

FALKIRK COUNCIL

Subject: PENSION FUND CASH MANAGEMENT
Meeting: PENSIONS COMMITTEE
Date: 6 December 2012
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

- 1.1 The question of the Fund's use of money market funds and its investment of short term cash with the Clydesdale Bank was raised at the last Pensions Committee meeting.
- 1.2 This report addresses those issues and provides the Committee with details of the Pension Fund's current approach to Cash Management.

2. REGULATORY CONTEXT

- 2.1 The Pension Scheme regulations require that an administering authority:
- invests any fund monies that are not immediately needed to meet benefit obligations;
 - holds any fund monies in a separate account; and
 - ensures that the separate account is maintained by an authorised deposit-taker

3. OPERATIONAL CONTEXT

- 3.1 The Pension Fund has net inflows from its dealings with members, so that generally in any month, the income from employee and employer contributions exceeds the pensions and lump sums being paid out.
- 3.2 Surplus cash is invested with either the Fund's banker, Clydesdale Bank, or forwarded to the Fund's custodian, Northern Trust, prior to being allocated to one or more of the Fund's investment managers.
- 3.3 A detailed review of the cash position is undertaken on a monthly basis around the 20th of each month. By that time, pensions have been paid out – this happens on the 15th of each month - and all contributions for the month received from fund employers.
- 3.4 The table below shows the contribution inflows and benefit outflows for the period April to September, 2012:

	April	May	June	July	August	September
Contributions	£5.6m	£5.9m	£6.1m	£6.6m	£5.6m	£6.2m
Benefits	-£5.1m	-£4.6m	-£5.1m	-£5.5m	-£6.3m	-£4.3m
Surplus	£0.5m	£1.3m	£1.0m	£1.1m	-£0.7m	£1.9m

- 3.5 Approximately £5 million is retained each month in an interest bearing account with the Clydesdale Bank to act as a “float” to meet immediate scheme benefit commitments, such as the £3.5m needed for monthly pension payments. The £5 million cushion also recognises the fact that some benefit obligations can arise unexpectedly (e.g. ill health retirements, death grants or pensioners electing to take extra cash in lieu of pension).
- 3.6 Under current treasury arrangements, the absolute maximum sum that may be held with the Clydesdale, or any single institution, is £8 million.
- 3.7 Any other surplus funds are invested with Northern Trust and are initially held in their Global Cash account, before being swept on a nightly basis into one of their money market funds – the Sterling Fund.
- 3.8 Not all monies held with Northern Trust in the Sterling Fund can be allocated to investment managers immediately. A “float” is again necessary to ensure that there are sufficient funds to meet the regular flow of private equity drawdowns (including capital calls from Credit Suisse and M&G).
- 3.9 In view of the current frequency of drawdowns – around £10 million since April, 2012 - the Fund’s practice is to maintain a cash balance with Northern Trust of at least £5 million.

4. CURRENT RATES OF RETURN

- 4.1 The rate of interest being paid by Clydesdale Bank is 0.50% p.a.
- 4.2 The rate of interest being paid by Northern Trust’s Sterling Fund is 0.46%, however the fund fee of 0.20% effectively reduces the rate to 0.26%
- 4.3 The Clydesdale Bank has a long term investment grade A2 credit rating from Moody’s.
- 4.4 The Northern Trust Sterling Fund has a AAA credit rating from Standard and Poor’s.
- 4.5 Both counterparties have acceptable credit ratings in terms of the Council’s treasury management guidelines.
- 4.6 There is an option of lending the funds to certain designated counterparties (e.g. local authorities), however this will only be done where a competitive interest rate is offered.
- 4.7 Whilst there are money market funds providing higher yields, the interest rate differential is not sufficient at this time to justify the additional operational overhead that would be incurred. For example, the RBS GBP Global Treasury Fund offers a net yield of around 0.4% for short term deposits. If £2m of the monies normally deposited with Northern Trust were instead invested in the RBS Fund, the additional interest over a year would equate to around £2,500. It should be noted, however, that it is unlikely additional monies could be held in this fashion continuously for a year.
- 4.8 Whilst the aim is for the Fund is to achieve an optimum return on its cash deposits, this has to be balanced against the need to invest cash securely and in a manner conducive with day to day transactional activities.

5. TREASURY MANAGEMENT STRATEGY

- 5.1 At present, the Fund uses the same criteria for investing cash as is set out in the Council's Treasury Management Strategy. This includes setting limits on the level of funds that may be held with a single institution and the level of counterparty credit worthiness that is acceptable.
- 5.2 As part of its own treasury arrangements, the Council monitors the money markets and will alert the Fund where investment opportunities present themselves.
- 5.3 In view of the need to demonstrate "clear water" between the financial transactions of the Fund and those of the Council, it is suggested that a separate Cash Management Strategy be constructed for the Fund and brought to the next Panel and Committee for approval. It is noted that a number of local authority funds are following this approach and that there is an outstanding audit recommendation for treasury/cash management arrangements for the Fund to be formalised more precisely.

6. CONCLUSION

- 6.1 The Fund needs to hold short term cash deposits to undertake its daily business. Funds are invested with either the Clydesdale Bank or with Northern Trust. Depending on the interest rates on offer, funds may be loaned to other entities subject to their credit worthiness.
- 6.2 The rates of return received from the Clydesdale Bank and Northern Trust are consistent with the need to hold cash as a secure and liquid asset.

7. RECOMMENDATION

7.1 The Committee is asked:

- (i) to note the Fund's practices in relation to the management of cash, and**
- (ii) to agree to a Cash Management Strategy being prepared for the Fund.**

Chief Finance Officer

Date: 7 November 2012

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LIST OF BACKGROUND PAPERS

NIL