Flinders Council Policy Manual F5

SUBJECT: *INVESTMENT POLICY*		**FILE NO:**	FIN/0501
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1. Background

Council generally has funds in excess of those needed to meet its immediate day-to-day activities. Those funds are then available for investment until required, with the resultant investment income forming part of Council's budgeted revenue.

When exercising this policy, consideration is to be given to the preservation of capital, liquidity, and the return on the investment.

Preservation of capital is the principal objective of the investment portfolio whilst optimising return. Investments are to be placed in a manner that seeks to ensure security and safeguarding the investment portfolio. This includes managing credit and interest rate risk within identified thresholds and parameters.

Investments should be allocated to ensure there is sufficient liquidity to meet all reasonably anticipated cash flow requirements, as and when they fall due, without incurring the risk of significant costs due to the unanticipated realisation of an investment.
Investments are expected to achieve a market average rate of return in line with the Council's risk tolerance as set out in the risk assessment framework in this policy.

2. Policy Objective

In accordance with legislative and common law responsibilities the objective of this Policy is to authorise and regulate the investment of Council's surplus funds so as to maximise earnings from authorised investments whilst ensuring the security of those funds.

3. Policy Guidelines

Funds for Investment

Any surplus Council's funds are to be invested in terms of this Policy document.

Authority for Investment

Investments of Council's funds are to be in accordance with Council's power of investment under:

- *Local Government Act 1993* - Section 75.
- The *Trustee Amendment (Investment Powers) Act 1997*

Prudent Persons Standard

The investment portfolio will be managed with the care, diligence and skill that a prudent person would exercise. As trustees of public monies, officers are to manage the Council's investment portfolio to safeguard the portfolio in accordance with the spirit of this policy, and not for speculative purposes.

Ethics & Conflicts Of Interest

Officers of the Council, Councillors and members of the Audit and Finance Special Committee will not engage in personal activities that may conflict with the proper execution and management of the Council's investment portfolio. All officers must disclose any actual or potential conflict of interest to the General Manager who shall disclose the interest in accordance with prescribed practice. In the case of the General Manager such a disclosure is to be made to the Mayor.

Any person from whom advice is sought in relation to investments must also declare, in writing, that they have no actual or potential conflict of interest.

4. Approved Investments

Investments made under delegation are limited to the following:-

A. Commonwealth/State/Territory Government security (eg bonds);

B. Interest Bearing Deposits issued by an authorised deposit taking institution (ADI);

C. Bills of Exchange guaranteed by an authorised deposit taking institution; and

D. Deposits with Tasmanian Public Finance Corporation.

E. Managed Funds with a minimum long term Standard and Poor (S&P) rating of "A" and short term rating of "A2".

5. Prohibited Investments

The following investments are prohibited under this policy:-

A. Derivative based financial instruments;

B. Principal only investments or securities that provide potentially nil or negative cash flow;

C. Investments that have underlying futures, options, forward contracts and swaps of any kind;

D. Any type of collateralised debt obligation investment; and

E. Any financial investment that requires the Council to borrow (leverage) in order to make that investment.

6. Investment Guidelines

In order to meet the policy objectives the Council must take into consideration all of the following factors when carrying out investment functions:-

a) Existence of Guarantee and Security, including the Financial Claims Scheme

b) Risk Assessment Framework (including credit and maturity frameworks), as detailed below

c) Interest Rate; and

d) Access to, and customer service history of, the institution.

6.1 Risk Assessment Framework

Investments are expected to achieve a market average rate of return taking into consideration the following risk assessment framework.

a) Preservation of Capital – the requirement for preventing losses in an investment portfolio's total value.

b) Diversification – the requirement to place investments in a broad range of products so as not to be over exposed to a particular sector of the investment market.

c) Market Risk - the risk that the fair value or future cash flows of an investment will fluctuate due to changes in market prices.

d) Liquidity Risk - the risk an investor is unable to redeem the investment at a fair price within a timely period.

e) Maturity Risk - the risk relating to the length of term to maturity of the investment. The larger the term, the greater the length of exposure and risk to market volatilities.

f) Leverage Risk - the magnification of an investor's risk and return that occurs when the investor takes on financial leverage through an investment product.

Credit and Maturity Frameworks

Investments are to comply with three key criteria relating to:

a) Overall Portfolio Credit Framework - The purpose of this is to limit the overall credit exposure of the portfolio;

b) Institutional Credit Framework - The purpose of this is to limit exposure to individual institutions based on their credit ratings; and

c) Term to Maturity Framework - The purpose of this is to limit risk based upon the time to maturity of the investment.

Overall Portfolio Credit Framework

To control the credit quality on the entire portfolio, the following credit framework limits the percentage of the portfolio exposed to any particular credit rating category.

S&P Long Term Rating*	S&P Short Term Rating*	Maximum %
AAA (incl. government guaranteed deposits)	A-1+	100%
AA	A-1	80%
A	A-2	60%
BBB	A-3	20%

* or equivalents

All categories include any intermediate ratings (ie BBB includes BBB+, BBB and BBB-).

Institutional Credit Framework

Exposure to an individual institution will be restricted by their credit rating so that single entity exposure is limited, as detailed in the table below:

S&P Long Term Rating*	S&P Short Term Rating*	Maximum %
AAA (incl. government guaranteed deposits)	A-1+	45%
AA	A-1	35%
A	A-2	20%
BBB	A-3	10%

* or equivalents

All categories include any intermediate ratings (ie BBB includes BBB+, BBB and BBB-)

If any of the Council's investments are downgraded such that they no longer fall within the investment policy, they will be divested as soon as practicable. In the case of a downgrade of an investment, the General Manager is to inform the Mayor immediately of becoming aware of the event. The short-term credit rating limit will apply in the case of discrepancies between short and long-term ratings.

Where a bank has a demonstrated commitment to the distribution of funds to the community within the Council municipal area the maximum amount of funds that can be deposited by the Council with that institution be increased by 5% from the benchmarks in the Institutional Credit Framework table above.

<u>Term to Maturity Framework</u>

The investment portfolio is to be invested within the following maturity constraints:

Overall Portfolio Return to Maturity		
Portfolio % < 1 year	Min 40%	Max 100%
Portfolio % 1-2 years	Min 0%	Max 60%
Portfolio % 2-3 years	Min 0%	Max 20%

6.2 Interest Rate and Quotations on Investments

Not less than two (2) quotations shall be obtained from authorised deposit taking institutions and/or investment advisors whenever an investment is proposed.

6.3 Investment advisor

Where Council obtains the services of an investment advisor, the advisor must be approved by Council and licensed by the Australian Securities and Investment Commission. The advisor must be an independent person who is free to choose the most appropriate product within the terms and conditions of this policy.

The advisor will be required to provide written confirmation that they do not have any actual or potential conflicts of interest in relation to the products that they may be reviewing or recommending, including that they are not receiving any commissions or other benefits pertaining to the related investments and will not do so in the future.

7. Performance Benchmarks

The Benchmark Rate for purposes of measurement of the portfolio's performance will be set in the applicable financial year's budget. This rate will be determined by reference to interest rate forecasting.

As the budget figure is based on predicted investment levels and expectations about future interest rates, using it as the sole comparison may be misleading, therefore an external benchmark may be used.

The external benchmark rate will be the Reserve Bank of Australia 90 Day Bank Accepted Bill Rate for the short term. The long term benchmark should be the composite bond index.

The investment performance will be determined on a monthly accrual basis (the income applicable for each month being determined) and compared to the above benchmark on a weighted 3 month average investment performance (the accrued interest being compared to the average investment balance for the month, averaged over 3 months).

8. Reporting

Documentary evidence must be held for each investment and details thereof maintained in an investment Register. The documentary evidence must provide the Council legal title to the investment. Certificates must be obtained from the financial institutions confirming the amounts of investments held on the Council's behalf as at 30 June each year and reconciled to the Investment Register.

All investments are to be appropriately recorded in the Council's financial records and reconciled at least on a monthly basis.

A monthly report summarising investment performance will be provided to Council. A quarterly report detailing the investment portfolio in terms of performance, percentage exposure of total portfolio, maturity date and changes in market value will also be provided to Council.

9. Variations to Policy

The General Manager is authorised to approve temporary variations to this policy in exceptional circumstances, if the investment is to Council's advantage and/or also due to revised legislation.

Such variation will be reported to the Mayor immediately. Any major variations to this policy will be submitted to Council for approval.

10. Review

This Investment Policy will be reviewed at least every 2 years, or as required in the event of legislative changes.

Any amendment to the Investment Policy must be by way of Council resolution.

Appendix 1- Information about deposit and wholesale funding guarantees

AUSTRALIAN GOVERNMENT'S 2008 DEPOSIT AND WHOLESALE FUNDING GUARANTEES

The Australian Government's deposit and wholesale funding guarantee arrangements operate as set out below.

Purpose of the guarantees

The Prime Minister announced the deposit and wholesale funding guarantees on 12 October 2008.

The Government guarantees are designed to promote financial system stability and ensure the continued flow of credit throughout the economy at a time of heightened turbulence in international capital markets.

The guarantees apply to authorised deposit-taking institutions (ADIs) incorporated in Australia, which, as a group, are of systemic importance to the functioning of the financial system and the broader economy, and which are subject to prudential regulation by the Australian Prudential Regulation Authority (APRA) in accordance with international standards.

Recent developments in international wholesale funding markets have restricted the ability of Australian financial institutions to access funding, with potentially serious implications for liquidity and lending activity.

To address these pressures, the guarantees are designed to assist Australian banks, credit unions and building societies to continue to access funding in domestic and international credit markets. The guarantees are also designed to ensure that Australian institutions are not placed at a commercial disadvantage vis-à-vis their international competitors that have received similar government guarantees on their bank debt.

Scope of the guarantees

The guarantees are limited to Australian owned banks, Australian ADI subsidiaries of foreign banks, credit unions and building societies ('eligible ADIs'). The guarantee applies to the foreign branches of eligible ADIs but not their foreign subsidiaries.

Wholesale funding guarantee

The guarantee will be extended on an issue by issue basis. Eligible securities will be restricted to securities issued by eligible ADIs with a term of up to 60 months with the guarantee to apply for the full term of the relevant security including in the period following the closure of the scheme to new issuances.

The facility is restricted to senior unsecured debt instruments. Certificates of deposit and bank bills will be covered by this facility. They will not be covered by the deposit guarantee. The guarantee will not cover structured debt.

The facility will apply to debt issuance in all major currencies including AUD, NZD, Euro, USD, Sterling, Yen and HKD. It will apply to eligible securities issued domestically or off-shore.

The Government will withdraw the facility once market conditions have normalised.

Deposit guarantee

The Government has guaranteed the deposits in eligible ADIs for a period of three years.

For deposits under $1 million, the guarantee will be free. For deposits over $1 million a fee will be charged to receive the benefit of the deposit guarantee.

Coverage of the deposit guarantee

The guarantee applies to deposits held in eligible ADIs by all types of legal entities, including individuals, partnerships, businesses, trusts (including in their offshore branches) and government entities.

The guarantee will not apply to products that are not deposit products with eligible ADIs. It does not apply to market-linked investment products such as share portfolios or managed funds, as these products provide an incentive for investors to pursue higher returns through investments that may involve greater risks, including the risk of making capital losses. It will also not apply to retirement income products including annuities.

The guarantee will not apply to products offered by non-ADI entities, including non-ADI subsidiaries of Australian ADIs. These entities are not subject to the prudential regulation framework that applies to ADIs, which protects the interests of depositors. Because of this, non-ADI entities are not permitted to offer deposits in Australia.

It will apply to the deposits held in eligible institutions, regardless of where the depositor resides. It will apply to deposits held in any currency.

Fee Structure and level for the guarantees

Fees will be set at a single rate for all maturities for eligible securities up to 60 months, with a different rate applying to eligible ADIs based on their credit rating. The fees will apply to the wholesale guarantee and to the guarantee for deposits above the $1 million threshold. The fees will be levied annually.

The fee scale is outlined in Table 1.

Table 1

Credit Rating	Debt Issues Up to 60 Months
AA	70bp
A	100bp
BBB and Unrated	150bp

Review of parameters

The deposit and wholesale guarantees contain features and variables that may require refinement or adjustment in light of market developments. These include the setting of the appropriate fee level and structure, the threshold for the deposit guarantee and the overall coverage of the scheme. The deposit and wholesale guarantee scheme will be reviewed on an ongoing basis and revised if necessary.

Foreign bank branches

The wholesale funding guarantee will be extended to APRA-regulated foreign bank branches in respect of their short term wholesale funding raised from Australian residents with maturities up to the end of 2009. This will be available at the same premium as applying to eligible ADIs.

Foreign bank branches will also be able to access the deposit guarantee in respect of domestic deposits held by Australian residents on the basis of the fee schedule; however, there will be no fee-free threshold.

Access to these guarantees will be subject to the following conditions:

- The amount guaranteed be limited to 110% of the combined value of short-term wholesale liabilities and deposits held in respect of Australian residents as at 24 October 2008;

- Branches cannot use guaranteed liabilities to support their parents; and

- The guarantee is only available if the liabilities are not guaranteed by the home authorities and the branch provides a statement from the home regulator that the parent bank is meeting relevant prudential requirements.

These requirements will ensure the funding is used for Australian operations only and that Australian taxpayer funds are protected.

The guarantees will be extended to foreign bank branches from 28 November 2008. Until that date the guarantees will not be available to foreign bank branches.

Administration of the guarantees

The Reserve Bank of Australia (RBA) will administer the guarantees as agent for the Commonwealth. The RBA will perform administrative tasks, including processing applications from institutions for coverage of liabilities and collecting fees.

The RBA will consult with APRA to ensure that the interests of the Commonwealth are protected. The Rules will allow for information sharing between the RBA, APRA and other relevant agencies. It is proposed that information and statistics about the scheme's operation will be made available on a public website.

The legal framework for the scheme will be deeds entered into by the Commonwealth and the participating institutions. The deeds will refer to scheme Rules that will be published by the Commonwealth.

Details of the scheme, including participating institutions and the liabilities that are covered will be made available on a suitable public website. The Government will provide six monthly reports to Parliament on the scheme operations.

Wholesale funding guarantee

Eligible ADIs must apply to the RBA for coverage of their liabilities. Eligible ADIs will be required to meet set criteria specified in Rules before they receive coverage. The Rules will be released in the near future.

Deposit guarantee over the threshold

Eligible ADIs will apply to the RBA for coverage of their deposits over the $1 million threshold.

Eligible ADIs would choose whether to 'opt in' to the guarantee for their deposits above the threshold. If an eligible ADI opts in, it would be up to the ADI to determine the most suitable arrangements with its customers for those deposits it wishes to offer on a guaranteed basis

Depending on the arrangement chosen by the ADI, depositors may need to indicate to the ADI whether they wish to receive the benefit of the guarantee for amounts over $1 million.

If an ADI agrees to opt in, they would be required to pay the relevant fee to the RBA.

The fee would be payable on the value of the depositor's account(s) over the fee threshold.

It is expected that the ADI will pass on costs of the guarantee to depositors.

Commencement of guarantee arrangements

The guarantee scheme commenced on 28 November 2008. Up until that date deposits and wholesale funding eligible for the guarantee arrangements were guaranteed without charge. After that date, deposits over the $1 million threshold and wholesale funding will only be guaranteed if an application has been made to the RBA and the relevant fee has been paid.