
REPORT TO:	FINANCE AND MANAGEMENT COMMITTEE	AGENDA ITEM: 10
DATE OF MEETING:	31st AUGUST 2017	CATEGORY: RECOMMENDED
REPORT FROM:	DIRECTOR OF FINANCE and CORPORATE SERVICES	OPEN
MEMBERS' CONTACT POINT:	KEVIN STACKHOUSE (01283 595811) Kevin.stackhouse@south-derbys.gov.uk	DOC: u/ks/treasury management/lending policy/money market funds/use of MMFs Proposal
SUBJECT:	MONEY MARKET FUNDS	REF:
WARD(S) AFFECTED:	ALL	TERMS OF REFERENCE: FM 08

1.0 Recommendations

- 1.1 That the Council's Lending Policy and Counterparty List are updated to include the use of Money Market Funds as detailed in the report.
- 1.2 That a maximum overall limit of £10m is placed on deposits in Money Market Funds with a maximum of £2m invested in any one Fund.
- 1.3 That delegation is given to the Director of Finance and Corporate Services to select and monitor the use of individual Funds.
- 1.4 That, if approved, the performance of Money Market Funds is reported to the Committee on at least a quarterly basis.

2.0 Purpose of the Report

- 2.1 To review the Council's Lending Policy and Counterparty List and to propose the use of Money Market Funds (MMFs) for depositing cash balances on a short-term (less than 364 days) basis.

3.0 Detail

- 3.1 Recent Financial and Treasury Management Reports to the Committee have highlighted the increasing level of cash and reserves available for short-term investment. The Council's approved lending policy priorities security and liquidity of deposits over yield.
- 3.2 All deposits are short-term (less than 364 days) and tend to be held in instant access accounts, although longer fixed-term arrangements exist with other local authorities.

- 3.3 In recent years, the number of named investors on the approved Counterparty List has diminished due to stricter lending criteria and the reduction in credit ratings of several financial institutions.
- 3.4 In addition, spreading the Council's deposits is proving more difficult within the credit limits set for each type of investment. Typically, the Council has between £10m to £20m on deposit during the year.
- 3.5 There are no proposals to change current limits or the overall lending criteria. Generally, these serve the Council well and are in accordance with that recommended by the Council's Treasury Advisors (Arlingclose).
- 3.6 However, given the level of cash and reserves, some research has been undertaken to determine whether there are any other safe and secure methods of depositing cash on a short-term basis in accordance with the Council's overall lending policy.
- 3.7 Besides cash being deposited with banks and lent to other local authorities, there are other financial instruments available. For example, the Council could consider entering the Bond Market or buying Government Treasury Bills.
- 3.8 These instruments are regulated and tend to generate greater returns. However, they are more risky, involve intermediaries, incur a cost and can create complications on how they are accounted for and shown on the Council's Balance Sheet. Ideally, these are suited to where capital can be tied up for a fixed-term longer period and could extend beyond 364 days.

Money Market Funds – MMF(s)

- 3.9 MMFs are pooled funds that invest in short-term debt instruments, which provide a diverse investment portfolio. Each investor who invests in a MMF is considered a shareholder of the investment pool.
- 3.10 MMFs have become an alternative short-term deposit option for local authorities as they have very high liquidity, diversity and offer competitive yields compared to, for example, the Debt Management Office (DMO). Credit ratings are generally high and greater than many leading banks.
- 3.11 The greatest benefit is diversification which protects overall capital from being lost. The funds invest in financial instruments such as government securities, treasury bills, certificates of deposit, etc. Each holding in a pool is limited to 5% of the overall Fund value, with investment typically spread across 30 to 40 different names. This provides pool members with safer access to financial instruments than they could get individually.
- 3.12 There are several funds available for investors and each one is monitored and rated individually – they are regulated.
- 3.13 Fund ratings are based on the range of investment assets, maturity spread, together with their past record and the experience of each Fund Manager.

3.14 A key component is the weighted average maturity portfolio (WAM). For a MMF to get the highest credit rating, the WAM should not exceed 60 days. This ensures that a fund is highly liquid.

Is Capital invested Safe?

3.15 Clearly, there is risk with any deposit. As part of the regulations, funds have to operate on a “*Stable Net Asset Value Basis*”. This means that for every £1 of principal invested, the Fund will return £1 on withdrawal, plus interest. Interest in the Fund is accrued daily.

3.16 In addition, all assets in the Fund belong to the shareholders and not to the Fund Management Company. For example, in a Fund managed by Goldman Sachs, the assets in the Fund are “ring-fenced” from the assets held by Goldman Sachs. The Fund Manager deducts their management fee from the interest so that interest is paid net and there are no other direct costs to individual investors.

Operational Arrangements

3.17 MMFs operate on a same-day subscription or withdrawal basis. Therefore, subject to cut-off deadlines for trading, monies are invested on the same day they are transferred and repaid on the same day as notice is given, i.e. effectively instant access.

3.18 Due to the liquidity requirement and the WAM, deposits can only be made for a maximum period of 60 days.

3.19 Administration is fairly minimal. Once a Fund is selected and set-up, trading is undertaken on-line in accordance with normal day-to-day treasury management operations.

3.20 As part of the services provided by the Council’s Treasury Advisors, they will assist with Fund selection, liaise and monitor Fund performance on behalf of the client. They also issue monthly bulletins on MMFs.

Performance and Potential Yield

3.21 The best performing funds currently available are detailed in **Appendix 1**. This shows the net return after fees have been deducted. The current yields range from 0.245% down to 0.121%. Clearly these are low but reflect the short-term nature of deposits and the low Base Rate of 0.25%.

3.22 However, these rates should be compared with those that the Council currently receives from the DMO facility, which is 0.1% and from the instant access accounts with HSBC, Barclays and the Bank of Scotland, which currently pay even less.

Adding MMFs to the Council's Counterparty List

- 3.23 It is considered that the use of MMFs is a viable option compared to the Government's DMO facility and instant access accounts in order to place funds on deposit on a short-term basis. This will help to diversify the Council's investment portfolio with a minimal amount of risk.
- 3.24 The Council's Treasury Advisors recommend that exposure should be limited to 0.5% of a MMF size. Most of the available funds are valued in billions of pounds as shown in **Appendix 1**.
- 3.25 The more relevant recommendation is that deposits in each MMF should be limited to 10% of total investments available, which will be up to £2m in the Council's case. In addition, the Advisors recommend that overall investments in MMFs as a whole should be limited to 50% of the total investment portfolio for those with portfolios of greater than £10m.
- 3.26 This would place a maximum limit of up to £10m depending on cash flow during the year. Currently, the Council operates within a £15m limit for the DMO and £2m for each of its three instant access accounts.
- 3.27 To maintain diversification, the Council does invest on a longer fixed-term basis by depositing funds with other local authorities. These achieve a higher rate of return compared to MMFs but usually have fixed terms between 3 and 9 months.
- 3.28 It is considered that the principle of using MMFs is that it will generate a greater yield on shorter-term cash deposits and is an alternative to the DMO facility and instant access accounts. Therefore, it is recommended that MMFs are added to the Counterparty List with the following criteria:
- A maximum investment of £10m overall.
 - A maximum of £2m invested in any one Fund.
- 3.29 Therefore, more than one Fund will be chosen and opened to ensure that the Council has multiple choices with broadly equal exposure to each Fund.
- 3.30 The selection and use of each Fund should be delegated to the Director of Finance and Corporate Services in accordance with their duties and responsibilities for Treasury Management. This would be based on recommendations from the Council's Treasury Advisors and kept under review within the approved limits.
- 3.31 If approved, performance on MMFs would be incorporated into the quarterly financial report and form part of treasury management operations.

4.0 Financial Implications

4.1 As detailed in the report.

5.0 Corporate Implications

5.1. None directly

6.0 Community Implications

6.1 None directly

7.0 Background Papers

None