Appendix B

Somerset Council Lending Counterparty Criteria 2023-24

The following criteria will be used to manage counterparty risks to Somerset Council investments for new deposits / investments from 1st April 2023.

Please note that the limits in this appendix apply only to Treasury Management Investments, not to those detailed in the Separate Investment Strategy.

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 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
<u>Deposits or instruments of less than 13 months duration (refer to long-term ratings)</u>
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. This is approximately 4.4% of investment balances held at 30th September, or 6.5% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

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. This is approximately 5.5% of investment balances held at 30th September, or 8.1% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

<u>Deposits or instruments of more than 13 months duration (refer to long-term ratings)</u>
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 are currently within the minimum criteria. If they should fall below 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	**F1+**	Exceptionally strong	**P-1**	Superior	**A-1+**	Extremely strong
	F1	Highest quality			**A-1**	Strong
	F2	Good quality	**P-2**	Strong	**A-2**	Satisfactory
	F3	Fair quality	**P-3**	Acceptable	**A-3**	Adequate
	B	Speculative	**NP**	Questionable	**B and below**	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		**(1,2, or 3)**		**(+) or (-)**	
Long-Term	**AAA**	Highest quality	**Aaa**	Exceptional	**AAA**	Extremely strong
	AA	V High quality	**Aa**	Excellent	**AA**	Very strong
	A	High quality	**A**	Good	**A**	Strong
	BBB	Good quality	**Baa**	Adequate	**BBB**	Adequate capacity
	BB	Speculative	**Ba**	Questionable	**BB and below**	Significant speculative characteristics
	B	Highly Speculative	**B**	Poor		
	CCC	High default risk	**Caa**	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 £30m. This is approximately 6.6% of investment balances held at 30th September, or 9.7% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Money Market Funds
Any LVNAV Mpney Market Fund used must be rated by at least two of the main three ratings agency, and must have the following ratings.

Fitch AAAmmf 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 LVNAV MMFs.

VNAV and other 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.

A full review of Pooled Funds after the amalgamation of the five Council's portfolios will determine strategy and investment in these longer-term assets. It is the Council's intention to not invest further in Pooled Funds until the review is complete.

It is Somerset Council's ambition that any strategic investments within the treasury assets in pooled funds invested in bonds/equities or property would be held exclusively against general and earmarked reserves of the Council or cash and the Council will not borrow or use existing debt to support such investments. Depending on the position inherited from the 5 predecessor Councils a period of adjustment may be needed to realise this ambition and consideration must be given to waiting for the correct pricing point to obtain best value for the Council.

The decision to stay invested / invest further / disinvest / rebalance the Pooled Funds portfolio will be primarily based on the liability benchmark, and specifically whether the duration of debt and the necessary level of reserves supports longer-term investments. As potential investment would lock away capital for 3 to 5-years plus, the level of prudent investment would be commensurate with the level of core balances and reserves available for/during that timeframe.

Diversification of asset classes/funds and the overall level of investment will be determined by the Section 151 Officer with reference to the level of core balances and reserves. Secondly, it will consider the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth of individual funds.

It may be decided that a percentage of core balances and reserves is deemed the most appropriate limit for Pooled Funds, but in any case, this will not exceed the £144.3m in total currently held, or £20m in any one fund. (with the exception of the amalgamated CCLA Property Fund holding which is £31m).

Other Indicators

The Council will continue to 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