

Appendix B

SCC Lending Counterparty Criteria 2022-23

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 is passed by Full Council at its meeting in February 2022.

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

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. This is approximately 5.6% of maximum balance, 6.4% of average balance for the year to 31st December 2021-22. 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 7.0% of maximum balance, 8.0% of average balance for the year to 31st December 2021-22. The % may be significantly less if borrowing up to the CFR is taken early in the year.

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 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.

Due to the Local Government Reorganisation, it will be appropriate to consider the potential borrowing and investment needs of the other Somerset Councils. If they needed short-term borrowing, it may be possible and appropriate for SCC to cover that need. For this reason, there will be no limit on the lending to the other 4 Somerset Councils.

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 8.4% of maximum balance, 9.6% of average balance for the year to 31st December 2021-22. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Money Market Funds

With regulatory changes now effected, previously titled Constant Net Asset Value (CNAV) Money Market Funds have been converted into Low Volatility Net Asset Value (LVNAV) funds. Any LVNAV Fund used 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 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.

Whilst it is not currently the Council's intention to invest further in Pooled Funds during 2022-23. The decision to invest in a particular asset class or fund 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. Secondly, it will consider the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth. 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. 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.

Fluctuations in SCC cash balances, and particularly cash balances net of external bodies is difficult to predict over a 3 to 5-year timeframe. Furthermore, the amalgamation of the five Council's portfolios due to LGR will determine strategy in longer-term assets. The Section 151 Officer will determine a suitable level of longer-term investment with reference to the level of core balances and reserves, it may be that a % of core balances and reserves is deemed the most appropriate limit for Pooled Funds, but in any case, this will not exceed £60m in total (Including current Pooled Fund investments of £25m), or £15m in any one fund.

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