Pension Panel

28 January 2019

Pension Fund Policy Documents : Treasury Management Report

Report by Director of Finance, Performance and Procurement

Executive Summary
The Director of Finance, Performance and Procurement recommends a continuation of the current treasury management strategy in 2019/20, with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds.
The strategy is recommended on the assumption of an agreement being reached between the UK and the European Union (EU) in accordance with the original Brexit timetable. The investment strategy contained within the attached report may therefore need to be revisited if such Brexit assumptions do not materialise.

Recommendations

1. The Panel approves the 2019/20 Treasury Management Strategy as set out in Appendix A.

2. The Panel notes the treasury activity undertaken during 2018/19 (1 April to 31 December 2018).

Background

1. The CIPFA "Treasury Management Code of Practice" requires the West Sussex Pension Fund to determine a treasury management strategy on an annual basis regarding the investment of its internally managed cash balances. The strategy includes the "Annual Investment Strategy" (AIS) that is a requirement of the Ministry of Housing, Communities and Local Government's (MHCLG) "Investment Guidance".

2. The CIPFA Code also requires regular reports detailing compliance and performance against approved treasury strategies to be reviewed by the Pension Panel.

3. With regard to internally managed cash, the purpose of this report is to:
   - Approve the 2019/20 Treasury Management Strategy.
   - Review compliance against treasury strategies and performance of treasury activity undertaken during the period 1 April 2018 to 31 December 2018.

Economic Summary (including Brexit)

4. During 2018 the overall balance of risks to the UK economy was neutral, based on a reasonably orderly Brexit through to the end of the original two-year negotiation period (March 2019) and the following transitional period ending around December 2020. The flow of generally positive UK economic data after the quarter ending 30 June 2018 meant however that it came as no surprise that the Bank of England's Monetary Policy Committee (MPC) came to a decision in August 2018 to make the first increase in UK Bank Rate above 0.5% since the financial crash (to 0.75%). UK Growth whilst remaining healthy since that meeting was expected to weaken somewhat during the last quarter of 2018. At their November 2018 meeting the MPC therefore left the Bank Rate unchanged but expressed some concerns regarding the build-up of future inflationary pressures that potentially could result in further increases to the Bank Rate in 2019.

5. Against this economic backdrop the Council's treasury management advisor (Link Asset Services) do not consider that the MPC will increase Bank Rate in February 2019 ahead of the March deadline for Brexit, but forecast the Bank Rate to average around 1.00% during 2019/20; a consequence of two 0.25% rate increase during the period. However, the pace of any rate increase in 2019/20 is dependent on a reasonably orderly Brexit on 29 March 2019. The risks of a no-deal Brexit, or conversely a compromise agreement that removes all threats of economic and political disruption, may materially change forecasts (in either direction) for the path of the UK Bank Rate (and corresponding short-term investment rates). For example, in the event of an orderly non-agreement exit it is likely the Bank of England would take action to cut the UK Bank Rate from 0.75% in order to help economic growth deal with the adverse effect of this situation.

6. The Director of Finance, Performance and Procurement will keep under review the risks arising from various Brexit outcomes; including a negotiated deal by 29 March 2019, an extension to Article 50, or a no-deal scenario. In addition to differing economic and interest rate forecasts (for each scenario) and credit risks relating to approved counterparties (for example a UK sovereign downgrade following a no-deal Brexit would negatively impact UK banks), there are potential liquidity risks that on the date the UK leaves the European Union the Pension Fund is temporarily (or for an extended period in a no-deal scenario) unable to access funds invested with short-term Money Market Funds that operate in a non-UK jurisdiction.

7. Dependent on how the UK exits from the EU, the Director of Finance, Performance and Procurement may approve a temporary increase to monetary limits for UK banks (in addition to the Pension Fund's main provider of banking services; Lloyds Bank plc) and UK-domiciled short-term Money Market Funds to ensure effective cash flow management and liquidity arrangements on the Brexit leave date (and any immediate transitional period thereafter) is maintained. Additionally, legislative changes to short-term Money Market Funds domiciled outside of the UK are under review to ensure that such funds continue to remain appropriate for Pension Fund investment after Brexit.

Treasury Management Strategy (2019/20)

8. The Director of Finance, Performance and Procurement recommends a continuation of the current treasury management strategy in 2019/20 *(as originally approved by the Pension Panel at their February 2018 meeting with no subsequent amendments)* with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds. Given the strategy of maintaining a highly liquid investment portfolio held exclusively in bank unsecured deposits, the Pension Fund's internally managed cash will remain subject to bail-in risks under UK Banking Directives.

9. Dependant on levels of internally managed cash balances, the Director of Finance, Performance and Procurement will give consideration to passing surplus cash over to the Pension Fund's external fund managers (Baillie Gifford and UBS). Such approval will be made given the expected timing of any large payments out of the fund, including the purchase of any new investment properties as agreed by the Pension Fund's property managers (Aberdeen Asset Management).

10. The recommended 2019/20 Treasury Management Strategy is attached at Appendix A. Note that a key changed compared with last year's strategy is UK Banks that offer instant access accounts only has reduced the number of approved institutions. This is highlighted as a change in the Strategy, with Goldman Sachs, HSBC and Nationwide therefore no longer on the list of institutions as they were in 2018.

Treasury Management Performance (2018/19)

11. At 31 December 2018 the Pension Fund's internally managed cash, including balances held in EUR/USD bank accounts, amounted to £44.5m (£35.8m at 31 March 2018). During 2018/19 (to 31 December) the Pension Fund had an average internally managed investment balance, excluding foreign currency, of £49.4m (£49.2m for 2017/18; to 31 December 2017). Throughout the period investments were held in a Lloyd's interest earning current account and a series of short-term (AAA credit rated) Money Market Funds.

12. The Director of Finance, Performance and Procurement confirms that there were no breaches of the approved 2018/19 Treasury Management Strategy regarding internally managed cash during the period 1 April 2018 to 31 December 2018. The Director of Finance, Performance and Procurement further confirms that in addition to balances held for investment, foreign currency (EUR/USD) balances were held in attempting to achieve the most beneficial rates when exchanging back into Sterling.

13. At 31 December 2018 the total amount of foreign currency held was valued in GBP at £1.7m (based on 31 December exchange rates as provided by BNP Paribas):

	Balance at 31/12/18	**Average Balance**
Lloyds - Euro Account	€0.747m	€1.087m
Lloyds - US Dollar Account	$1.352m	$7.340m

14. In accordance with the investment strategy approved in February 2018 the Pension Fund received interest totalling £0.33m during the period 1 April 2018 to 31 December 2018 *(£0.09m for 2017/18; to 31 December 2017)*. The rate of return achieved on GBP balances held during the period was 0.59% *(0.23% during the same period in 2017/18)* reflecting the low interest rates applicable on instant access GBP investments.

	Average Balance £'m	**Interest Received £'m**	**Rate of Return %**
Lloyds-Current Account (GBP)	10.4	0.05	0.63
Short-Term Money Market Funds	39.0	0.17	0.58
Total (GBP)	**49.4**	**0.22**	**0.59**
Lloyds-Foreign Accounts		0.11	
Total Interest Received		**0.33**	

15. During the same period West Sussex County Council achieved a rate of return of 0.99% on its invested cash balances. The higher yield reflects the Council's treasury management strategy of investing a proportion of its cash balances for periods up to 365 days and beyond (including long-term externally managed pooled investment funds) at interest rates higher than those available on the instant access accounts used by the Pension Fund.

Recommended

16. The Panel approves the 2019/20 Treasury Management Strategy as set out in Appendix A.

17. The Panel notes the treasury activity undertaken during 2018/19 (1 April to 31 December 2018).

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Appendices
Appendix A - Treasury Management Strategy (2019/20)

Background Papers
None