Appendix 1

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. These policies remain appropriate and no changes are proposed for 2015/16.

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 2014 and 31 December 2014 (current).

Table A – Schedule of Investments

	Maturing in:	Actual 31.03.14 £'m	Interest Rate %	Current 31.12.14 £'m	Interest Rate %
Fixed Rates					
Term Deposits	< 365 days	5.75	0.85	0.00	0.00
	365 days & >	0.00		0.00	0.00
Callable Deposits					
Variable Rate					
Call & Notice Accounts		29.22	0.65	35.26	0.49
Accounts linked to LIBOR Rates		0.00		0.00	
Money Market Funds (MMFs)		0.00		0.00	
All Investments		**34.97**	**0.68**	**35.26**	**0.49**

The recent investment performance of the Pension Fund's cash has been affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch. Interest rates have also been impacted by the introduction of new banking regulations requiring banks to hold higher levels of liquidity to act as a buffer.

The rates on offer during 2014/15 continue to be low and the returns on the Pension Fund's cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

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, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

UK interest rates have been held at their record historic low level of 0.5% since March 2009. In addition, Quantitative Easing measures to provide liquidity to markets remain in place and these may be added to by the European Central Bank in the near future. The introduction of new regulations requiring banks to hold a higher cash buffer has also had the effect of reducing the rates on offer.

A rise in the Bank of England Base Rate is thought likely during 2015, as a result of the improving economy, and the potential for stronger wage growth and higher inflation. However, most commentators are now not expecting a rise in the interest rate until the second half of 2015. Capita, who provide a treasury advisory service to the Pension Fund, have also amended their forecast and have pushed back their forecast for the first rise to December 2015.

The following Table B sets out interest rate forecasts over the next year. These surveys of industry practitioners reflect the view that rates will increase from the second half of 2015, but only in small increments.

Table B – Base Rate Forecasts

Base Rate	Dec (act) 2014	March 2015	June 2015	Sep 2015	Dec 2015	March 2016
Capita	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%
Legal & General Investment Management	0.50%	0.50%	-	-	0.75%	-
Bloomberg L.P. - Survey of Market Participants (median value)	0.50%	0.50%	-	-	1.25%	-

Investment Strategy 2015/16 – 2017/18

The Devon Pension Fund continues to adopt a very prudent approach to counterparties to whom the Fund is willing to lend. As a result only a small number of selected UK banks and building societies and Non-Eurozone overseas banks in highly rated countries are being used, 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 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.

A variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Pension Fund to invest, for example, in UK Government Gilts, bond funds and property funds. However, these alternative instruments would either require the Fund to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Fund's policy therefore is not to invest in these more risky and less liquid forms of investment.

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. 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 Fund's external advisors.

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, they are deemed to be 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 summarises the current 'Approved List' criteria.

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 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.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Council is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

Credit ratings are subject to change, and a review of implied Government support for banks within its jurisdiction may lead to downgrades across the banking sector. Should such an event occur and have a significant impact on the Pension Fund’s ability to implement its investment strategy then a report will be brought to Committee to consider any changes required to achieve the objective of our investment strategy going forwards.

For the period 2015/16 – 2017/18 it has been assumed that the interest rate earned on short-term lending will be **0.65%** p.a. throughout the three years. This will be reviewed in the light of changes to the Bank of England's base rate and any consequential improvement in the rates on offer. The inclusion of overseas counterparties provides additional flexibility, but the rates offered by some banks have reduced over the last year. The target we have set is thought to be one that is achievable.

Borrowing Strategy 2015/16 – 2017/18

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%**.