

<b>Essex Pension Fund Board</b>	<b>EPB/17/14</b>
<b>date: 9 July 2014</b>	

**Investment Steering Committee (ISC) Quarterly Report**

Report by the Director for Essex Pension Fund

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**1. Purpose of the Report**

1.1 To provide a report on ISC activity since the last Board meeting.

**2. Recommendations**

2.1 That the Board should note the report.

### **3. Background**

- 3.1 In accordance with its Terms of Reference, the ISC is required to submit quarterly reports on its activities to the Essex Pension Fund Board.
- 3.2 Since the Board's last meeting the ISC has met twice on 26 March 2014 and 18 June 2014.

### **4. Report of meeting of ISC on 26 March 2014**

- 4.1 The Committee reviewed the draft Treasury Management Strategy 2014/15, which was brought to the Committee for the first time following the Board's decision of 5 March 2014. It was agreed that an additional annex be included detailing the Essex Pension Fund internally management Counterparty Lending List. The main 2014/15 Treasury Management Strategy is attached at Appendix A.
- 4.2 A report on the market conditions was discussed followed by the Q4 2013 Investments Tables, which detailed investment manager performance. It was noted that the Fund's value had risen from £4.075bn as at 30 September 2013 to £4.253bn as at 31 December 2013.
- 4.3 The Committee noted the traffic light report on investment managers and the reports of meetings that officers & advisers had held with First State and Hamilton Lane 19 December 2013 and 3 February 2014 respectively.
- 4.4 An update was given on the proposal to rebalance the bond portfolio back to its strategic allocation. The Committee agreed to the proposal outlined.
- 4.5 Presentations were received from Hamilton Lane on private equity and Alpha Opportunities on the bond portfolio.

### **5. Report of meeting of ISC on 18 June 2014**

- 5.1 The Committee noted its new membership, its revised Terms of Reference, and the appointment of Cllr Bass as Chairman following the May 2014 annual meeting of Essex County Council. Cllr Hume was appointed as Vice Chairman
- 5.2 The Committee received a report summarising the key areas and providing initial thoughts of the DCLG consultation documentation, published on 1 May 2014 entitled "Opportunities for collaboration, cost saving and efficiencies" along with the analysis undertaken by Hymans Robertson.
- 5.3 The Committee noted that the Fund had been successful at the annual *Professional Pensions* awards – Essex has been judged to be "Public Sector Scheme of the Year".
- 5.4 A report on Q1 2014 market conditions was discussed followed by the Investment Tables which detailed Investment Managers performance. It was noted that as at 31 March 2014 the value of the Fund's assets had risen to a provisional value of £4.287bn.
- 5.5 Consideration was given to reports on Investment Manager monitoring and Investment Structure. The Committee noted the traffic light report on investment managers, the successful implementation of the rebalancing of the bond mandates back to their strategic allocation and the progress of possibly allocating 2% (£80 - £100m) of assets to an illiquid debt opportunity pooled fund. After discussions, it

was agreed that a shortlist of preferred managers be interviewed at the Strategy meeting of the 23 July 2014.

- 5.6 Presentations were received from First State on the emerging market equity portfolio and Aviva on the property portfolio. In respect of the latter it was agreed that the £25m that had yet to be drawn down be released to Aviva as and when required.

## **6. Link to Essex Pension Fund Objectives**

- 6.1 Investments  
To maximise the returns from investments within reasonable risk parameters.  
To ensure the Fund is properly managed.

## **7. Risk Implications**

- 7.1 None other than those already identified as part of the Fund's investment strategy.

## **8. Communication Implications**

- 8.1 None

## **9. Finance and Resources Implications**

- 9.1 None other than those already identified as part of the Fund's investment strategy.

## **10. Background Papers**

- 10.1 ISC meetings of 26 March 2014 and 18 June 2014 – agenda and draft minutes.

# Essex Pension Fund

## Treasury Management Strategy for 2014/15

# Investment Steering Committee 26 March 2014

## Introduction

The treasury management activities covered by this document are comprised of two separate areas:

### Section A

- The day to day management of the Pension Fund's cash flows and associated short term cash investments known as "In house cash". These activities are undertaken by Essex County Council on behalf of the Pension Fund under a service level agreement.

### Section B

- The cash held and managed by the Global Custodian as part of the Fund's investment strategy.

Longer term investments are administered separately by external fund managers and these activities are covered in the Pension Fund Statement of Investment Principles agreed by the Investment Steering Committee each year.

## Section A – “In House Cash” Treasury Management Arrangements

In undertaking the treasury management activities for the Essex Pension Fund, in the absence of any specific guidance on treasury management for Local Government Pension Scheme funds, Essex County Council will comply with the Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes (the Treasury Management Code) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

A fundamental aim of treasury management is to effectively control the risks associated with treasury management activities and to pursue value for money, in so far as this is consistent with the effective management of risk.

The Treasury Management Code requires the following:

- A **Policy Statement** which states treasury management policies, objectives and approach to risk management.
- **Treasury Management Practices** (TMPs) which set out the manner in which the organisation will seek to achieve those policies and objectives, and prescribe how these activities will be managed and controlled.
- An annual **Treasury Management Strategy** that outlines the expected treasury activity. The strategy must define the organisation's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Policy Statement and TMP's were updated and approved by the Board in March 2010. As no further changes or updates are considered necessary, neither have been reproduced in this report.

## Treasury Management Strategy

The Treasury Management Strategy is set out in the subsequent paragraphs.

### Short Term Cash Investment Strategy

- **Key objectives**  
The primary objectives of investment activities are:
  - Firstly, to **safeguard** the principal sums invested;

- Secondly, to ensure adequate **liquidity**; and
- Lastly, to consider investment returns or **yield**.

Surplus cash balances will only be invested on a short term basis (up to a maximum period of 364 days) until the funds are next required. Longer term investments are outside the scope of this document.

▪ **Investment counterparty selection criteria**

Funds will be invested according to the Secretary of State's definition of specified investments, these being sterling deposits made for periods of less than one year, offering high security and high liquidity. Specified investments may include deposits with the UK Government, other local authorities, money market funds and bodies of high credit quality.

A lending list will be compiled to include counterparties satisfying the criteria set out within **Annex 1**. The lending limits that will be applied to counterparties satisfying these criteria are also set out within **Annex 1**. Additional operational market information (e.g. Credit Default Swaps, negative rating watches/outlooks) will also be considered before making any specific investment decisions.

The criteria for choosing counterparties provide a sound approach to investment in normal market circumstances. However, the Executive Director for Corporate Services will determine the extent to which the criteria set out within **Annex 1** will be applied in practice (i.e. according to prevailing market circumstances).

▪ **Liquidity**

Liquidity is defined as having adequate, but not excessive cash resources, borrowing arrangements and overdraft or standby facilities to ensure that funds are available, at all times, for the achievement of the Pension Fund's objectives. In this respect, the Pension Fund will seek to maintain a contingency of at least **£1m** of cash available with a week's notice. This will be in excess of amounts available at short notice for managing expected cash flows.

▪ **Performance**

Investment performance will be measured against the Local Authority Seven Day rate; the aim being to achieve investment returns that are equivalent to, or greater than, the average LA7DR for the year (i.e. subject to security and liquidity considerations being fully satisfied).

## Interest Rates

An estimate of the movement in interest rates over the forthcoming three years is provided below :-

Expected movement in interest	2013-14	2014-15	2015-16	2016-17
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<b>rates</b>	<b>Latest estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
<b>Bank rate (at each 31 March)</b>	0.5%	0.5%	0.5%	1.25%
Source : Capita (January 2014)				

The estimated average balance for “In house cash” is around **£15m**. A **1%** movement in interest rates would affect the level of income earned from short term investments by **£150,000**.

Given the short term nature of “In house cash”, no limits are proposed on the maximum exposure to fixed or variable rates of interest.

## Borrowing

The administering authority does not have the power to borrow on behalf of the Pension Fund, other than temporary borrowing for the following specific purposes detailed in section 5 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 :-

- paying benefits due under the Scheme, or
- to meet investment commitments arising from the implementation of a decision by the Fund to change the balance between different types of investment.

In the context of this Strategy, short term borrowing will only be undertaken in exceptional circumstance to manage unexpected cash flow fluctuations which occur as a result of the above circumstances.

If short term borrowing is necessary, this will be secured via an overdraft facility with the Fund’s bankers or by borrowing from the money markets or other local authorities.

## Treasury Management Advisors

Essex County Council uses Capita as its treasury management advisor. Capita provides a range of services, including technical advice on treasury matters, economic and interest rate analysis and credit worthiness information. The services received from Capita are kept under regular review.

Whilst Capita provides treasury management advice to the Council, the final decision on treasury matters remains vested with the Essex Pension Fund Board, and for day to day treasury management, with the Executive Director for Corporate Services.

## Section B – Custodian Cash Management

### Arrangements

One of the functions provided by the Fund's custodian, Northern Trust, is a banking service. A separate bank account is set up in each currency required by each mandate. At 28 February 2014, the Fund held £ 102.4m in cash at the

custodian. The details are set out in the table below.

out in	<b>28 Feb 2014</b>	<b>£m</b>	<b>%</b>
Sterling		66.8	65.2 %
Dollar		29.9	29.2%
Euro		2.6	2.6%
Other		3.1	3.0%
		<u>102.4</u>	<u>100.0%</u>

If no other action were taken, these monies would remain on deposit with Northern Trust earning interest at the Custodian's rates.

However, in order to maximise the interest earned where possible, a "cash sweep" is in place for amounts held in sterling, US dollar and euro. This ensures that balances in these currencies across the Funds are swept each day into Global Liquidity Funds (GLFs) managed by either BNP Paribas Insticash or Northern Trust Global Funds PLC where they earn a higher rate of interest. The three currencies subject to the sweep typically constitute in excess of 90% of all custodian cash balances.

The GLF vehicles used have obtained, and seek to maintain an Aaa/MR1+ rating from Moody's and an AAA rating from Standard & Poor's. The GLFs operates a soft limit of 10% in any single security, although there are circumstances in which higher holding levels are permitted. A listing of the investment restrictions for both the Northern Trust GLFs and BNP Paribas GLFs are shown in **Annex 3.1** and **3.2**.

The GLFs are open-ended collective investment companies (OEIC). This means that in placing monies in the GLFs via the cash sweep, the Essex Pension Fund becomes a shareholder and has a share in the pool of investments. A GLF must appoint a board of directors, an investment manager, an administrator and custodian. Clients invest, not with the fund manager, but in the fund run by the fund manager. The manager manages the investments of the fund, an administrator runs the back office and the assets are kept in safe-keeping for the fund by the custodian. The GLFs' overall ratings have two components: a credit risk rating (normally AAA) and a market risk rating. To achieve and maintain the rating, the funds must meet rigorous standards on investment quality, diversification and liquidity profile. Both internal management and the rating agencies ensure compliance with regulatory, prudential, investment

and credit policy guidelines. The processes are monitored further by administrators, custodians and auditors.

In order to limit the exposure of the Fund to any single financial institution the maximum exposure to each of the Northern Trust and BNP Paribas GLFs has been set at £60m. The total cash holdings with the Custodian will be carefully monitored. If necessary we will negotiate with individual managers in order to arrange for them to make direct investments in other MMF/GLFs, so that the maximum limit of £120m is not breached.

To accommodate the reallocation of £120m between the Bond mandates and the receipt of deficit contributions from employers in April, the Chairman agreed on 17 April 2014 to a temporary variation to the Pension Fund Treasury Management strategy increasing the upper limit on funds placed with the Northern Trust Global Liquidity fund from £60m to £80m. The temporary limit was effective from 17 April to 12 May 2014.

A series of detailed questions on the how the GLFs operate in practice are shown in **Annex 2** of this document.

## Counterparty Criteria for Investments – In House Cash Annex 1

### Lending List

The Pension Fund will only invest its short term funds with UK banks and building societies, and non UK banks domiciled in a country with a minimum sovereign long term rating of **AA**, that have credit ratings equivalent to or better than the following:

Rating category	Credit rating agencies		
	Fitch	Standard and Poor	Moody's
Short term rating	<b>F1</b>	<b>A-1</b>	<b>P-1</b>
Long term rating	<b>A</b>	<b>A</b>	<b>A2</b>
Viability / financial strength rating	<b>a</b>	-	<b>C</b>
Support rating	<b>3</b>	-	-

The above ratings will be used to determine the pool of counterparties with whom the Pension Fund can transact. Where the counterparty is rated by more than one credit rating agency, the lowest ratings will be used to determine whether or not it is included on the counterparty list. However, financial institutions will only be considered for inclusion if they have a credit rating in each of the four rating categories.

The criteria outlined above will ensure that funds are only invested with high quality counterparties. The short and long term ratings will be used to determine the maximum amount that can be invested with each of these counterparties, and for what period – see lending limits section.

In addition, the Pension Fund may invest its funds with:

- The UK Government.
- Other local authorities.
- Pooled investment vehicles (i.e. Money Market Funds) that have been awarded an **AAA** credit rating.
- Financial institutions fully or part nationalised by the UK Government whose credit ratings do not meet the above criteria.
- Bank subsidiaries and treasury operations which do not have a full set of credit ratings, provided the parent bank has the necessary ratings outlined above. In addition, the subsidiary must itself have a short and long term rating meeting the above criteria or have an unconditional guarantee from the parent bank.

In the event that the Pension Fund's own banker falls below the minimum credit rating criteria outlined above, and is not nationalised or part

nationalised, the bank will be used for transactional purposes only, and not as an active outlet for investments.

**Notes:**

- There are three main credit rating agencies that assign ratings to financial institutions, namely Fitch, Standard and Poor and Moody's. When these agencies assign ratings, they take account of any country specific circumstances. Ratings are therefore applicable worldwide; hence the risk of investing with two different counterparties that have similar ratings is the same, irrespective of their country of origin.
- Definitions of the credit ratings of the three main credit rating agencies are not reproduced within this report, but are available upon request.
- For group organisations, the viability rating of the group will be used if an individual entity does not have a viability rating.
- A minimum viability rating of **α+** will apply to non UK financial institutions.
- Credit ratings are continually monitored, with changes in credit ratings being notified by the Council's treasury management advisors. Counterparties will be removed from the Pension Fund's lending list in the event that they receive a downgrading to their credit rating status below the minimum criteria outlined above.
- Counterparties that are placed on 'negative ratings watch' will remain on the Pension Fund's lending list at the discretion of the Executive Director for Corporate Services, in consultation with the Chairman of the Pension Fund Board (or Deputy Chairman of the Pension Fund Board if the Chairman is unavailable).
- Money Market Funds (MMFs) are short term pooled investments that are placed, by a manager, in a wide range of money market instruments. The size of the investment pool of a MMF enables the manager to not only offer the flexibility of overnight and call money, but also the stability and returns of longer dated deposits. Strict rules and criteria are set down by the official rating agencies, covering the types of investment counterparties used, the maturity distribution of the funds and investment concentrations. The MMFs that the Pension Fund uses will be denominated in sterling and be regulated within the EU.



## Lending Limits

For banks and building societies satisfying the 'lending list' criteria, lending limits will be determined with reference to the counterparties' short and long term credit ratings, as follows:

- Investment limit of **£7.5m** for investments of up to **1** year:

Rating category	Credit rating agencies		
	Fitch	Standard and Poor	Moody's
Short term rating	<b>F1+</b>	<b>A-1+</b>	<b>P-1</b>
Long term rating	<b>AA-</b>	<b>AA-</b>	<b>Aa3</b>

- Investment limit of **£5m** for investments of up to **1** year:

Rating category	Credit rating agencies		
	Fitch	Standard and Poor	Moody's
Short term rating	<b>F1</b>	<b>A-1</b>	<b>P-1</b>
Long term rating	<b>A</b>	<b>A</b>	<b>A2</b>

Lending limits for other counterparties will be as follows:

- No restrictions will be placed on the amounts that can be invested with the UK Government (i.e. Debt Management Office). It is not possible to set up a separate Pension Fund account with the DMO so funds would be placed via the County Council, although the credit risk would remain with the Pension Fund.
- An investment limit of **£10m** will be applied for investments of up to **one** year with individual Money Market Funds.
- An investment limit of **£7.5m** will be applied for investments of up to **one** year with individual top tier local authorities. Top tier local authorities will include county councils, unitary and metropolitan authorities and London boroughs.
- An investment limit of **£5m** will be applied for investments of up to **one** year with individual lower tier local authorities. Lower tier local authorities will include district / borough councils, and police and fire authorities.
- In addition to the limits outlined above, a further restriction will be applied in respect of investments with non UK financial institutions; that is, a country limit of **£5m** will be applied. The country limit will restrict the total amount that can be invested within any one country outside of the UK at any one time.



## Institutional Lending List

Counterparty	Investment limit £m	
<b>ESSEX PENSION FUND</b>		
<b>UK BANKS</b>		
<b>Barclays Bank</b>		
Group limit	0.00	
Barclays - CALL.acct	0.00	
Barclays - fixed term	0.00	
<b>HSBC</b>		
Group limit	7.50	364 days
HSBC - fixed term	7.50	364 days
HSBC - BIBCA (call account)	7.50	call
<b>Lloyds Banking Group</b>		
Group limit	5.00	364 days
Lloyds TSB Bank - fixed term	5.00	364 days
Lloyds TSB current account	5.00	call
<b>Royal Bank of Scotland</b>		
RBS Group Limit	5.00	364 days
RBS - fixed term	5.00	364 days
RBS - CALL account	5.00	call
<b>UK BUILDING SOCIETIES</b>		
<b>Nationwide</b>	5.00	3 mnths
<b>FOREIGN BANKS (Country limit £5m)</b>		
<b>Australia</b>		
* Commonwealth Bank of Australia	5.00	364 days
<b>Canada</b>		
* Total country limit	5.00	
Bank of Montreal	5.00	364 days
Bank of Nova Scotia	5.00	364 days
<b>Netherlands</b>		
* Rabobank	5.00	364 days
<b>Singapore</b>		
* Total country limit	5.00	
Development Bank of Singapore	5.00	364 days
Overseas Chinese Banking Corporation	0.00	364 days
<b>Sweden</b>		
Total Svenska Handelsbanken limit	5.00	364 days
Svenska Handelsbanken - call a/c	5.00	call
<b>OTHER</b>		
<b>Money Market Funds</b>		
Black Rock - Govmnt Sterling fund	10.00	364 days
<b>Standard MMFs (limit £20m)</b>		
Black Rock - Inst. Sterling Liquidity	10.00	364 days
Ignis - Sterling Liquidity Fund	10.00	364 days
J.P Morgan	0.00	
<b>LOCAL AUTHORITIES</b>		
<b>Top Tier Local Authorities</b>		
- Essex County Council	7.50	364 days
- [Name of Authority]	7.50	364 days
<b>Lower Tier Local Authorities</b>		
- [Name of Authority]	5.00	364 days
- [Name of Authority]	5.00	364 days