



Investment (Financial Securities) Policy

MSC14E

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1. INTRODUCTION

The Investment Policy establishes the framework within which Council's cash and investment portfolio will be managed, monitored and reported on. This policy has been established in compliance with section 625 of the Local Government Act 1993 and provides guidance for the investment of Council's funds, with consideration given to the following primary objectives:

- Preservation of capital. Preservation of capital is the principal objective of the investment portfolio. Investments are to be placed in a manner that seeks to safeguard Council's cash and investments portfolio. This includes managing credit and interest rate risk within identified thresholds and parameters.
- Maximise investment returns within Council's risk appetite as outlined within this policy. Investments are expected to achieve a market average rate of return in line with Council's risk tolerance.
- Manage Council's cash resources to ensure sufficient liquidity to meet Council's business objectives over the short, medium and long term.

The policy reinforces Council's ongoing commitment to maintain a conservative risk and return portfolio, an important component of its ongoing prudent financial management practices.

For clarity, this policy does not apply to investments made by the Future Fund that operates under the Future Fund Policy, Operational Plan and Budget.

2. POLICY STATEMENT AND SCOPE

2.1 Funds for Investment

Investments are maintained to meet specified business needs, including:

- Strategic purposes consistent with Council's long-term strategic plan.
- Holding short-term investments for working capital requirements.
- Holding investments that are necessary to carry out Council operations consistent with annual long-term plans.

2.2 Legislative Authority for Investments

All investments are to be made in accordance with:

- Australian Accounting Standards
- NSW Office of Local Government Investment Circulars
- NSW Office of Local Government Investment Policy Guidelines
- Local Government (General) Regulation 2005 - Clause 212
- Local Government Act 1993 (particularly section 625)
- NSW Local Government Code of Accounting Practice and Financial Reporting
- Minister's Investment Order (gazetted)
- The Trustee Amended (Discretionary Investments) Act 1997 - Sections 14A(2), 14C(1) and (2)

2.3 Investment Governance

The following internal control practices are in place to ensure adequate governance and allow transparent and clear performance measurement for the management of Council's cash and investment portfolio:

- Financial planning and cash flow management
- Delegated authorities and investment approval
- Measurement of investment performance
- Performance benchmarks
- Reporting and review
- Audit oversight

2.4 Delegation of Authority

Authority for the implementation of the Investment Policy is delegated by Council to the General Manager in accordance with the *Local Government Act 1993*.

The General Manager (GM) has delegated the day-to-day management of Council's investment portfolio, including authority to invest surplus funds as follows:

- Chief Financial Officer (CFO)
- Other senior financial officers who have the requisite skills to undertake investment functions (as per the Delegations Register)

Officers with delegated authority are required to acknowledge they have received a copy of this policy and understand their obligations in this role.

2.5 Prudent Person 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 Council's investment portfolio to safeguard the portfolio in accordance with the spirit of this Investment Policy, and not for speculative purposes.

2.6 Ethics and Conflicts of Interest

Officers shall refrain from personal activities that would conflict with the proper execution and management of Council's investment portfolio. Any potential conflicts of interest should be appropriately disclosed in accordance with Council's Code of Conduct.

Independent advisors are also to declare that they have no actual or perceived conflicts of interest and receive no inducements in relation to Council's investments.

2.7 Approved Investments

Current investment regulations require Councils to invest with either the NSW Treasury Corporation (NSW TCorp) or Approved Deposit-taking Institutions (ADI) such as Australian banks or branches of foreign owned banks, credit unions and/or building societies as it acknowledges the additional assurance that arises from their regulation by the Australian Prudential Regulation Authority (APRA).

Investments are limited to those allowed by any current Ministerial Investment Order that has been issued by the NSW Minister for Local Government.

2.8 Prohibited Investments

In accordance with any current Ministerial Investment Order, this investment policy prohibits but is not limited to any investment carried out for speculative purposes, including:

- Derivative based instruments
- Collateralised Debt Obligations (CDO's)
- Principal only investments or securities that provide potentially nil or negative cash flow
- Standalone securities issued that have underlying futures, options, forward contracts and swaps of any kind.

This policy also prohibits the use of leveraging (borrowing to invest) of an investment.

2.9 Local Economic Benefit

Council will give consideration to investment products from institutions that provide a direct economic benefit to the Muswellbrook Shire community. This may include:

- Institutions that operate a retail branch in the Shire
- Institutions specifically established for the purpose of investing in the local area such as local credit unions

This is conditional upon the Council complying with its other obligations under this policy and the achievement of comparable investment security and rates of return. Any such consideration will be in line with the Council's obligations under legislation and its purchasing policies and procedures.

2.10 Investment Advisor

In managing its investments Council may, from time to time, engage the services of an independent investment advisor, licensed by the Australian Securities and Investment Commission for the purpose of achieving the aims of this policy. Independence includes receiving no commissions or other benefits in relation to the investments being recommended or reviewed, except as fully rebated to Council, promptly.

The independent advisor will review and assess the market value of the investment portfolio on a monthly basis.

Council's investment advisor is required to provide written confirmation that they do not have any actual or potential conflicts of interest in relation to the investments they are recommending or reviewing, including that they are not receiving any commissions or other benefits from the product providers in relation to the investments being recommended or reviewed.

2.11 Mandatory Investment Criteria

2.11.1 Scope

Investments must comply with the legislative authorities as described in the Legislative Authority for Investments paragraph of this policy.

2.11.2 Placing Investments

All new and renewal investments must be authorised by two (2) senior financial officers of Muswellbrook Shire Council one of which will be the Chief Financial Officer.

2.11.3 Currency

Investments must be denominated in Australian Dollars.

2.11.4 Ownership

Investments must be held in Muswellbrook Shire Council name.

2.11.5 Term / Maturity

The term to maturity of investments may not exceed the periods shown below:

Investment	Maximum term
Fixed Rate Term Deposits	5 years
Floating Rate Notes (FRNs)	5.5 years
Other Investments	10 years

2.11.6 Risk Management Framework

Council's risk profile in relation to investing surplus funds is to be relatively prudent, conservative and risk averse. The profile will be achieved by effectively managing within the investment portfolio:

- The diversity of the investments
- The creditworthiness of the investments

Diversity is achieved by placing limits on the maximum exposure Council may have to individual funds or financial institutions and individual credit rating bands.

Creditworthiness of investments is primarily determined using industry standard credit ratings.

Investments are to comply with three key risk management criteria:

- Overall Portfolio Credit Framework: limit overall credit exposure of the portfolio
- Institutional Credit Framework: limit exposure to individual institutions based on their rating
- Term to Maturity Framework: limits based on maturity of securities

Overall Portfolio Credit Framework

To control the credit quality of the entire portfolio, the following credit framework limits the percentage of the total portfolio exposed to particular credit rating categories.

Credit rating agencies apply short-term ratings to investments with 12 months or less to maturity and long-term ratings to those with greater than 12 months to maturity.

Short-term credit rating	Long-term credit rating	Overall portfolio exposure (as a % of Total Portfolio)
A-1+	AAA	100%
A-1	AA	100%
A-2	A	70%

Short-term credit rating	Long-term credit rating	Overall portfolio exposure (as a % of Total Portfolio)
A-3	BBB	60%
Unrated	Unrated	10%
NSW Treasury Corp Deposits		100%
TCorp IM Funds (allowable under the Ministerial Order)		25%

- Credit ratings apply to both products and institutions. This policy requires the rating applicable to the institution responsible for the product (e.g. guarantor) to be taken as the relevant rating given this represents the underlying risk to Council.
- Credit risk investment parameters are based on credit rating bands as published by the credit rating agencies (e.g. S&P, Moody's, Fitch). If an investment is rated by more than one ratings agency, the credit rating to be used will be based on the order of S&P, Moody's and then Fitch. In the event of disagreement between agencies as to the rating band ("split ratings") Council shall use the higher in assessing compliance with portfolio policy limits, but for conservatism shall apply the lower in assessing new purchases.
- Where the principal amount and accrued interest of any investment with a financial institution are directly guaranteed by the Australian Federal Government for full repayment, the exposure of the total portfolio to credit ratings lower than AAA may be exceeded, provided that the excess amount comprises only guaranteed investments. As a result, investments directly guaranteed by the Australian Federal Government may comprise the total investment portfolio. Management should ensure that any excess of investments over the parameters specified in the table above that is comprised of Australian Federal Government guaranteed investments can be managed back to within the specified parameter levels prior to the expiration of any such guarantee.

Institutional Credit Framework

Council's exposure to an individual institution will be restricted by their credit rating so that single entity exposure is limited.

Where Council has short-term and long-term holdings with the same institution, the limit associated to the institution's long-term rating will be used.

Short-term credit rating	Long-term credit rating	Individual institution exposure (as a % of Total Portfolio)
A-1+	AAA	30%
A-1	AA	30%
A-2	A	20%
A-3	BBB	10%
Unrated	Unrated	5%
NSW Treasury Corp Deposits		100%

Short-term credit rating	Long-term credit rating	Individual institution exposure (as a % of Total Portfolio)
NSW TCorp IM Funds (allowable under the Ministerial Order)		25%

- Credit ratings apply to both products and institutions. This policy requires the rating applicable to the institution responsible for the product (e.g. guarantor) to be taken as the relevant rating given this represents the underlying risk to Council.
- Credit risk investment parameters are based on credit rating bands as published by the credit rating agencies (e.g. S&P, Moody's, Fitch). If an investment is rated by more than one ratings agency, the credit rating to be used will be based on the order of S&P, Moody's and then Fitch. In the event of disagreement between agencies as to the rating band ("split ratings") Council shall use the higher in assessing compliance with portfolio policy limits, but for conservatism shall apply the lower in assessing new purchases.
- Where the principal amount and accrued interest of any investment with a financial institution are directly guaranteed by the Australian Federal Government for full repayment, the exposure to individual institutions may exceed the stated limits provided that the excess amount comprises only guaranteed investments.

Term to Maturity Framework

The term to maturity framework specifies the maximum amounts or percentages of Council's total investment portfolio that can be held within the various investment maturity bands.

Maximum thresholds are set to control the proportion of the total portfolio that can be invested into longer term investments to ensure that Council has adequate access to short and medium term liquidity to satisfy its business objectives. The maximum thresholds reduce as the maturity horizon extends further into the future.

	< 1 Year	1 to 3 Years	3 to 5 Years	> 5 Years
Maximum % of Total Portfolio	100%	70%	40%	10%

Minimum thresholds are set to ensure that there will always be an adequate amount of liquidity available for ongoing working capital purposes. Remaining funds are invested across the various investment horizons, seeking the best relative value at the time of investment.

< 1 Year	
Minimum % of Total Portfolio	40%

2.11.7 Breaches of Criteria

This policy imposes limits and thresholds in relation to the acquisition and holding of investments. However, situations may occur where inadvertent breaches of these limitations or thresholds arise, other than from the acquisition of investments. For example:

- Amendments to regulatory directives or legislation

- Changes in the total value or amount of Council's investment portfolio which consequently changes any of the threshold limits so that they no longer meet the portfolio liquidity parameters

If the credit ratings of any of Council's investments are downgraded to an extent that they no longer fall within the investment policy limits, they will be divested as soon as practicable having regard to potential losses resulting from early redemption and subject to minimising any loss of capital that may arise from compliance with this provision.

Those limitations or thresholds breached due to amendments to regulatory directives or legislation, the investment portfolio must be managed in accordance with the respective amendments. Where the amendments enable retention and grandfathering of existing investments, Council may continue to actively manage those investments within the portfolio in accordance with all other regulations and policies applicable to such investments. This includes a strategy of holding or divesting such investments in accordance with regular investment considerations.

Where limitations or thresholds are breached due to a change in the overall size of the total investment portfolio, the following process will apply:

- An immediate freeze is imposed on the acquisition of new investments in the relevant category until the portfolio can be effectively managed back to accord with the requirements of this policy
- The relevant category of investments must be managed back in accord with the policy limits within a period that takes into account any adversity created by market liquidity, current valuations of these investments and the risks of default.

The immediate forced sale of the investments in breach of the limits or thresholds will not be required.

2.12 Investments in Financial Institutions which Support the Fossil Fuel Industry

Subject to consideration of the Risk Management Guidelines in this policy, preference is to be given to financial institutions that publicly state that they do not invest in or finance the fossil fuel industry if:

- The investment is compliant with Council's Investment Policy, and
- The investment rate of interest is equivalent to or more favourable to Council relative to other similar investments that may be on offer to Council at the time of the investment.

2.13 Measurement of Investment Performance

Investment performance includes both interest returns and any change in the underlying capital value of the investments.

Interim fluctuations of capital value are excluded from the monthly measurement of investment performance on the basis that:

- Investments are mainly acquired with the intention of holding them through to maturity, although some liquid assets may be sold prior to maturity should it be to the benefit of Council
- Cash liquidity requirements are structured and managed to ensure that Council is not in a financial position that will require a forced sale of these assets

Notwithstanding the above, changes in capital value are important and the monthly investment report will therefore provide Council with indicative market valuations of each investment. In the event that the capital value of any investment becomes impaired, or a

capital gain or loss is actually realised (through disposal), the gain or loss of value will be recognised within that month's financial accounts.

Investment performance will be measured monthly against the chosen benchmarks in relation to both current month and 12-month rolling returns.

The CFO will approve the use of independently determined benchmarks. Where Council changes independently determined benchmarks, monthly reports for the month of change and the next five months thereafter shall contain reporting of investment returns against benchmark for both the following:

- The benchmark that is being replaced, and
- The new benchmark backdated on a twelve-month basis.
- Council currently uses two performance benchmarks:
 - Bloomberg AusBond Bank Bill Index (formerly known as UBSA Bank Bill Index) – the Bank Bill Index represents the performance of a notional rolling parcel of bills averaging 45 days and is the widely used benchmark for local councils and other institutional cash investments
 - 30-day Bank Bill Rate - provides a fair indicator of the risk free rate of return so that Council can understand the return that has been earned from diversifying its investment portfolio and accepting conservative levels of risk

2.14 Reporting and Review

Council will maintain a separate record of money it has invested under section 625 of the *Local Government Act 1993*, in accordance with the criteria defined by the *Local Government Code of Accounting Practice and Financial Reporting*.

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

Pursuant to the *Local Government (General) Regulation 2005* (clause 212), the CFO will provide a monthly report to Council on investments. The monthly report to Council will detail the investment portfolio in terms of performance and rate of return on the overall portfolio for the period and will detail the purchase price, face value, current (market) value, credit rating and coupon / yield for each individual investment.

For audit purposes, the FM will obtain certificates from the banks or fund managers confirming the amounts of investment held on Council's behalf at 30 June each year.

The Investment Policy will be reviewed at least once a year or as required in the event of legislative changes.

3. REFERENCES

Laws and standards	<ul style="list-style-type: none"> • Australian Accounting Standards • NSW Office of Local Government - Local Government Code of Accounting Practice & Financial Reporting • NSW Office of Local Government Investment Circulars • Office of Local Government Investment Policy Guidelines • Local Government (General) Regulation 2005 • Local Government Act 1993 • Minister's Investment Order (gazetted) • The Trustee Amended (Discretionary Investments) Act 1997 - Sections 14A(2), 14C(1) & (2)
Policies and procedures	<ul style="list-style-type: none"> • Code of Conduct • Financial Management • Procurement of Assets and Services • Disciplinary Policy & Procedures • Protected Disclosures Internal Reporting System • Fraud and Corruption Prevention

4. DEFINITIONS

Term	Meaning
Total investments	<p>Total investments comprise:</p> <ul style="list-style-type: none"> • Call accounts • Term deposits • Floating rate notes • Bonds with an active secondary market with government (including NSW T-Corp) and Authorised Deposit-taking Institutions (ADIs) <p>Investments also include grandfathered structured investments with other institutions as defined.</p>
Active investments	<p>Active investments are a part of total investments and comprise:</p> <ul style="list-style-type: none"> • Call accounts • Term deposits • Floating rate notes • Bonds with an active secondary market
Grandfathered investments	<p>Grandfathered investments are a part of total investments and comprise:</p> <ul style="list-style-type: none"> • Investments where new investment activity is prohibited by regulation • Other investments over which new investment activity is temporarily prohibited due to unintentional breaches of investment thresholds and limitations that arise due to changes in the level of unrelated

Term	Meaning
	investments within the portfolio, (the prohibition only remains as long as the breaches remain in place)
Impairment	The impairment of an investment represents the amount of the original cost of the investment that is not expected to be recovered at the investment's maturity date due to current adverse economic or investment conditions that impact on the investment's financial performance.
AusBond Bank Bill Index	The Bank Bill Index (BBI), formerly the UBS BBI, represents the performance of a notional rolling parcel of bills averaging 45 days, and is the widely used benchmark for local councils and other institutional cash investments.
Approved Deposit-taking Institution (ADI)	An institution that is authorised under the Banking Act 1959 to accept term deposits and conduct banking activities in accordance with that Act and under the prudential supervision of the Australian Prudential Regulation Authority (APRA).
Active secondary market	A market where investors purchase securities or assets from other investors, rather than from issuing companies themselves on an arm's length (independent) basis.
Benchmark rates	<p>Benchmark rates comprise:</p> <ul style="list-style-type: none"> • Bloomberg AusBond Bank Bill Index - The Australian Bloomberg (formally UBSA) Bank Bill index is constructed as a benchmark to represent the performance of a passively managed short-term money market portfolio. It comprises thirteen Bank Bills of equal face value, each with a maturity seven days apart. The average term to maturity is approximately 45 days. A Bank Bill is a non-interest bearing security issued by a bank whereby the bank takes on an obligation to pay an investor a fixed amount (face value) at a fixed future date. It is sold to an investor at a discount to the face value. Bank Bills are short-term money market investments with maturities usually between 30 days and 180 days. • 30 Day Bank Bill Index - The Bank Bill Index is designed to measure the performance of the Australian short-term money market and consists of 13 weekly maturities out to varying dates. Interest rates applied to these maturities are interpolated from cash and Bank Bill Swap (BBSW) rates. BBSW rates are administered by the Australian Stock Exchange (ASX).
Call funds	Call funds are closely linked with investments but do not constitute investments. Call funds are used to meet immediate operational cash needs and may be retained in Council cheque accounts and call accounts at an ADI. Call funds must be accessible immediately or up to a maximum of 24 hours' notice within normal ADI operating hours.

Term	Meaning
Credit risk	The risk that an institution or a product the Council has invested in fails to pay the interest and/or repay the principal of an investment.
Market risk	The risk that the fair value or future cash flows of an investment will fluctuate due to changes in market prices.
Liquidity risk	The risk the Council is unable to redeem the investment at a fair price within a timely period.
Maturity risk	The risk relating to the length of term to maturity of the investment - the longer the term, the greater the length of exposure and risk to market volatilities.
Preservation of capital	The requirement for preventing losses in an investment portfolio's total value (considering the time value of money)
Diversification	Setting limits to the amounts invested with a particular financial institution or government authority to reduce credit risk.
Liquidity	Ensuring that funds are available in a timely manner to meet the Council's cash flow requirements without the unanticipated, and potentially disadvantageous, sale of investment products.

Schedule 1 - Investment Instrument Description

At call deposits

Cash invested on an overnight basis with an Australian Authorised Deposit-taking Institution (ADI). Funds can be recalled or re-invested prior to the bank's Real Time Gross Settlement cut-off each day.

Term Deposit

Interest bearing deposit held at an ADI for a specific contracted period. Term deposits are not tradeable in the market. They typically have a fixed rate for their life, but floating rate term deposits are also available. Prior to the introduction of Covered Bonds into the Australian market, in early 2012, term deposits ranked at the top of an ADI's capital structure.

Bank Bills and Negotiable Certificates of Deposits (NCDs)

Similar types of interest-bearing securities issued/accepted by ADIs, typically short dated. Unlike term deposits, these are tradeable in the market prior to maturity.

Floating Rate Note/Bond (FRN)

The FRN is a longer-term debt security issued for a fixed period of time but has a variable (floating) coupon on a monthly or quarterly basis. The coupon reflects current interest rates, which is determined as a margin over the BBSW rate set. FRN's appeal to investors who are reluctant to commit funds to fixed interest investments for longer periods in times of fluctuating interest rates. Typical issuers are banks, corporates, financial institutions and securitised vehicles. Only Senior FRNs issued by an Australian Authorised Deposit Taking Institution such as a bank, credit union or building society are an eligible form of FRN investment.

Fixed Interest Securities (Bonds)

Securities issued by Commonwealth, State or corporate institutions that pay a fixed rate of interest (coupon) and mature at a fixed point in time. The interest (coupon) is paid at regular intervals (semi-annually, but can be paid monthly, quarterly, or annually). These securities are generally issued for a period of greater than one year.

NSW Treasury Corporation's Investment Management Funds:

The NSW Treasury Corporation Investment Management Funds (TCorp IM Funds) comprises a number of pooled managed funds options each set up as a unit trust. The current cash and fixed income options available through TCorp IM are the Cash Fund and the Short-Term Income Fund.

The Cash Fund is primarily a cash management tool allowing for same day access to funds whilst paying a slightly higher return than could be expected from a bank cash management account. This fund is designed as a high-volume transactional account for investors that deposit and redeem large tranches of funds at least weekly. The fund is designed for investments with time horizons ranging from overnight to 1.5 years.

The Short-Term Income Fund holds longer dated securities than the Cash Fund, consequently it has potential for more volatile month-to-month returns than its sister fund. The intended investment time horizon for the Strategic Cash Fund is 1½ to 3 years, making it an alternative to medium length term deposits.

Both funds will pay back the balance of the investment generally within 24 to 72 hours.

Schedule 2 - Standard and Poor's Ratings descriptions

Credit Ratings

Standard & Poor's (S&P) is a professional organisation that provides analytical services. An S&P rating is an opinion of the general creditworthiness of an obligor with respect to particular debt security or other financial obligation — based on relevant risk factors.

Credit ratings are based, in varying degrees, on the following considerations:

- Likelihood of payment
- Nature and provisions of the obligation
- Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganisation or other laws affecting creditors' rights

The issue rating definitions are expressed in terms of default risk.

Long-term Obligation Ratings are:

AAA: An obligation/obligor rated AAA has the highest rating assigned by S&P. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA: An obligation/obligor rated AA differs from the highest rated obligations only in a small degree. The obligor's capacity to meet its financial commitment on the obligations is very strong.

A: An obligation/obligor rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations/obligor in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB: An obligation/obligor rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to the obligor to meet its financial commitment on the obligation.

Plus (+) or Minus (-): The ratings from "AA" to "CCC" may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

CreditWatch highlights an emerging situation, which may materially affect the profile of a rated corporation and can be designed as positive, developing or negative. Following a full review, the rating may either be affirmed or changed in the direction indicated.

A Rating Outlook assesses the potential direction of an issuer's long-term debt rating over the intermediate-to-long term. In determining a Rating Outlook, consideration is given to possible changes in the economic and/or fundamental business conditions. An outlook is not necessarily a precursor of a ratings change or future CreditWatch action. A "Rating Outlook – Positive" indicates that rating may be raised. "Negative" means a rating may be lowered. "Stable" indicates that ratings are not likely to change. "Developing" means ratings may be raised or lowered.

Authorisation Details

Authorised by:	Council
Minute No:	
Date:	
Review timeframe:	Earliest of Alteration of relevant Ministerial Investment Order, or within the first 12 months of the term of each new Council
Department:	Finance
Document Owner:	Chief Financial Officer

Details History

Version No.	Date Change	Policy type	Modified by	Amendments made
2	17/12/19	Council minute no 220	CFO	
3	TBD		CFO	Major rewrite