

The following criteria will be used to manage counterparty risks to Somerset County Council Investments for new deposits / investments from the time that the new Treasury Management Strategy Statement, (which includes the Annual Investment Strategy) is passed by Full Council at its meeting in February 2018: -

Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

**Deposits** - Any Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.

**Unrated Building Societies**

Unrated Building Societies as identified by Treasury Advisors can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.

**Marketable Instruments** – Any bank, other organisation, or security whose credit ratings satisfy the criteria below: -

**Rating of Counterparty or Security**

Deposits or instruments of less than 13 months duration (Refer to long-term ratings)

Fitch A- or above

S&P A- or above

Moody's A3 or above

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £20m (approximately 7.7% of average investments during 2017-18 (to November 30th).

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-, and Moody's Aa3, will be £25m (approximately 9.7% of average investments 2017-18 (to November 30th).

Deposits or instruments of more than 13 months duration (Refer to long-term ratings)

Fitch AA- or above

S&P AA- or above

Moody's Aa3 or above

The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £10m. This figure is to be included in the overall figure above.

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors. Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

### Operational Bank Accounts

As the Council's current bankers, Nat West fall below the minimum criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements. This will generally be for smaller balances where it is not viable to send to other counterparties or in the event of unexpected receipts after the daily investment process is complete. Money will be placed in the instant access Nat West call account overnight.

### Public Sector Bodies

Any UK Local Authority or Public Body will have a limit of £15m and a maximum maturity of 5 years.

The UK Government, including Gilts, T-Bills, and the Debt Management Office (DMADF) will be unlimited in amount and duration.

The table below gives a definition and approximate comparison of various ratings by the three main agencies: -

### Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	<b>F1+</b>	Exceptionally strong	<b>P-1</b>	Superior	<b>A-1+</b>	Extremely strong
	<b>F1</b>	Highest quality			<b>A-1</b>	Strong
	<b>F2</b>	Good quality	<b>P-2</b>	Strong	<b>A-2</b>	Satisfactory
	<b>F3</b>	Fair quality	<b>P-3</b>	Acceptable	<b>A-3</b>	Adequate
	<b>B</b>	Speculative	<b>NP</b>	Questionable	<b>B and below</b>	Significant speculative characteristics
	<b>C</b>	High default risk				
	<b>(+) or (-)</b>		<b>(1,2, or 3)</b>		<b>(+) or (-)</b>	
Long-Term	<b>AAA</b>	Highest quality	<b>Aaa</b>	Exceptional	<b>AAA</b>	Extremely strong
	<b>AA</b>	V High quality	<b>Aa</b>	Excellent	<b>AA</b>	Very strong
	<b>A</b>	High quality	<b>A</b>	Good	<b>A</b>	Strong
	<b>BBB</b>	Good quality	<b>Baa</b>	Adequate	<b>BBB</b>	Adequate capacity
	<b>BB</b>	Speculative	<b>Ba</b>	Questionable	<b>BB and below</b>	Significant speculative characteristics
	<b>B</b>	Highly Speculative	<b>B</b>	Poor		
	<b>CCC</b>	High default risk	<b>Caa</b>	Extremely poor		

## **Financial Groups**

For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) investments can be split between entities, but an overall limit equal to the highest rated constituent counterparty within the group will be used.

## **Country Limits**

Excluding the UK, there will be a limit of (approximately) 10% of total investments in any one country. For 2018-19, this will be £30m, 10% of maximum balance for 2017-18 to December (£287m), rounded up to the nearest £5m, a typical investment principal sum.

## **Money Market Funds**

Until such time as proposed regulatory changes come into effect, Constant Net Asset Value (CNAV) Money Market Funds (and LVNAV funds when changes are effected) must be rated by at least two of the main three ratings agency, and must have the following, (or equivalent LVNAV) ratings.

Fitch AAmmf

Moody's Aaa-mf

Standard & Poor's AAAM

Subject to the above, deposits can be made with the following limits: -

The lower of £15m or 0.5% of the total value for individual Funds.

No more than 50% of total deposits outstanding are to be held in CNAV (LVNAV) MMFs.

## **VNAV Pooled Funds**

Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Many VNAV bond funds are not rated. Equity, multi-asset and property funds are also not credit rated. The decision to invest in a particular asset class or fund will be based on the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth.

No more than £30m of total deposits outstanding are to be held in VNAV Funds (excluding LVNAV MMFs).

## **Other Indicators**

As had previously been the case with SCC, and is now a requirement of the revised CLG guidance, the Authority will use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors