Appendix A – Cash Management Strategy – Proposed Amendment to ISS – January 2023

1. Context

1.1 The Barnet Pension Fund (the "Fund") does not have a strategic allocation to cash. This is because, in general, cash is a low yielding asset class and not suitable for a pension fund looking to maximise return subject to an acceptable level of risk.

1.2 However, there are occasions where the level of cash held by the Fund is materially high. This could happen for a number of reasons:

- Distributions from managers, particularly Private Market managers, can be lumpy and there may be some time before another manager is selected and the distribution can be re-invested;
- A shift in strategy may necessitate a temporary holding in cash;
- The Fund may need to disinvest from a specific manager or asset class due to particular market factors (as happened with the disinvestment from the Alcentra Fund);
- The timing of contributions does not equal benefit payments – an issue where there is any prepayment of employer contributions, as what happened following the 2019 Valuation.

2. Current Cash Position

2.1 The Fund has relatively high cash balances due to the disinvestment of the Schroders DGF (the DGF which was being used to fund Capital Calls, but holding the DGF meant the Pension Fund was overweight in Growth assets relative to the Fund's 50% target – i.e. disinvestment of the DGF was a de-risking measure which Officers implemented following a review by Hymans of the market risk profile.

2.2 We currently have cash holdings of c£130m, but, due to planned investments towards LCIV's MAC Fund and expected Capital Calls, we project this will fall to around £70 / £80m by the time of the next Committee meeting on 31 January 2023. The balance will then reduce further as Capital Calls are made through 2023.

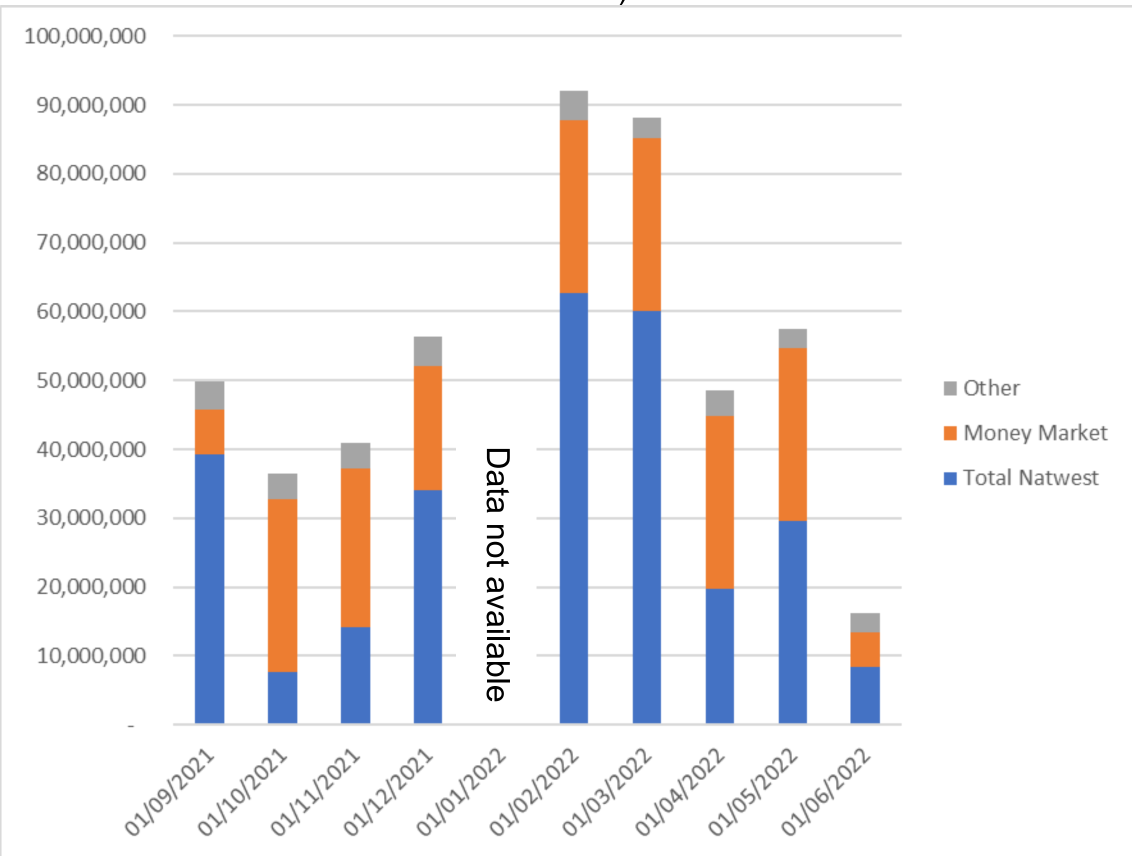
3. Prior policies around cash management

3.1 The ISS is silent on how to manage cash balances and, while this is not uncommon for LGPS funds, the recent increase in interest rates generally means that this is something we are looking to address through this paper.

3.2 Prior to November, the Fund had access to one Money Market Fund (MMF) (the Aberdeen Standard Liquidity Fund (Lux) – Sterling Fund). As a recap, MMFs invest in highly secure (usually "A" rated or higher) and liquid (usually instantly accessible) instruments which protects the capital value of funds placed. The high security and liquidity mean returns are generally relatively low. There was an internally imposed limit of £25m towards this Fund. This appears to have been set due to a wider Treasury side limit of £25m on MMFs – however, the Treasury Team has access to around seven MMFs and so has capacity to manage large Treasury cash balances within the limits set.

3.3 There is no restriction stipulated in the Fund's Investment Strategy Statement and / or wider regulations around limits to MMFs for pension funds – i.e. the £25m limit was self-imposed. In context the Fund has historically held very little in cash balances and interest rates were low and so did not necessarily need specific protocols around managing cash balances.

3.4 The level of cash balances held within the Fund over the period September 2021 to June 2022 is summarised in the chart below (note balances at 31 January 2022 are not summarised within immediate sources).



3.5 Note that over this period the Fund has had high cash balances. Due to the £25m limit within the MMF, this has meant high balances have been left within the Fund's current account with Natwest (for example, in February 2022, the Fund had £92m of cash balances with £62m held with Natwest, £25m held in the MMF and around £5m held with LCIV and WYPF).

3.6 The higher cash balance over this period followed from the Fund's disinvestment from Alcentra MAC after Hymans' research team lost conviction in the strategy and effectively issued a 'sell' rating. The Committee agreed to reinvest the proceeds in the LCIV MAC strategy after the PIMCO strategy was added to the fund (completed July 2022).

4. Increase in Cash Balances due to Schroder disinvestment

4.1 From June 2022 the Fund's cash balances started to reduce. However, on 21 October, as the Schroders DGF Fund was disinvested, we faced a similar situation where we would be holding very high cash balances and that if we kept to the £25m limit with the Aberdeen MMF then our Natwest balance would have exceeded £50m.

4.2 To manage exposure to Natwest, Pension Officers sought approval from the S151 Officer to extend the limit with the Aberdeen MMF to keep cash balances with Natwest to a more reasonable level.

4.3 The primary rationale for this was that, as a diversified managed high credit quality fund, the Aberdeen MMF was less risky than having concentrated money held with Natwest, which only provides protection for balances up to £85k under the Financial Services Compensation Scheme (FSCS) in the event that Natwest fails.

4.4 To manage overall exposure to Aberdeen, we decided to set up another MMF with LGIM (LGIM Sterling Liquidity Fund) - LGIM already invest a substantial amount of Fund assets and we have an established relationship with them.

5. Proposals to manage cash balances

5.1 Money Market Funds, whilst highly liquid and of good credit quality, are typically low yielding. This means that where substantial cash is held for a period of time, the Fund may not be maximising its return potential.

5.2 We may therefore wish to consider alternatives to Money Market Funds where cash balances are expected to be high for a period of time.

5.3 Any alternative to Money Market Funds necessarily means more risk will be taken, but in context, it is a fundamental part of our overall Investment Strategy that risk is taken – indeed, taking risk in return for a higher investment performance is what makes the Fund sustainable from a financial perspective.

5.4 It should also be borne in mind that holding excess cash is likely to be a transient position and the ultimate destination for the cash will involve asset classes that are intrinsically risky, and so accepting a degree of risk for the transient holding is not irresponsible and simply better matches the ultimate destination for the funds.

5.5 Two levers of risk which could be taken in respect of cash are liquidity risk and credit risk. We will also need to manager overall concentration risk.

5.6 We consider each of these risks and make an overarching proposal below.

Consideration	Comment	Proposal
Liquidity Risk	Any holding in cash will need to be repurposed towards alternative investment classes and funds may be called at short notice. Officers are normally able to forecast with relative confidence when investments would be needed and so can plan around liquidity requirements. In addition, the Fund holds highly liquid equity and listed bond investments and so is unlikely to be in a position where liquidity is likely to be an issue.	We believe liquidity risk can be managed through appropriate planning and so propose that additional funds based on monthly dealing would enable the Fund to benefit from additional return through an illiquidity premium.

Credit Risk	Credit risk is crucial to the management of cash assets. However, taking an element of Credit Risk can enhance returns substantially. Credit Risk can be managed via diversification and by setting controls around the minimum level of credit ratings.	We propose to explore funds which diversify across a number of counter parties and where duration of finance is generally for 12-months or less. Our advisors will comment on the suitability of the credit risk we are taking before we utilise any particular fund.
Concentration Risk	Funds with less liquidity and higher credit risk are intrinsically more specialised and likely to have less overall diversification compared to pure MMFs. Given the specialist nature of these funds we will also be required to take 'suitability' advice from our investment consultants. *Hymans have recommended two suitable Funds, Allianz and Pemberton – Hymans's report setting out their recommendation is provided as appendices B and C*	To manage any exposure to any specific manager (where the manager is not a high quality, high liquidity MMF) we propose an absolute investment limit of £30m per fund

6. Proposed Framework (to incorporate into the ISS)

6.1 We have developed a framework in collaboration with Hymans, which, subject to approval from the Committee, can be incorporated into the Investment Strategy Statement.

6.2 In designing this framework we have develop three tiers of potential cash investments. These are summarised below together with assessment of Liquidity, Credit, Diversification attributes and yield:

	Liquidity	Credit	Diversification	Return (Nov 2022)
Tier 1 – Natwest (Current Account)	Very High	Based on Natwest	Poor - one counter party	0.8% p.a.
Tier 2 – MMF (Primary)	Very High (daily dealing)	Very High (typically AA or higher)	Very High (Typically 100+ counter-parties)	3% p.a.
Tier 3 – Higher yield (Secondary option if cash balances high for sustained period)	Medium (monthly dealing)	High (Investment grade on average)	High (Hymans to advise)	5% p.a.

Proposed addition to ISS

Officers may invest transient cash balances in line with the following principles:

	Strategy	Number of BPF Funds
Tier 1 (Current Account)	Minimise allocation to manage day-to-day cash flow.	N/A
Tier 2 MMF (Primary)	Invest balance between Tier 1 and Tier 3. This will be the Fund's primary destination for cash balances unless the Fund is expected to hold significant levels of cash for a sustained period. To manage exposure to one manager, cash will be allocated broadly equally between each MMF.	2 (LGIM / Aberdeen)
Tier 3 Higher yield (Secondary)	Officer discretion to invest up to £30m for each Tier 3. Investment in Tier 3 will be subject to managing appropriate liquidity through cashflow forecasting.	2 [Allianz / Pemberton] SUBJECT TO APPOINTMENT