

Investment Strategy 2009/10 to 2011/12

For Consideration by Council 04 March 2009

Introduction

1. In the current climate, the main principle governing the Council's investment criteria is the security of its investments. After this main principle the Council will ensure:
 - It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
 - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

Counterparty criteria and investment types

2. The Head of Financial Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. It is highlighted that these criteria select which counterparties the Council will choose, rather than defining what its investments are. The ratings criteria will use the 'lowest common denominator' method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside of the lending criteria.
3. The use of the lowest common denominator method reflects the current economic climate and the Council's priority to ensure the security of its financial assets. The credit rating limits to be applied are as follows:
 - The Council will use banks, subsidiary and treasury operations of banks, Money Market funds, building societies, local authorities, the UK government and supranational institutions (i.e. the European Central Bank (ECB)) in line with the limits set out in table 1.
 - In exceptional circumstances, the Council will consider using UK banks whose ratings fall below the criteria specified in table 1 if all of the following conditions are met
 - (a) wholesale deposits in the bank are covered by a government guarantee;
 - (b) the government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poors); and

- (c) the Council's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.
- The Council will also consider using banks whose ratings fall below the criteria specified in table 1 if the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008.
 - In addition, should the authority's own bank (i.e. currently the Co-Operative Bank) fall below the criteria specified in table 1, Council will consider still using it for investment purposes, with the caveat that this will be monitored on a daily basis, with funds being moved to other counterparties meeting the criteria per table 1 at the first opportunity. Although, due to the nature of Local Government funding, there will be spikes in the balances on the current account that mean it may well exceed the £4M upper limit set in table 1 at some point (e.g. overnight), daily banking practices are already in place which aim to maintain the net current account balance at 0 +/- £100K.
4. Due to the uncertainty in the financial markets, it is acknowledged that Officers may restrict further the pool of available counterparties from the above criteria, to safer instruments and institutions. Currently this involves the use of the Debt Management Account Deposit Facility (DMADF), AAA rated Money Market Funds and institutions with higher credit ratings than those outlined in the investment strategy, or which are provided support from the Government.
 5. The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its treasury management consultants, on a daily basis, in respect of any changes in ratings, and counterparties are checked promptly. On occasion, ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Financial Services. New counterparties which meet the criteria will, similarly, be added to the list. More details on the different ratings can be found in Appendix E2.
 6. The Authority will make deposits in both Specified and Non Specified Investments, these are defined in Appendix E1. As the Council will no longer risk investing cash for greater than 1 year at present, this effectively prevents using most Non Specified products apart from the exceptions included in paragraph 3 above.
 7. In addition to the credit ratings applied to institutions, the Council will only deposit with institutions in EU countries with a AAA sovereignty rating. Precedence will be given, however, to institutions listed as UK banks in the Butler's counterparty listing.
 8. The exception to these sovereignty limits relates to institutions within the UK. In these cases the limits will apply as per table 1 but no sovereignty limit will apply. The Head of Financial Services retains the discretion to apply further limits where the relationship between institutions and sovereignties is ambiguous, for example UK banks who are owned by foreign institutions.
 9. For the above categories of Specified and Non Specified Investments, and in accordance with the Code, the Council has developed additional criteria to set the maximum amounts which will be invested in these bodies. The criteria, using the lowest common denominator approach (see paragraph 3 above) are set out below.

Table 1: Counterparty criteria and investment limits.

	Minimum across all three ratings			Money Limit	Time Limit
	Fitch	Moody's	Standard & Poors		
Upper Limit ¹	F1+/AA-	P-1/AA3	A-1+/AA-	£4M	Instant Access
Middle Limit ²	F1/A-	P-1/A3	A-1/A-	£2M	1 Year
Other Institutions ³	N/A	N/A	N/A	£4M	1 Year
Money Market fund ⁴	AAA	AAA	AAA	£4M	N/A - Instant Access Only
DMADF deposit ⁵	N/A	N/A	N/A	£10M	1 Year
Sovereign rating to apply to all foreign counterparties except UK investments ⁶	AAA	AAA	AAA	N/A	N/A
Notes:					
1 & 2 The Upper and Middle Limits apply to appropriately rated banks and building societies.					
3 The Other Institutions limit applies to other local authorities and supranational institutions (e.g. ECB).					
4 Sterling, constant net asset value funds only, sovereignty limits apply to domicile of host institution.					
5 The DMADF facility is direct with the UK government, it is extremely low risk and hence the higher limit.					
6 UK investments are defined as those listed under UK banks or building societies in the Butler's counterparty listing.					

Operational issues

10. In the normal course of the Authority's cash flow operations it is expected that both Specified and Non-specified Investments will be utilised for the control of liquidity as both categories allow for short term investments. The Council will maintain a minimum £2M of investments in Specified Investments provided that the cashflow allows for this.
11. To control the geographical risk, no more than £4M will be invested in any one country, with the exception of institutions listed as UK banks on the counterparty listings supplied by Butlers.
12. The use of longer term instruments (greater than one year from inception to repayment) will not be used.
13. Expectations on shorter-term interest rates, on which investment decisions are based, show a likelihood of the current 1.0% Bank Rate reducing during 2009/10. This means that the average rate receivable on the Council's investments will be significantly below that for 2008/09, which was running at an average of 5.1% over the year to the end of December 2008.
14. The criteria for choosing counterparties set out above provide a sound approach to investment in current market circumstances. Whilst formal Member approval is required for the base criteria above, under exceptional market conditions the Head of Financial Services will temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out above.
15. Examples of these restrictions would be the greater use of the Debt Management Account Deposit Facility (DMADF) – the Government body which accepts local authority deposits, but at very low rates of interest.