**	**61.61**	**2.02**

The level of the Fund's cash investments has reduced significantly over the year, as a result of the allocation of an additional £20m per quarter to the Fund's Property mandate.

The recent investment performance of the Pension Fund's cash has been affected by two major factors:

- The world economy has been in a fragile state since the global banking sector crisis in 2008, and the current uncertainty looks set to continue for some time.
- Very low interest rates (as part of the measures used to alleviate the global credit crunch and as a tool by the Central Banks to prevent recession impacting on major world economies).

In response to the former the Pension Fund has continued to adopt a very prudent approach to counterparties to whom it is willing to lend. A number of UK banks have been removed from the counterparty list following downgradings of their credit ratings by the main credit rating agencies. Non-Eurozone overseas banks have been added to the counterparty list, but subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

The full effect of the second factor has now been seen in the rates being offered for new deposits in both the current year and going forward into 2013/14. The returns on the Pension Fund's cash investments are therefore forecast to remain at the current low levels.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. The factors affecting interest rate movements are clearly outside the Pension Fund's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors e.g. the market in Gilts.

The Pension Fund retains an external advisor, Sector, who forecast future rates several years forward. Similar information is received from a number of other sources. When setting targets for interest receipts a prudent approach has been adopted to ensure that, as far as is possible, the target rate will be achieved.

The following Table B sets out forecast interest rates over the next year. These surveys of industry practitioners point to the likelihood that the current very low short-term rates (lending) are likely to continue for the foreseeable future.

Table B – Base Rate Forecasts

Base Rate	Dec (act) 2012	March 2013	June 2013	Sep 2013	Dec 2013	March 2014
Sector	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%

PWLB Rates	Dec 2012	March 2013	June 2013	Sep 2013	Dec 2013	March 2014
Sector forecast						
5 Year	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%
25 Year	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%
50 Year	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%

Investment Strategy 2013/14 – 2015/16

The Pension Fund adopts a very prudent approach to its cash investments. Events since 2008/09 have proved the value of this approach. It must be borne in mind that as the current low interest environment is largely outside the Fund's control, this will impact on the interest receipts that can be achieved on the Fund's cash investments. The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The Investment and Pension Fund Committee is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Pension Fund's strategy continue to be to:

- Limit the risk to the loss of capital;

- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

Security is achieved by the creation of an 'Approved List of Counterparties'. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

Banks are expected to have a high credit rating. The Pension Fund uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Fund through its external Treasury Advisors – Sector. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. This rating also determines the maximum amount which can be loaned to an individual counterparty. Additionally, any bank in which the UK Government has in excess of a 30% shareholding will be considered to be a safer investment. Non-Eurozone overseas banks that meet the criteria are included from countries with a high Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council's external advisors (Sector).

Money Market Funds must have an 'AAA' rating, but are not currently being used.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The 'Approved List of Counterparties' specifies individual institutions, and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

Table C below summarises the current 'Approved List' criteria.

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Table C – Counterparty Approved List Summary

Counterparty Type		Fitch	Moody's	Standard & Poor's	Credit Limit
UK Banks with >30% UK Government ownership					
	not below	A- & F1	A3 & P-1	A- & A-1	£50 million
Other UK Banks					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Building Societies					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
Non-Eurozone Overseas Banks					
	Sovereign Rating of	AAA	Aaa	AAA	
	and not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	and not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Public Bodies					
Central Government					
	– Debt Management Office				Unlimited
Local Government					
	– County Councils				£10 million
	– Metropolitan Authorities				£10 million
	– London Boroughs				£10 million
	– English Unitaries				£10 million
	– Scottish Authorities				£10 million
	– English Districts				£5 million
	– Welsh Authorities				£5 million
Fire & Police Authorities					£5 million
Money Market Funds		AAA	Aaa	AAA	Not in use

The credit ratings shown in the table for UK banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes or may be general balances, and this will be a consideration in determining the period over which the investment will be made. In particular, funds will be managed to ensure their availability when required by the Committee to make new investments.

For the period 2013/14 – 2015/16 it has been assumed that the interest rate earned on short-term lending will be **1.0%** p.a. throughout the three years. The addition of overseas counterparties to the list has provided greater flexibility, but the rates offered by a number of banks have reduced over the last year. The target we have set is thought to be one that is achievable.

Borrowing Strategy 2013/14 – 2015/16

The Pension Fund will not normally need to undertake borrowing. There may, however, on an exceptional basis be a requirement for short term borrowing to aid cashflow. If short term borrowing is required, this will be targeted at an average rate of **1%**.