

## **Investment of Pension Fund Cash**

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### **1. Summary**

- 1.1 The legal position regarding how the fund can invest cash was revised by the Government with the introduction of the LGPS (Management and Investment of Funds) Regulations 2009, which came into force from 1 January 2010. Since 1st April 2010 the pension fund cash has been managed by the Somerset Council's investments team on a completely segregated basis.
- 1.2 As a matter of good governance the Committee is asked annually to review the arrangements for the management of the Fund's cash and approve the strategy and counterparty criteria.

### **2. Recommendations**

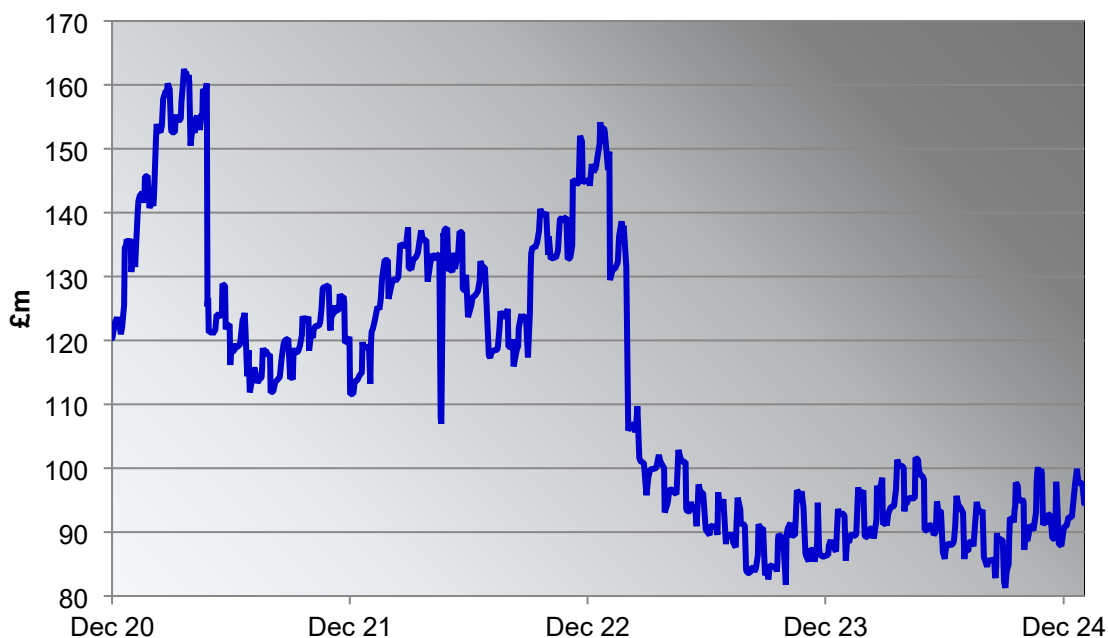
- 2.1 Review the arrangements for the management of the Pension Fund sterling cash balances from the following options:
  1. Re-appoint the in-house team to manage these balances on a segregated basis.
  2. Appoint an external cash manager.

If the committee wish to appoint an external manager, the current in-house management arrangements would remain in place whilst a competitive tender process is undertaken.

- 2.2 Review and adopt a cash management strategy, the current strategy is attached as **Appendix A**.
- 2.3 Adopt a counterparty criteria for the investment of sterling cash balances, a suggested criteria is attached as **Appendix B**.

### 3. Background

- 3.1 The sterling balances of the Fund are managed with a periodic sweep undertaken with the Fund's custodian to clear sterling balances back to the fund's bank account. The balances are mostly balances of the fund that are being received monthly from employers and paid out to pensioners and cash awaiting investment. These balances do vary. A graph showing the daily value of cash balances since December 2020 is below.



- 3.2 The current practice of the Fund is to leave non-sterling balances in the bank accounts supplied to us by the Global Custodian (State Street), these balances do earn interest but at very low rates. Since the transition to Brunel managed funds typically these balances are less than £100,000 in total.
- 3.3 Officers are proposing a similar counterparty policy to the one adopted for 2024-25 (attached as appendix B).

### 4. Consultations undertaken

- 4.1 None

### 5. Financial implications

- 5.1 Over time the performance of the pension fund investments will impact the amount that Somerset Council and other sponsoring employers have to pay into the fund to meet their liabilities. The fund actuary calculates these amounts every three years and sets payments for the intervening periods.

## **6. Legal implications**

There are no specific legal implications associated with this report.

## **7. Background papers**

7.1 None

**Note:** For sight of individual background papers please contact the report author.

## **Pension Fund Cash Management Strategy**

### **Introduction**

The following is the cash management strategy adopted by the Somerset Council Pension Fund as adopted by the Pensions Committee and sets a broad framework for the management of all cash positions of the fund.

### **Short-Term Borrowing**

The Pension Fund will maintain overdraft facilities on all cash accounts in all currencies at the Global Custodian (State Street) and on its main sterling bank account (NatWest). These facilities are to be used to ensure the clearing of un-anticipated payments from time to time and all overdraft positions, however incurred, should be cleared at the earliest possible opportunity.

It is not envisaged that any borrowing will be required above the overdraft facilities highlighted above however it is prudent to allow the borrowing of funds via a broker from banks, building societies and other local authorities to provide flexibility if unexpected cash flows are incurred. Any borrowing will be limited to a maximum of 1 calendar month in duration and should be limited to a level no higher than cash deposits not instantly realisable (the fund should not incur a net negative cash position).

### **Investments**

Certain balances under the control of fund managers are left in various non-sterling currencies and these are deposited in the cash accounts of the Global Custodian (State Street). The cash does attract interest in these accounts but at a low level.

All sterling funds in the cash accounts at the custodian are the subject of a regular sweep back to the Pension Fund's account with its main bank (NatWest). These funds will then be placed on deposit with counterparties in accordance with the counterparty criteria. The cash fund manager will maintain a list of acceptable counterparties, which meet the counterparty criteria and they intend to utilise, on an on-going basis.

In common with other local authority cash management best practice the emphasis when making deposits will be on security of the principal deposited and liquidity. Only once these criteria are met will the highest yield consistent with these priorities be sought.

Given that the vast majority of the cash funds of the Pension Fund could be required either by fund managers or to meet pension payments and transfers at relatively short notice it is anticipated that a significant level of cash at any time will be invested via time deposits with a short term (a month or less) or deposited in instant access call accounts or money market funds. Should cash flow be such that an amount of funds are identified that are not immediately required these can be deposited for periods up to a maximum of 1 year (370 days). Where time deposits are made these can be made via direct contact with the respective counterparty or via a broker.

The only allowable instruments for the investment of cash are time deposits with suitable counterparties, deposits in interest bearing bank and building society accounts, investments in appropriate Money Market Funds and investments in appropriate UK government bond funds.

### **Benchmark**

The cash investment portfolio will be benchmarked against Bank of England base rate.

## **Item 13**

### **Appendix B**

#### **Pension Fund Cash Lending Counterparty Criteria**

The following criteria will be used to manage counterparty risks to Somerset Council Pension Fund for cash deposits from 14th March 2025 (subject to adoption by the SC Pension Fund Committee).

##### **Financial Institutions**

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.

##### **Rating of Counterparty**

The following long term ratings are the minimum acceptable level:

Fitch A-  
S&P A-  
Moody's A3

The maximum deposit amount for any authorised counterparty that has at least two out of the three ratings above will be £10m.

##### **Operational Bank Accounts**

Amounts contained in operational bank accounts with the Pension Fund's main Bank (currently Nat West) will not count in the calculation of Nat West's limit as defined above. In the event of unexpected receipts after 2pm on any given working day, money may be placed in an instant access Nat West call account overnight, in breach of the above limits. Whenever this occurs the total lending to Nat West must be reduced to back within their limit on the following working day.

If the Pension Fund's main bank (currently Nat West) have their ratings downgraded below minimum criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements.

## Public Sector Bodies

Any UK Local Authority or Public Body will have a limit of £10m. Any employer member of the fund may not be used.

The UK Government Debt Management Office (DMADF) will be unlimited.

The table below gives a definition and rough 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) a consolidated limit equal to the limit of a single counterparty (£10m) will apply to the group.

## Money Market Funds

Any Low Volatility Net Asset Value (LVNAV) Money Market 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

UK Government bond funds and Sterling short dated investment grade corporate bond funds may also be used.

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

The lower of £10m or 0.5% of the total value for individual Funds.

## **Diversification**

At least three counterparties/financial groups must be used if total funds invested are greater than £10m, with each having an investment of at least £1m. No more than 50% of total funds invested can be placed with any single counterparty/financial group.

## **Other Indicators**

The Fund 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.
- Government Guarantees and Support, including ability to support.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Other macroeconomic factors.