Appendix B

Essex Pension Fund

Treasury Management Strategy for ~~2019/20~~2020/21

Investment Steering Committee ~~27 March 2019~~ 21 July 2020

Introduction

The treasury management activities covered by this document are comprised of three 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 Investment Strategy Statement agreed by the Investment Steering Committee each year.

Section C

- The requirement to realise investment income in order to meet a shortfall in income to meet a proportion of future benefit payments.

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-Sectoral Guidance Notes (the Treasury Management Code) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Statutory Guidance.

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 Essex Pension Fund Strategy 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 and Customer Services~~ Finance and Technology 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 7 Day London Interbank Bid Rate (LIBID); the aim being to achieve investment returns that are equivalent to, or greater than, the average 7 Day LIBID rate 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 rates~~	~~2018-19 (Current)~~	~~2019-20 Estimate~~	~~2020-21 Estimate~~	~~2021-22 Estimate~~
~~Bank rate (at each 31 March)~~ ~~Source : Link Asset Services (December 2018)~~	~~0.75%~~	~~1.25%~~	~~1.50%~~	~~2.00%~~

Expected Movements in Interest Rates	2020-21 as at 30 Jun 20	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate
Bank Rate Source: Link Asset Services (Mar 20)	0.10%	0.10%	0.10%	0.10%

The estimated average balance for "In house cash" is around ~~£33m~~£20m. A **1%** movement in interest rates would affect the level of income earned from short term investments by **£200,000**.

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 Advisers

Essex County Council currently employs **Link Asset Services** (Treasury Solutions) as its treasury management adviser.

Link Asset Services provide a range of services, including technical advice on treasury matters, economic and interest rate analysis and credit worthiness information. Notwithstanding this, the final decision on treasury matters remains vested with the Essex Pension Fund Investment Steering Committee, and for day to day treasury management, with the Executive Director~~, for Corporate and Customer Services~~ Finance and Technology.

The services received from the Treasury Management Advisers are subject to regular review.

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 ~~11 March 2019~~ 29 May 2020 the Fund held ~~£ 146.1m~~ £160.2m in cash at the Custodian. The details are set out in the table below.

~~11-Mar-19~~	~~£m~~	~~%~~
~~Sterling~~	~~96.5~~	~~66%~~
~~Dollar~~	~~41.2~~	~~28%~~
~~Euro~~	~~7.3~~	~~5%~~
~~Other~~	~~1.1~~	~~1%~~
	~~146.1~~	~~100%~~

29-May-20	£m	%
Sterling	95.7	59.7
Dollar	42.5	26.5
Euro	21.1	13.2
Other	0.9	0.6
	160.2	100.0

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 and US dollar. This ensures that balances (not required to settle trades) in these currencies across the Funds are swept each day into Global Liquidity Funds (GLFs) managed by either BNP Paribas Investment Partners UK Limited 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 95% of all custodian cash balances.

The Fund is also able to utilise the Euro GLF sweep, however due to its adoption of negative interest rates in May 2015 this facility is not currently in use. The GLF vehicles used have obtained and seek to maintain an Aaa/Mf+ rating from Moody's and a 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 a maximum limit is set for both the Northern Trust and BNP Paribas GLFs.

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

Impact of lump sum deficit contributions and income realisation

In addition to the working balances of the investment managers, cash management arrangements now need to accommodate the impact of lump sum deficit payments and income realisation.

Under the terms of the current Funding Strategy Statement, it is possible for certain fund employers to opt to pay deficit "up front" in April (rather than the traditional 12 monthly instalments). Furthermore, as highlighted in Section C, it is forecast that some investment income will need to be used rather than automatically reinvested in order to finance part of the Fund's benefit expenditure going forward ~~from 2018/19~~.

As a consequence, the GLFs will be used in order to allow the most effective management of monies immediately prior to being allocated to fund managers or directed to pay benefits.

GLF Limits

As its meeting of 21 February 2018, the ISC agreed principles in respect of any reallocation of equities to the alternative and bond mandates. It was agreed that up to 1% of the Fund's assets can be held in cash (separate to that the managers may hold for efficient portfolio management) in expectation of a drawdown notice or other cash flow requirement for the Fund.

The limits for ~~2019/20~~2020-21 are set out below and ~~reflect~~ show an increase for both the Northern Trust GLF and BNP Paribas GLF to reflect the circumstances outlined above and have also been adjusted to take account of the increase in the Fund value over the last few years:

Northern Trust GLF	-	~~£80m~~ £120m (~~no~~ change on an operational basis, previously £80m)
Northern Trust GLF	-	~~£150m~~ £200m (on a temporary basis to facilitate the redeployment of assets, previously £150m)

BNP Paribas GLF - ~~£60m~~ £120m (~~no~~ change on an operational basis, previously £60m)

BNP Paribas GLF - ~~£130m~~ £200m (on a temporary basis to facilitate the redeployment of assets, previously £130m)

Section C – Cashflow Management Arrangements

The Fund is maturing, and analysis has been undertaken to forecast when new contributions (employees and employers including deficit) are not enough to meet all benefit payments falling due. This is normal for a pension scheme and reflects the purpose of the Fund (accumulate monies and then pay it out in benefits).

The current position is that the Fund is broadly cash neutral, with differences between the income and expenditure in the years analysed in the table below.

Table: Fund cashflow forecast

	~~2017/18 actual £ (000)~~	~~2018/19 estimate £ (000)~~	~~2019/20 forecast £ (000)~~
~~Expenditure (benefits, transfers out and expenses)~~	~~245,621~~	~~260,134~~	~~272,528~~
~~Income (ongoing contributions, deficit contributions and transfers in)~~	~~289,150~~	~~238,338~~	~~246,207~~
~~Net cashflow excl. Investment Income~~	~~43,529~~	~~(21,795)~~	~~(26,321)~~

	2018/19 actual £ (000)	2019/20 actual £ (000)	2020/21 forecast £ (000)
Expenditure (benefits, transfers out and expenses)	**278,937**	**288,188**	**304,674**
Income (ongoing contributions, deficit contributions and transfers in)	**253,005**	**267,063**	**318,219**
Net cashflow excl. Investment Income	**(25,932)**	**(21,125)**	**13,545**

The cashflow forecast will be subject to regular periodic review.

Income Realisation Strategy

In order to meet the short to medium term cashflow requirements, the Investment Steering Committee at its 23 February 2015 meeting agreed to realise income from Passive UK assets and Aviva property portfolio, when required.

Realised income may be held in cash short term in order to meet a proportion of benefit payments.

The income realisation strategy will be subject to regular periodic review.

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	F1	A-1	P-1
Long term rating	A	A	A2

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 both of the 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 a 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 summarised in Annex 2. Full details are available upon request.
- Credit ratings are continually monitored, with changes in credit ratings being notified by the Council's treasury management advisers. 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 and Customer Services~~, Finance and Technology in consultation with the Chairman of the Pension Fund Investment Steering Committee~~Board~~ (or ~~Deputy~~Vice 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 an 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	F1+	A-1+	P-1
Long term rating	AA-	AA-	Aa3

- 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	F1	A-1	P-1
Long term rating	A	A	A2

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.

~~Current Institutional Lending List (as at February 2019)~~

-	-	-	-	-
~~Counterparty~~			~~Investment Limit (£m)~~	~~Maximum Duration~~
-			-	-
~~UK BANKS~~	-	-	-	-
-	~~Barclays Bank~~		-	-
-	-	~~**Group limit**~~	~~**5.00**~~	-
-	-	~~Barclays - CALL acct~~	~~5.00~~	~~Call~~
-	-	~~Barclays - fixed term~~	~~5.00~~	~~364 Days~~
-	-	-	-	-
-	~~HSBC~~	-	-	-
-	-	~~**HSBC Group limit**~~	~~**7.50**~~	-
-	-	~~HSBC - BIBCA (CALL account)~~	~~7.50~~	~~Call~~
-	-	-	-	-
-	~~Lloyds Banking Group~~		-	-
-	-	~~**Lloyds Group limit**~~	~~**5.00**~~	-
-	-	~~Lloyds current account~~	~~5.00~~	~~Call~~
-	-	-	-	-
-	~~Santander UK~~		-	-
-	-	~~**Santander Group Limit**~~	~~**5.00**~~	-
-	-	~~Santander - CALL account~~	~~5.00~~	~~Call~~
-	-	-	-	-
~~UK BUILDING SOCIETIES~~			-	-
-	~~Nationwide~~	-		
		~~**Nationwide Group Limit**~~	~~**5.00**~~	
		~~Nationwide – Fixed Term~~	~~5.00~~	~~6 months~~
-	-	-	-	-
~~FOREIGN BANKS (Country limit £5m)~~			-	-
	~~Sweden~~			
-	-	~~**Total country limit**~~	~~**5.00**~~	~~364 days~~
-	-	~~Svenska Handelsbanken – CALL account~~	~~5.00~~	~~Call~~
-	-	-	-	-
~~OTHER~~	-	-	-	-
-	~~Money Market Funds~~		-	-
		~~**Standard MMFs (limit £20m)**~~	~~**20.00**~~	
-	-	~~Black Rock - Inst. Sterling Liquidity~~	~~10.00~~	~~364 days~~
-	-	-	-	-
-	~~Local Authorities~~		-	-
-	~~Top Tier Local Authorities~~		~~**7.50**~~	-
-	-	~~- Identified at time of investment~~	~~7.50~~	~~364 days~~
-	-	-	-	-
-	~~Lower Tier Local Authorities~~		~~**5.00**~~	-
-	-	~~- Identified at time of investment~~	~~5.00~~	~~364 days~~

Current Institutional Lending List as at June 2020

Jun-20 ESSEX PENSION FUND COUNTERPARTY LIST			Investment limit £m	Maximum Duration
UK BANKS				
	HSBC		5	364 days
	Lloyds Banking Group		5	364 days
	Royal Bank of Scotland		5	364 days
	Santander UK		5	3 months
UK BUILDING SOCIETIES				
	Nationwide		5	364 Days
FOREIGN BANKS				
	Sweden	Total Country Limit	5	364 days
		Svenska Handelsbanken - call a/c	5	364 days
OTHER				
	UK Government			
		Debt Management Office (Unlimited)	9999	364 days
		Debt Management Office via ECC	9999	364 days
	Money Market Funds			
		Black Rock - Govmnt Sterling Fund	10	364 days
		LGIM - Sterling Liquidity Fund	10	364 days