

## TREASURY MANAGEMENT STRATEGY 2018/19

### Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

**Recommendation:**        **That the Committee adopts the revised Treasury Management Practices as set out in Appendix 1 and the Treasury Management Strategy for 2018/19 as set out in Appendix 2.**

#### **1.        Introduction**

- 1.1        In February 2016 the Pension Fund, in accordance with the revised CIPFA Code of Practice for Treasury Management in the Public Services, adopted a revised Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). In December 2017, the Chartered Institute of Public Finance and Accountancy published a revised Code of Practice for Treasury Management. An amended version of the TMPs is therefore being brought to this Committee for consideration.
- 1.2        The policy requires the Investment and Pension Fund to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year.

#### **2.        Treasury Management Practices**

- 2.1        The revised Treasury Management Practices are shown in draft at Appendix 1. The TMPs set out the manner in which both Devon County Council and the Devon Pension Fund will seek to achieve their treasury management objectives and how they will manage and control those activities. In some cases they will not relate directly to the Pension Fund but for the most part they have been reported in their entirety.
- 2.2        They incorporate a number of minor changes to wording set out in the new Code of Practice, which strengthen some of the language in relation to risk management and prioritising the security of investments over liquidity and yield.
- 2.3        A key focus of the revised code is on the requirement to include in treasury management policies Council investments that are not part of treasury management activity. In the Pension Fund's case, there is clearly a much wider range of investments. However, the strategy for these investments is fully detailed in the Fund's Investment Strategy Statement, so it is not considered necessary to duplicate that within the Pension Fund's TMPs and treasury management strategy.
- 2.4        Another key change required by the new Treasury Management code is to set out the position in relation to the Markets in Financial Instruments Directive II (MiFID II) that came into effect on 3 January 2018. Under MiFID II all local

authorities are automatically classed as retail clients in relation to investments, which may restrict the availability of some types of investments used in treasury management. The Financial Conduct Authority have set rules under which local authorities and pension funds can “opt up” to elective professional client status, and the Investment and Pension Fund Committee has already resolved to opt up with the relevant institutions.

- 2.5 TMP4 sets out that the Council will seek elective professional client status where required, and will publish in its annual treasury management strategy those organisations with which it is registered as a professional client for the purposes of its treasury management activities.

### **3. Treasury Management and Investment Strategy**

- 3.1 The Treasury Management and Investment Strategy is shown in draft at Appendix 2. It sets out the current treasury position, cash investments, prospects for interest rates and the investment strategy.
- 3.2 The strategy is broadly consistent to that agreed for 2017/18. The target return for investments will remain at 0.40%, which is a lower target than the County Council, reflecting the fact that Pension Fund cash balances are kept at a low level with the main purpose being to provide the required level of liquidity, and would not therefore benefit from the higher rates on offer for longer term deposits.

### **3. Conclusion**

- 3.1 The Committee is asked to approve the adoption of the Treasury Management Strategy for 2018/19 as set out in Appendix 2.

Mary Davis

Electoral Divisions: All

Local Government Act 1972

List of Background Papers – Nil

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## **Treasury Management Code of Practice**

### **Clauses to be formally adopted by the Devon Pension Fund**

The Devon Pension Fund will create and maintain, as cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities; and
- suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The Pension Fund will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, quarterly updates and an annual report after its close, in the form prescribed in the TMPs.

The Investment and Pension Fund Committee will be responsible for the implementation and regular monitoring of its treasury management policies, and delegates responsibility for the execution and administration of treasury management decisions to the County Treasurer, who will act in accordance with the Pension Fund's policy statement and TMPs and if he/she is a CIPFA member, CIPFA's Standard of professional Practice on Treasury Management.

The Investment and Pension Fund Committee will be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## **Treasury Management Policy**

The Pension Fund defines its treasury management activities as: The management of the Fund's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance within those risks.

The Pension Fund regards the successful identification, monitoring and control of risk to be the prime criteria by which effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The Pension Fund acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The relevant Treasury Management Practices (TMPs) set out below will be applied to ensure that this Policy is delivered. The Fund will through the use of these practices ensure that security and liquidity are prioritised ahead of yield within the defined risk framework. For the sake of clarity the TMP's set out are those being adopted by Devon County Council and in some instances will cover areas of treasury management not relevant to the Pension Fund e.g. debt management policies.

## Treasury Management Practices

Treasury Management Practices (TMPs) set out the manner in which both Devon County Council and the Devon Pension Fund will seek to achieve its treasury management policies and objectives and how it will manage and control those activities. In some sections they will not relate directly to the Pension Fund but have been reported in their entirety.

### TMP1 Treasury Risk Management

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment.

The County Treasurer will ensure the design, implementation and monitoring of all arrangements for the identification, management and control of treasury management risk. She will report at least annually on their adequacy and suitability, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Council's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting requirements and management information arrangements.

In respect of each of the following risks, the arrangements, which seek to ensure compliance with these objectives, are set out.

#### Liquidity risk management

The Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available which are necessary for the achievement of its business and service objectives.

The daily cash flow is managed by officers in order to 'smooth' the flow of funds into and out of the Council, ensuring best returns on surplus funds, whilst minimising borrowing costs on days where there is a shortage. Short term borrowing and lending is generally undertaken in periods of under one month to ensure as far as is possible that on no one day should there be a requirement to have to fund shortages in excess of £1 million. Days when it is known that large outflows of money will take place e.g. payroll dates, are obvious dates to ensure there is sufficient liquidity.

Balances that are identified as not being for immediate use, say within the next few months, may be invested for longer periods.

#### Interest rate risk management

The Council will manage its exposure to fluctuations in interest rates with a view to containing its net interest costs, or achieving its interest revenues, as set out in the Revenue Budget.

It will achieve these objectives by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

The level of exposure to Interest Rate Risk depends on the balance of fixed to variable monies. Here the risk is twofold. Being locked in to fixed funding when rates are falling, or failing to take advantage at a time when rates are perceived as low, or are forecast to rise; conversely, being locked into investments when rates are rising, and being unable to take advantage of this situation.

The Council has had, for a number of years, the policy of borrowing the fixed rate long-term element of its loans portfolio with loans from the Public Works Loan Board (PWLb) or the Money Market. This policy is reassessed annually as part of the adoption of the Treasury Policy Statement.

Interest Rate Risk is not increased by this policy as it is still possible to manage by switching existing loans from fixed to variable or vice versa, or re-scheduling existing debt, i.e. repaying existing debt, and re-borrowing over a shorter, or perhaps longer period. However, the existing arrangements operated by the Board of different rates for repaying loans as to those applied to new advances, mean that such changes are often uneconomic. Regard must always be had of the potential costs of any re-scheduling, as often they will attract a premium payable to the lender. This point is also referred to later under 'Re-financing Risk.'

Market Loans, usually in the form of Lender's Option Borrower's Option (LOBOs), offer an alternative to borrowing from the PWLB. Here money is borrowed for an initial period against the issue of a Bond, and gives the Lender the Option of varying the rate at the end of the period. If this Option is taken, the Council as Borrower can in turn agree to the new rate, or repay the loan without penalty. The flexibility offered by such loans can be a great help in managing this type of risk. The lender, who has the choice to (or not to) exercise the first option, has to be seen as having the greater control of the arrangement.

On the investment side, the use of Call Accounts, Notice Money, Money Market Funds, and Callable Deposits all introduce a degree of flexibility not offered by fixed term investments.

The CIPFA Code requires that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs. Derivatives are securities whose price is dependent upon or derived from one or more underlying assets, the most common being stocks, bonds, commodities, currencies, interest rates and market indexes. They can be used to hedge (provide insurance) against risk or for speculative purposes; however it is the Council's policy not to use derivatives in its treasury management activities.

### **Exchange rate risk management**

The Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

It will achieve this objective by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of exchange rates. The above is subject at all times to the consideration and, if required, Council approval of any policy or budgetary implications.

The risk from fluctuating exchange rates is not material as far as the Council is concerned, as there is currently very little of either income or expenditure transacted in currencies other than Sterling.

### **Inflation risk management**

The Council will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation's inflation exposures. During the current period of low and stable inflation, there is little requirement for active consideration of its impact. The key objectives are that investments reap the highest real rate of return, with debt costing the lowest real cost. Should this change, projections of inflation will become part of the debt and investment decision-making criteria, both strategic and operational.

### **Credit and counterparty risk management**

The Council regards a prime objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 'Approved Instruments, methods and techniques'. It also

recognises the need to have, and maintain, a formal counterparty policy in respect of those organisations with whom it may enter into financing arrangements.

The County Council's arrangements have been formulated to restrict the exposure to risk by taking account of the credit standing of counterparties, and setting limits to different types of borrowers.

The credit ratings of all three major rating agencies (Fitch, Moody's and Standard & Poor's ) will be used to ensure that commercial institutions satisfy the requirements of the current policy. In essence the County looks for the highest rating from banks and sets lending limits against each one. Banks and UK Building Societies that do not attract these ratings are not considered at all. The actual ratings sought by the Council may be varied as part of the regular review of lending policy and counterparties.

Lending to other Local Authorities, and Public Bodies is allowed, with differing credit limits according to the type of institution.

The List of Approved Counterparties is kept under close review and is subject to amendment in the light of changes to credit ratings, takeovers and mergers, or changes to the type of institution.

Approved institutions are placed on the lending list, deposits may not be made to any institution, which does not conform to the requirements of the Lending List, nor is any transaction allowed to be entered into through any money broker not featuring on the approved list. The financial press and other sources are monitored with a view to discovering cases where an institution on the List is in any difficulty, financial or otherwise. If appropriate, any organisation will be immediately suspended from the list until such time that they demonstrate their creditworthiness. The decision to suspend a counterparty is made by the Assistant County Treasurer (Investments and Treasury Management), and notified to other officers by the issue of a revised Approved List.

Funds available to the County for investment are substantial, and the current lending policies ensure a balance of there being no difficulty placing funds, whilst at the same time the credit risk is minimised.

### **Refinancing risk management**

The Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised is managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid over-reliance on any one source of funding if this might jeopardise its achievement.

External long term funding is arranged by the Treasury staff in accordance with the Treasury Strategy, which is adopted by the Council's members before the start of each financial year. All borrowings are with either the Public Works Loan Board or a major bank as lender.

Loans are offered by the Board over periods of one to fifty years and can be either at fixed or variable rates. There are also three methods of repaying loans; Maturity, by Equal Instalments of Principal (EIP), or as Annuity loans. The Council currently uses only the first type, and pays interest half-yearly in September and March.

PWLB loans are fairly flexible; variable loans can be converted to fixed loans and vice versa, debt can be re-scheduled over different periods. Re-scheduling existing fixed rate debt however introduces an element of refinancing risk, which is increased in re-scheduling loans with long maturity profiles. The penalty (or premium) payable is dependent on the relationship between the loan rate and the current repayment rate for loans of a period equal to the unexpired term. As PWLB rates are reviewed daily, the timing of the rescheduling exercise is important if the costs of any penalties are not to cause problems to budgeted expenditure levels.

### **Legal and regulatory risk management**

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 'credit and counterparty risk management', it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.

Council officers carry out their duties with reference to Local Government Acts and Regulations, and in accordance with the Council's Treasury Management Policy.

In framing the Lending List, reference is made to official circulars from the Bank of England and to Credit Agency reports in order to vet potential counterparties. In return, the Council, if requested, will provide to those institutions, documentation to support the Council's and Council Officer's powers to enter into any transaction. Annual Accounts, Treasury Management Strategy Statements, and Schemes of Delegation are exchanged with counterparties.

Under no circumstances are officers involved in cash management allowed to borrow or lend for the purpose of generating surpluses from speculative money market dealings.

### **Fraud, error and corruption, and contingency management**

The Council will ensure that it has identified the circumstances that may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures to reduce exposure to these risks, in addition to providing effective contingency management arrangements.

Systems and procedures are in place to ensure that all money market deals are documented and authorised.

Proprietary systems are used to record money market transactions (Logotech Treasury Management), and to process transactions (Barclays.net). Both of these systems are operated with a clear division of duties between personnel involved in data entry, checking, and authorisation of transactions. Both systems are accessed only through a system of passwords. Reports and records from the systems also allow independent checks by others, for example Internal Audit, on the accuracy and completeness of all transactions, and to verify that they were made in accordance with agreed policy.

A summary of each day's activity is kept which shows the opening bank balances, and record of individual receipts and payments to be transacted during the day. This allows a forecast to be made of the end of day balance, and from this, the requirement to either borrow or lend funds.

Generally, if the forecast closing balance is less than £100,000 overdrawn, it is not economic to borrow at rates just marginally below the rate payable by having an overdrawn balance. The transaction costs, and the cost of brokerage, will more than outweigh any saving of interest.



## **Appendix 1**

A forecast credit balance of anything below £250,000 will not be offered to the 'market', but will be simply kept with Barclays Bank.

All borrowing is conducted via money brokers, and every effort is made to ensure that no one broker is given a disproportionate amount of business.

Lending can be arranged either direct with counterparties, or via a broker (as lending does not attract brokerage). It is clearly important to show that the interest rate for deposits made was competitive, and so a record is kept of rates available from other potential borrowers on the day.

Deals are entered into the Logotech system, and reports produced from it confirming the details entered, and a current list of all outstanding borrowing and lending. The Barclays.net system is used to electronically transfer funds where deposits have been agreed, or where borrowings are to be repaid. Hard copy confirmation reports of data input to Barclays.net are created, and together with the Logotech reports and the Summary Sheet are passed to another section for checking and validation.

Authorisation to release electronic payments is restricted to a small number of senior officers, each of whom has been allocated a unique sign in.

Arrangements are in place to ensure that the roles of creator, validation and authoriser are covered for holidays and other absences.

Officers responsible for cash management follow the recommended procedures set out in the London Code of Conduct. This code requires that:

- Officers should not disclose or discuss, or press others to disclose or discuss, any information relating to specific deals transacted without permission from the relevant counterparty or broker;
- Visits to or from brokers should not be organised without the express permission of a senior officer. Any hospitality received must be declared and recorded;
- All deals must be concluded in the Investment Team Office;
- The dealer must bear in mind that in accepting a firm price, they are committing the Council to dealing at that rate. If a dealer wishes merely an indicative price, this must be made clear; and
- Brokers must be supplied with a copy of the Council's current approved Counterparty Lending List.

### **Price risk management**

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

The majority of lending is in the form of cash deposits. However a proportion of the Council's funds may be invested in alternative forms of investment where the capital value may fluctuate. These will be managed in such a way as to minimise the risk of financial loss.

### **Commercial investments**

The Pension Fund has significant investments outside the scope of its treasury management activity. These investments are governed by the policies set out in the Fund's statutory Investment Strategy Statement.

### **TMP2 Performance Measurement**

The Council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the Council's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, and of the scope for other potential improvements.

The review of treasury management decisions is carried out at regular officer meetings held to discuss treasury matters. This forum reviews past actions as well as considering the period ahead.

The minutes of these meetings are made available to External Audit as part of their Annual Audit, and to Internal Audit should they be required.

Performance is measured against agreed benchmarks.

Long term debt is judged in terms of average rate of all external debt, and comparisons made with previous years.

Investment earnings are measured against published benchmarks, including Base Rate and the London Interbank Seven Day Rate (Libid).

Data is submitted to CIPFA for inclusion in its annual Treasury Management and Debt Management Statistics, which allow comparison with others. These comparative statistics will be used to monitor performance.

At present the Council has no plans to appoint external cash fund managers. It is not felt that the cost of such an appointment is likely to be covered by any marginal return over what is currently being achieved internally. However, this matter needs to be reviewed from time to time, and records are kept of the performance of a number of fund managers.

### **TMP3 Decision-Making and Analysis**

The Council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

In respect of every decision made, Devon County Council's Treasury staff will have certainty about the legality of the transaction, and be content that the transaction helps deliver the organisation's objectives as set out in the Strategy Statement.

Third parties will have been checked to ensure their credit worthiness and to ensure that limits have not been exceeded. Rates will be fully checked against the market to ensure they are competitive.

With particular regard to borrowing, market and economic factors will influence the timing of any funding, the most appropriate period, and the repayment profile.

Similarly, before investing, account will be taken of the existing cash flow, and market conditions, before fixing the optimum period.

The Council employs Treasury Management Advisors, who are able to ensure that the officers are informed of any potential changes that may affect treasury decisions.

Records are kept not only of all transactions, but also of all documents that were a part of reaching the decision. For example, when investing, bids will be obtained from a number of banks, and a record kept of these to demonstrate that the one taken was competitive.

## **TMP4 Approved Instruments, Methods and Techniques**

The Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed, and within the limits defined in 'TMP1, Risk Management'.

The following are approved activities performed by Devon County Council:

- Borrowing;
- Lending;
- Debt repayment and rescheduling;
- Consideration, approval and use of new financial instruments and treasury management techniques;
- Managing the underlying risk associated with capital financing and surplus funds; and
- Managing cash flow.

The Council's policy is not to use derivatives in its treasury management.

There are a number of ways of raising external capital finance, which are set out in Local Government Acts, but the Council has only used two of these, borrowing from the Public Works Loan Board, and from banks, in the form of LOBOs (see TMP 1 Treasury Risk Management – Interest Rate Risk for more information).

The County Treasurer considers these the most appropriate form of borrowing, but alternatives to these, which are allowed to Local Authorities, may well be considered in the future.

(Increasingly, there are other potential sources for the funding of capital projects, e.g. Private Finance arrangements, or the use of leasing, but they are not considered here).

The majority of lending is in the form of cash deposits. However a proportion of the Council's funds may be invested in alternative forms of investment where the capital value may fluctuate. These will be managed in such a way as to minimise the risk of financial loss. The potential list of alternative forms of investment includes UK Government Gilts, bond funds and property funds, but only those specified within the annual Treasury Management Strategy shall be permitted.

The Council has reviewed its classification with financial institutions under MIFID II and will seek elective professional client status where required in order to access the investment opportunity sets set out in its treasury management policies and strategy. The Council will set out in its annual treasury management strategy those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

## **TMP5 Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements**

The Council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, and for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principles on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

## **Appendix 1**

If and when the Council intends to depart from these principles, the County Treasurer will ensure that the reasons are properly reported in accordance with TMP6 Reporting requirements, and the implications properly considered and evaluated.

The County Treasurer will fulfil all such responsibilities in accordance with the Council's policy statement and TMPs and, as a CIPFA member, the Standard of Professional Practice on treasury management. She will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangement for absence cover.

The responsible officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

There are a number of bodies and individuals with responsibilities in this area.

### **Councillors**

Members will receive reports on treasury management policies, practices and activities, including audit reports. As a minimum, each year, Council will have to consider:

- The Treasury Strategy Report, setting out the strategy and plans to be followed in the coming year. This report is part of the Budget process;
- A Mid-Year Monitoring Report; and
- An Annual Treasury Management Stewardship Report on the performance of the Treasury Management function, and highlighting any areas of non-compliance with agreed policy.

(The content of these three reports are more fully explained in TMP 6 'Reporting Arrangements'.)

Members are required to approve any amendments to the organisation's adopted Treasury Management Policy Statement, and the selection of external service providers, including agreeing terms of appointment.

### **The County Treasurer**

The County Treasurer is responsible for recommending (changes to) Treasury Management Policies to Members for approval, and for ensuring they receive as a minimum, the three annual reports referred to above. The County Treasurer will ensure that Treasury Policies are adhered to, and if not will bring the matter to the attention of elected members as soon as possible.

The County Treasurer will receive reports from the Treasury Team, both Internal and External Audit, and from other sources regarding performance. It is the responsibility of the County Treasurer to consider such reports, and any recommendations arising from them.

Prior to entering into any long term borrowing, lending or investment transaction, it is the responsibility of the County Treasurer to be satisfied, by reference to the Investment Team that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations.

The County Treasurer has delegated powers to take the most appropriate form of borrowing from the approved sources, and to take the most appropriate form of investments in approved instruments. In practice these powers are in turn delegated to the Investment Team.

### **The Assistant County Treasurer – Investments and Treasury Management**

The Assistant County Treasurer needs to ensure the adequacy of treasury management resources and skills, the effective division of responsibilities within the treasury management function, and that all transactions are authorised in accordance with the financial regulations of the Council.

### **The Treasury Management Team**

The Treasury management Team are responsible for optimising the Council's investment returns commensurate with minimum risk, and in accordance with agreed policy and strategy.

Nominated team members are responsible for the execution of transactions, and for ensuring that they are documented in accordance with agreed practice.

In performing their roles they need to be aware of maintaining relationships with third parties and external service providers, which may well lead to identifying and recommending opportunities for improved practice.

Reports, both verbal and written are required to be made to the County Treasurer and the Assistant County Treasurer.

### **Internal Audit**

The responsibilities of Internal Audit include ensuring compliance with approved policy and procedures, reviewing division of duties and operational practice, assessing value for money from treasury activities, and undertaking probity audit of the treasury function.

### **TMP6 Reporting Requirements and Management Information Arrangements**

The Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and the transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

Before the start of each financial year, the Council must adopt the Treasury Management Strategy. The Strategy sets out the expected treasury activities for the forthcoming year, and is concerned with:

- The prospects for future interest rates;
- The expected strategy with regard to borrowing and temporary investments (including the appointment of external managers); and
- Policies regarding debt redemption and rescheduling.

A mid-year monitoring report will bring Members up to date with actions taken. This will draw on the regular meetings which the County Treasurer has with the Assistant County Treasurer (Investments and Treasury Management) and Treasury staff to consider activity to date, and to discuss particular aspects of treasury management activity.

An annual Treasury Management Stewardship Report will be presented to the Corporate Services Scrutiny Committee, and then to the Cabinet at the end of the financial year. The Treasury Management report includes:

- A comprehensive picture for the financial year of all treasury policies, plans, activities and results;
- Details of transactions executed and their revenue (current) effects;
- A report on risk implications of decisions taken;
- Monitoring of compliance with approved policy, practices and statutory/regulatory requirements;
- Monitoring of compliance with powers delegated to officers;
- The degree of compliance with the original strategy and explanation of deviations;

- An explanation of future impact of decisions taken on the organisation;
- Measurements of performance; and
- A report on compliance with CIPFA Code recommendations.

### **TMP7 Budgeting, Accounting and Audit Arrangements**

The County Treasurer will prepare, and the Council will approve and, if necessary, from time to time amend, an annual budget for treasury management. This will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at a minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 'Risk Management', TMP2 'Performance Measurement', and TMP4 'Approved Instruments, Methods and Techniques'.

The Treasury Management Budget or supporting papers will identify

- Staffing numbers and related costs, together with on-costs;
- Interest and other investment income;
- Debt and other financing costs;
- Bank and overdraft charges;
- Brokerage, commissions and other transaction-related costs; and
- External advisors' and consultants' charges.

The County Treasurer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 'Reporting Requirements and Management Information Arrangements'.

The Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

The Council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.

### **TMP8 Cash and Cash Flow Management**

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this organisation will be under the control of the County Treasurer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Assistant County Treasurer (Investments and Treasury Management) will ensure that these are adequate for the purposes of monitoring compliance with TMP1 regarding Liquidity Risk Management.

A Cash Flow Report is produced at the start of each financial year, based upon information contained in the published Capital and Revenue Budgets.

Items of income and expenditure are examined and in discussion with finance staff from the different services, a time dimension is attached to the flows of cash.

All of the cash flow data is then entered into the Logotech Treasury Management System, which also contains information relating to all of the Council's treasury transactions, both lending and borrowing.

Actual receipts and payments are monitored against the forecast, and regular discussions are held with services staff who are likely to be able to explain the variations. The forecast is updated in the light of them

Cash flow is discussed at weekly meetings of the Treasury Team, and is used in determining investment strategy.

### **TMP9 Money Laundering**

The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures to minimise the risk of any such event occurring, and for verifying and recording the identity of counterparties and reporting suspicions. It will also ensure that staff involved in treasury transactions are properly trained.

The source of all monies received by the Council is required to be identified. Major unbudgeted income or receipts which had not been forecasted are investigated.

The County Council does not accept loans from individuals. All loans are obtained from the Public Works Loan Board or from authorised institutions under the Banking Act 1987. The names of these institutions formerly appeared on the Bank of England's quarterly list of authorised institutions, but in December 2001, the Financial Services Authority (FSA) took over many of the Bank's responsibilities in this area. In April 2013 the FSA was split up and responsibility passed to the Financial Conduct Authority and it is now responsible for maintaining the register.

### **TMP10 Staff Training and Qualifications**

The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to ensure that individuals involved, whether in-house or out-sourced, are both capable and experienced and provided with training to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

Career development and planning for succession are similarly the responsibility of the Departmental Management. Qualifications that are required for all treasury posts are contained in their job descriptions.

The Council's County Treasurer, as a member of CIPFA is committed to her professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.

She personally, and through her management team, accepts that these matters are ones that should be regularly assessed to ensure compliance.

### **TMP11 Use of External Service Providers**

The Council recognises the potential value of employing external providers of treasury management services, in order to acquire access to specialist skills and resources.

If and when it employs such service providers, it will ensure it does so for reasons, which will have been submitted to full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Where feasible, a spread of service providers will be used, to avoid over-reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The Council will be mindful of the requirements of the Bribery Act 2010 in their dealings with external providers. The monitoring of such arrangements rests with the County Treasurer.

## **TMP12 Corporate Governance**

The Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

The Council has adopted and has implemented the key recommendations of the Code. This, together with the other arrangements detailed in this document, are considered vital to the achievement of proper corporate governance in treasury management, and the County Treasurer will monitor and, if necessary, report upon the effectiveness of these arrangements.



# Treasury Management Strategy 2018/19

## Introduction

The Treasury Management Strategy sets out the Devon County Council Pension Fund's policies in relation to: the management of the Fund's cashflows, its banking, money market and capital market transactions and investment strategies.

The Pension Fund has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2017, and requires the Pension Fund to approve a Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). These policies have been reviewed for 2018/19 in the light of the revised code and revised TMPs have been submitted for approval. This Treasury Management Strategy document sets out:

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

## Schedule of Investments

The following schedule shows the Pension Fund's fixed and variable rate investments as at 31 March 2017 and as at 31 December 2017 (current).

**Table A – Schedule of Investments**

|   |              | Actual<br>31.03.17<br>£'m | Interest<br>Rate<br>% | Current<br>31.12.17<br>£'m | Interest Rate<br>% |
|---|--------------|---------------------------|-----------------------|----------------------------|--------------------|
| <b>Bank and Building Society Deposits</b> |              |                           |                       |                            |                    |
| <b>Fixed Rates</b>                        |              |                           |                       |                            |                    |
| Term Deposits                             | < 365 days   | 30.00                     | 0.55                  | 0.00                       |                    |
|   | 365 days & > | 0.00                      |                       | 0.00                       |                    |
| Callable Deposits                         |              |                           |                       |                            |                    |
| <b>Variable Rate</b>                      |              |                           |                       |                            |                    |
| Call & Notice Accounts                    |              |                           |                       |                            |                    |
|   |              | 10.00                     | 0.80                  | 0.00                       |                    |
| Money Market Funds (MMFs)                 |              |                           |                       |                            |                    |
|   |              | 10.12                     | 0.29                  | 45.82                      | 0.30               |
| <b>All Investments</b>                    |              | <b>50.12</b>              | <b>0.55</b>           | <b>45.82</b>               | <b>0.30</b>        |

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 continue to be low and the returns on the Pension Fund's cash investments are forecast to remain at 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 Council's control. Whilst short term rates are influenced by the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. Rates from overseas banks will be influenced by their national economic circumstances. The County Council retains an external advisor, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

At the beginning of November 2017, the Bank of England Monetary Policy Committee decided to remove the post EU referendum emergency monetary stimulus implemented in August 2016 and restore the Base Rate to 0.5%. At the same time, they also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020.

Economic forecasting remains difficult with so many external influences weighing on the UK. Bank rate forecasts will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e. equities, or the "safe haven" of government bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. A world economic recovery will likely see investors switching from the safe haven of bonds to equities. However, the outlook remains extremely uncertain. Risks to the downside include:

- Continuing uncertainty as a result of Brexit.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Rising protectionism under President Trump.
- A sharp Chinese downturn and its impact on emerging market countries.

The following Table 11 sets out interest rate forecasts over the next year. The forecasts from Capita and Capital Economics reflect the view that the Bank of England will increase the base rate by at least another 0.25% over the next financial year, but significant uncertainty remains. The longer-term rates available from the Public Works Loan Board (PWLB) are forecast to increase marginally over the period.

**Table B – Base Rate Forecasts and PWLB Rates**

|                   | Dec (act)<br>2017 | March<br>2018 | June<br>2018 | Sep<br>2018 | Dec<br>2018 | March<br>2019 |
|-------------------|-------------------|---------------|--------------|-------------|-------------|---------------|
| <b>Base Rate</b>  |                   |               |              |             |             |               |
| Capita            | 0.50%             | 0.50%         | 0.50%        | 0.50%       | 0.75%       | 0.75%         |
| Capital Economics | 0.50%             | 0.50%         | 0.75%        | 1.00%       | 1.25%       | 1.25%         |

### Investment Strategy 2018/19 – 2020/21

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, money market funds 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.**

The outlook for cash investment remains challenging. Whereas in the past there has been a perception that Governments would not allow banks to fail, the current regulatory environment puts more emphasis on the requirement for investors to take a hit by funding a "bail-in". A bail-in is where the bank's creditors, including local authorities depositing money with them, bear some of the burden by having part of the debt they are owed written off. The balance of risk has therefore changed, and as a result the Council has considered alternative forms of investment in order to diversify its risk.

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are now classed as retail clients by the Financial Conduct Authority (FCA). This has implications for the range of investments that are available to local authorities. While bank and building society deposits are unaffected by the new regulations, some banks have determined that they will only take term deposits from professional clients, and a range of alternative forms of investments are only available to professional clients. However, if the local authority meets criteria set by the FCA, then it can apply to the financial institutions with which it wishes to invest to request that the institution concerned "opts up" the local authority to elective professional client status. The Pension Fund has made applications and been opted up to elective professional client status where required.

Subject to the MiFID II regulations, 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 through its treasury management strategy, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Pension 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.

## Appendix 2

The Pension Fund has considered these alternatives but, given the wider investments of the Fund and the need for liquidity with respect to the Fund's cash, has concluded that these less liquid forms of investment should not form part of the Fund's treasury management strategy.

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 Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Council 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. Where the counterparty is only rated by two of the major ratings agencies the lowest rating published by either of the two is used. This rating also determines the maximum amount which can be loaned to an individual counterparty. 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.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Following the financial crisis these funds were seen as higher risk and were therefore not used by the Council. However, the new regulatory environment around the concept of "bail-in" means that many money market funds are now regarded as a more secure form of investment than bank deposits, as they diversify their investments across a range of financial institutions to spread the risk, and will therefore be used where appropriate. Money market funds must have an 'AAA' rating to be included on the counterparty list.

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. Those counterparties who have confirmed that they will treat the Council as a professional client under the MiFID II regulations are set out in Table C below.

**Table C – Counterparties that have “opted up” the Council to elective professional client status**

| Counterparty  | Counterparty Type |
|---------------|-------------------|
| Blackrock     | Money Market Fund |
| Standard Life | Money Market Fund |
| Insight       | Money Market Fund |

## Appendix 2

In addition, brokers Tradition and Tullett Prebon, and our treasury advisors, Capita, have opted up the Council to professional client status. The majority of bank and building society deposits are unaffected by the MiFID II regulations. This list only includes those counterparties relevant to the Pension Fund's treasury management strategy and the management of cash. The Pension Fund has also opted up to elective professional client status with the external investment managers it uses as part of its wider investment strategy.

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

**Table D – Counterparty Approved List Summary**

| Counterparty Type                    |                            | Fitch     | Moody's   | Standard & Poor's | Credit Limit |
|--------------------------------------|----------------------------|-----------|-----------|-------------------|--------------|
| <b>Other UK Banks</b>                |                            |           |           |                   |              |
|                                      | not below                  | AA- & F1+ | Aa3 & P-1 | AA- & A-1+        | £50 million  |
|                                      | not below                  | A- & F1   | A3 & P-1  | A- & A-1          | £30 million  |
| <b>UK Building Societies</b>         |                            |           |           |                   |              |
|                                      | not below                  | AA- & F1+ | Aa3 & P-1 | AA- & A-1+        | £50 million  |
|                                      | not below                  | A- & F1   | A3 & P-1  | A- & A-1          | £30 million  |
| <b>Non-Eurozone Overseas Banks</b>   |                            |           |           |                   |              |
|                                      | 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  |
| <b>UK Public Bodies</b>              |                            |           |           |                   |              |
| <b>Central Government</b>            |                            |           |           |                   |              |
|                                      | – Debt Management Office   |           |           |                   | Unlimited    |
| <b>Local Government</b>              |                            |           |           |                   |              |
|                                      | – 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   |
| <b>Fire &amp; Police Authorities</b> |                            |           |           |                   | £5 million   |
| <b>Money Market Funds</b>            |                            | AAA       | Aaa       | AAA               | £30 million  |

Where the short term rating of a counterparty is one notch below the stated criteria, but the counterparty meets the long term rating criteria, they may still be used subject to the advice of our external advisors (Capita) who will take into account a range of other metrics in arriving at their advice.

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, and this will be a consideration in determining the period over which the investment will be made.

## Appendix 2

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

For the 2018/19 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **0.40%**. This reflects the lower levels of cash maintained by the Pension Fund and the requirement for liquidity, which reduces the opportunity to make longer term deposits. The target we have set for 2018/19 is thought to be one that is achievable.

### **Borrowing Strategy 2018/19 – 2020/21**

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 **0.4%**.