



COUNCIL 28. 6. 2012

7. INVESTMENT MANAGEMENT POLICY, ADJUSTMENT OF COUNTERPARTY CREDIT LIMITS

General Manager responsible:	General Manager, Corporate Services, DDI 941-8528
Officer responsible:	Corporate Finance Manager
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PURPOSE OF REPORT

1. In the 2009-19 LTCCP the Council adopted an Investment Policy which included a number counterparty credit limits specifying the maximum amount the Council can invest with a range of approved categories of financial institutions.
2. While the Council's response to the Canterbury earthquakes will increase the level of Council's debt, in the short term large receipts of insurance and Crown funding are likely to result in significant increases in short term investments. The purpose of this report is to provide advice in relation to the maximum amounts Council invests with each party (known as counterparty credit risk), and recommend the adoption of new limits.

EXECUTIVE SUMMARY

3. Counterparty credit risk is the risk of losses arising from transactions with another party, such as a bank, when that party defaults on money owed to the Council. To manage its counterparty credit risk the Council:
 - (a) invests only in organisations that have long-term credit ratings (Standard & Poor's or Moody's) of A- and above, or short-term rating of A2 or above, or which are New Zealand Local Authorities, and
 - (b) seeks to spread its exposure over as wide a range of counterparties as reasonably possible.
4. The table below sets out the credit limits adopted in the 2009-19 LTCCP Investment Policy. These credit limits were based on the recommendations of Council's external treasury advisors, Asia Pacific Risk Management, and adopted based on the Council's anticipated investment profile at the time.

Counterparty/ Issuer	Minimum long term / short term credit rating -	Investments maximum per counterparty (\$m)	Interest rate risk management instrument maximum per counterparty (\$m)	Total maximum per counterparty (\$m)
NZ Government	A- / A2	unlimited	none	unlimited
NZD Registered Supranationals	AAA	50.0	none	50.0
State Owned Enterprises	A- / A2	15.0	none	15.0
NZ Registered Bank	A- / A2	50.0	70.0	70.0
NZ Registered Bank	Government guaranteed	Up to guarantee maximum	none	Up to guarantee maximum
Corporate Bonds/ CP	A- / A2	10.0	none	10.0
Local Government Stock/ FRN/CP	A- / A2 (if rated) Unrated	40.0 25.0	none none	40.0 25.0

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5. Provided that Council funds are not exposed to unacceptable risk the Council also seeks to maximise its returns on investment. Institutions with higher credit ratings, which are the safest counterparties, generally provide the lowest returns. For example, the Council can invest unlimited amounts in the NZ Government but the return is around 2.75 per cent, while investing in a AA rated bank for the same period could return in excess of 3.5 per cent.
6. The Council is currently at or near counterparty credit limits with the large trading banks which routinely provide the best investment return for the Council. The Council currently has relationships with 12 New Zealand registered banks that meet Council's minimum credit rating requirements and at 30 May 2012 could invest up to \$235 million with those banks without breaching counterparty credit limits. Any sum received in excess of that amount could be invested in NZ Government.
7. Earthquake related payments from the Crown and insurers are often received with one day's notice. Depending on the amount and timing of payments, based on current estimates and informal payment advice it is possible that Council could have in excess of \$300 million of new funds to invest for a short period. However, of the four banks regularly offering the best short term investment returns Council could invest a total of only \$63 million. The difference in investment return between investing in these four banks and the other lower return investments available to the Council under its existing policy could be as much as 1 per cent interest.
8. Staff have received advice from its external treasury advisors in relation to its current counterparty credit limits. This advice is that current limits are too low, particularly in relation to banks. Asia Pacific Risk Management advise that the old credit limits reflected the economic environment prior to the global financial crisis. Since then the number of banks in New Zealand diminished, the liquidity requirements placed on banks by the Reserve Bank have tightened, and the Australasian banks are now in the top ten in the world in terms of creditworthiness. Following a review Asia Pacific Risk Management recommend the following counterparty credit limits:

Counterparty/ Issuer	Minimum long term / short term credit rating –	Investments maximum per counterparty (\$m)	Interest rate risk management instrument maximum per counterparty (\$m)	Total maximum per counterparty (\$m)
NZ Government	A-/ A2	unlimited	none	unlimited
NZD Registered Supranationals	AAA	70.0	none	70.0
State Owned Enterprises	A-/ A2	20.0 <i>(from 15.0)</i>	none	20.0 <i>from 15.0</i>
NZ Registered Bank	A-/ A2	100.0 <i>(from 50.0)</i>	150.0 <i>(from 70.0)</i>	150.0 <i>(from 70.0)</i>
Corporate Bonds/ CP	A-/ A2	10.0	none	10.0
Local Government Stock/ Bonds/ FRN/CP	A-/ A2 (if rated) Unrated	40.0 25.0	none none	40.0 25.0

9. The Council's current Investment Policy, including counterparty credit limits, was adopted as part of the 2009-19 LTCCP. That Policy, and the counterparty credit limits set within it, can be changed by resolution of the Council. Therefore, it is proposed that the Council resolve to amend its counterparty credit limits as recommended by Asia Pacific Risk Management

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FINANCIAL IMPLICATIONS

10. Staff and Asia Pacific Risk Management consider that using the counterparty credit limits recommended above are prudent and do not expose the Council to an unreasonable or unacceptable level of risk.
11. Ongoing uncertainty about the amount and timing of earthquake related payments means it is not possible to determine the exact amount of interest revenue that could be lost should the Council decide not to adopt the recommended counterparty credit limits. However, on the assumption that \$300 million is received by the Council over the next three months the adoption of new credit limits could increase interest revenue by \$0.110 million per month.

Do the Recommendations of this Report Align with 2009-19 LTCCP budgets?

12. Not applicable.

LEGAL CONSIDERATIONS

13. Section 102 of the Local Government Act 2002 requires the Council to adopt an Investment Policy. The Council's current Investment Policy, including counterparty credit limits, was adopted as part of the 2009-19 LTCCP. Prior to the passing of the Local Government Act 2002 Amendment Act 2010 an Investment Policy could only be adopted or amended as part of a Long Term Council Community Plan. However, since the passing of that Act Council can amend its Investment Policy, by resolution, subject to the decision making requirements in the Local Government Act.

ALIGNMENT WITH LTCCP AND ACTIVITY MANAGEMENT PLANS

14. Not applicable.

Do the recommendations of this report support a level of service or project in the 2009-19 LTCCP?

15. No.

ALIGNMENT WITH STRATEGIES

16. Not applicable.

CONSULTATION FULFILMENT

17. Not applicable.

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STAFF RECOMMENDATION

It is recommended that the Council resolve to amend the counterparty credit limits in the Council's Investment Policy as follows:

Counterparty/ Issuer	Minimum long term / short term credit rating –	Investments maximum per counterparty (\$m)	Interest rate risk management instrument maximum per counterparty (\$m)	Total maximum per counterparty (\$m)
NZ Government	A-/ A2	unlimited	none	unlimited
NZD Registered Supranationals	AAA	70.0	none	70.0
State Owned Enterprises	A-/ A2	20.0	none	20.0
NZ Registered Bank	A-/ A2	100.0	150.0	150.0
Corporate Bonds/ CP	A-/ A2	10.0	none	10.0
Local Government Stock/ Bonds/ FRN/CP	A-/ A2 (if rated) Unrated	40.0 25.0	none none	40.0 25.0