Local Government Investment Guidelines

These Guidelines are made pursuant to sections 121(2) and 258(1) of the *Local Government Act*

1 Executive Summary

Councils involved in investment activities must comply with these guidelines. Pursuant to section 121(3) of the *Local Government Act*, investments must be consistent with these guidelines. The guidelines examine the process of constructing a robust investment policy and identify the key issues that must be addressed by a council when engaging in the investing of surplus funds.

These are:

- purpose or specific objective for investing surplus funds;
- duties and obligations of the council and staff;
- requirement for internal control procedures;
- compliance with legislation including the *Local Government Act*, Regulations and Guidelines;
- proper reporting and monitoring procedures;
- consideration of risk and return objectives,
- defined investment parameters and established benchmarks;
- recognising and being aware of market risk,
- maturity risk, liquidity risk, leverage risk and credit risk;
- an awareness of "deadweight costs" or a leakage of value every time an investment passes through the various financial intermediaries; and
- functions of External Auditor, Audit Committee and Independent Review.

These Guidelines also include:

- a sample investment policy;
- an investment policy checklist;
- an explanation of different types of risk;
- Ratings Agencies Credit Rating Table; and
- a sample monthly investment summary report to council.

Acknowledgement

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2 Key Issues

The following chart identifies the key issues for a council to consider when investing.

DETERMINE PURPOSE OF INVESTMENT

State purpose of surplus funds in specific terms.

Specify time horizon (short, medium and long term purposes) for the investment portfolio or for each sub-portfolio (pool).

ESTABLISH DUTIES AND CONTROL

The role of council

The role of council staff

Internal controls

WORK WITHIN THE LEGISLATIVE FRAMEWORK & PRUDENT PERSON RULE

Know, understand and comply with relevant legislation, regulations, guidelines and the “prudent person” rule.

DEVELOP AN INVESTMENT POLICY

RISK & RETURN OBJECTIVES

Assessment of risks, complex instruments, rate of return expectations and tolerance to volatility of returns.

Define Investment Types

(a) Security types and limits

(b) Counterparty limits

(c) Maturity limits

BENCHMARKS

Benchmarks must be congruent with the degree of risk

Identify perverse signals

Characteristics of Benchmarks

COMPLY WITH GOVERNANCE

Reporting and monitoring

AUDIT & EXTERNAL REVIEW

Audit scope

Audit Committee

External and independent review

3 Glossary of terms used in these guidelines

ADI

Authorised Deposit-Taking Institutions (ADI) are corporations that are authorised under the *Banking Act 1959* to take deposits from customers. Examples are:

- Commonwealth Bank of Australia
- National Australia Bank
- ANZ
- Westpac
- People's Choice Credit Union

Counterparty

Counterparty is both a legal and financial term that refers to the other individual or institution to an agreement or contract.

Credit Risk

Credit risk is the risk of loss to an investor due to counterparty's failure to pay the interest and/or repay principal of an investment.

Currency risk

Currency risk is the risk that the fair value or future cash flows of an investment will fluctuate because of changes in foreign exchange rates.

Financial Instrument

A financial instrument is any contract that gives rise to a financial asset of one entity, and a financial liability or equity instrument of another entity.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of an investment will fluctuate because of changes in market interest rates.

Investment Portfolio

A collection of investments.

Leverage Risk

Leverage risk is the magnification of an investor's risk and return that occurs when the investor takes on financial leverage through an investment product. Financial leverage is the degree to which a business is using borrowed money.

Liquidity Risk

Liquidity risk is the risk that an investor is unable to realise the investment at a fair price within a timely period resulting in a loss upon realisation

Market Risk

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

Maturity Risk

Maturity risk is the risk relating to the length of term to maturity of the investment. The longer the term, the greater the length of exposure.

OTC – Over the Counter

Over the Counter Markets ("OTC") can generally be described as markets where financial instruments are exchanged directly between two parties rather than through the mechanism of an organised market or centralised exchange, for example a swap arrangement traded between two entities.

Par Value

The maturity value or face value of a security that an issuer agrees to pay on maturity.

Preservation of Capital

Preservation of capital refers to an investment strategy with the primary goal of preventing losses in an investment portfolio's total value.

Prudent Person Rule

The "Prudent Person Rule" is derived by legislation and under case law to obligate the trustee to exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.

Rating Agencies

Credit Rating Agencies such as Standard and Poor's (S&P), Moody's and Fitch are professional organisations that provide an opinion on the general credit worthiness of an obligor (person or company who bind themselves by contract or agreement) with respect to particular debt security or other financial obligations. Credit ratings are based, in varying degrees, on the following considerations:

- Likelihood of payment;
- Nature and provisions of the obligation;
- Protection afforded by the obligation in the event of bankruptcy, reorganisation or impacts of other laws affecting creditor rights.

Risk Aversion

Risk aversion is the reluctance of an individual to invest in a product with a higher risk compared to a product with lower risk, but possibly lower returns.

Simple investment

An investment product that is commonly used, with a return that can be easily calculated eg Term Deposit or Cash.

Speculative

A speculative deal involves deliberately taking a higher risk, in the hope of making an extraordinary gain.

Vanilla Instrument/Transaction

A vanilla instrument is a straightforward one. These are the most basic or standard versions of a financial instrument and can be contrasted with its opposite, an exotic instrument, which alters the components of a traditional financial instrument, resulting in a more complex security. Structured products are therefore clearly not vanilla instruments. Vanilla instruments are generally also traded in more liquid markets according to more or less standardised contracts and market conventions.

Vanilla instruments are straightforward financial instruments, such as a standard fixed-interest loan or deposit.

Examples of structured products, also known as market-linked products, include pre-packaged investments based on derivatives, such as options, indices, commodities, and/or foreign currencies.

Yield

The annual rate of return on an investment.

1. INTRODUCTION

1) These guidelines are designed to identify key issues which must be taken into account in constructing an investment policy for a council. An investment policy provides direction for those undertaking the investment process. Investment staff must make investment decisions that are in accordance with the objectives, practices or acceptable risk under the investment policy approved by council.

2) An investment policy is a governing document that communicates an organisation's:

- investment philosophy and strategy;
- overall risk philosophy;
- investment objectives and expectations;
- delineation of roles for those involved in the investment process; and
- requirements for compliance with the policy's goals and procedures.

2. PURPOSE OF INVESTMENTS

3) Prior to the development of an investment policy, council must consider each of its purposes, or specific uses for investing surplus funds. For example, a pool of funds may be continually preserved to provide immediate liquidity for ongoing operational expenses, while other pools of funds may be retained to carry out specific future infrastructure projects.

4) A clear and explicit statement of each investment purpose is important to identify the risk profile of the council and align risk and return expectations with the specific purposes for the investment. It forms a framework for the development of the investment policy and guides the manner in which funds should be invested. The purposes for which the investments are held will define limits on the maturity profile[1], give guidance to the liquidity requirements and also provide direction to the selection of appropriate investment instruments for each investment pool.

5) A statement of investment purposes also provides accessible information to constituents about the nature and expectation of the investment portfolio and its components or sub-portfolios if these serve different purposes. It serves a useful function in relation to the governance of the investment policy and helps to ensure that the audit and external review processes enable the formation of a judgement as to whether or not the policy is aligned with the overarching purposes for surplus funds.

3. DUTIES AND CONTROLS

3.1 Duties and Responsibilities of Council

6) A council must have an investment policy which sets out the objectives of council for the allocation of its investment resources. For the policy to take

[1] For example, if funds are invested for the purpose of carrying out an infrastructure project and are required within the next twelve months, this provides a limit to the term of the investment.

effect, and for staff to act under the policy, it must have been passed by resolution of council. Council members will be held accountable for investments made under the policy.

7) Responsibility for control and operation of the council's affairs, the allocation of resources and determination of policies rests with Council.

8) The role of Council includes:

- directing and controlling the council's affairs;
- being responsible for the performance of the council's functions;
- overseeing the allocation of the council's finances and resources; and
- determining the council's policies.

9) Council must be satisfied that responsible staff have complied with the investment policy and that council has based its decisions on informed and correct reports.

3.2 Duties and Responsibilities of Local Government Staff

10) An investment policy must articulate the duties and obligations of responsible staff (usually referred to by the designation of their position) of a council. This obligates staff to conduct their investment duties with the care, skill, prudence and diligence that a prudent person would exercise. The principle of acting prudently is referred to under section 4.5 of these guidelines.

11) The responsible staff must provide monthly reports to Council on the performance and value of the investment portfolio supported by independent advice when required on new financial products and the valuation of the portfolio.

12) When proposing investments and weighing up relevant factors in relation to products, a staff member must consider the diversification, appropriateness, risk and anticipated return, and assess the performance of the financial product. The staff member must be capable of understanding and explaining how an investment product works.

3.3 Internal Controls

13) Internal controls encompass the policies, processes, tasks, behaviour and other aspects of a council that, taken together, facilitate effective and efficient operation. Sound internal controls enable a council to respond to significant operational, financial and other risks to achieve the council's objectives. This includes the safeguarding of assets and protection against inappropriate use or loss of the assets, providing a high quality of internal and external reporting and ensuring compliance with legislation and internal policies.

14) Separation of duties forms a critical component in the management and security of the investment portfolio. Well defined controls for the management of investments must include the separation of functions for approved authority, execution of transactions and reporting.

15) The purpose for the separation of duties is to reduce the risk of potential loss and misappropriation of an organisation's funds.

16) There must be proper procedures and controls in place for the placement and redemption of investments, the receipt of income and regular valuations of the investment portfolio.

4. LEGISLATIVE FRAMEWORK

17) The framework used for the establishment of an investment policy and the measurement and disclosure of investments is prescribed by legislation and includes the:

- *Local Government Act*;
- *Local Government (Accounting) Regulations*;
- *Guidelines pursuant to the Act* and;
- *Australian Accounting Standards*.

18) An investment policy must be amended so as to remain current whenever relevant legislation or standards are enacted or changed.

4.1 Local Government Act

19) Section 121(1) of the *Local Government Act* provides that “a Council may invest money not immediately required for the purposes of the Council.” Section 121(3) provides that “an investment must be consistent with guidelines in force at the time the investment is made.”

4.2 Local Government (Accounting) Regulations

20) Regulation 18(2) prescribes the disclosure requirements for investment in the Financial Reports to Council. Additional disclosure requirements are also provided under the Australian Accounting Standards.

4.3 Investment Guidelines

21) These guidelines prescribe the fact that council must have an investment policy and what must be in that policy.

4.4 Australian Accounting Standards

22) Councils are to account for financial instruments as required by the relevant Australian Accounting Standards.

AASB 132 – Financial Instruments: Presentation

AASB 132 prescribes the financial reporting requirements for financial instruments.

AASB 7 - Financial Instruments: Disclosures

AASB 7 has broadened the scope of financial instruments and requires more extensive balance sheet and income statement disclosures.

4.5 Prudent Person Rule

23) Council policy must include reference to the “Prudent Person Rule” and provide that staff involved in considering and monitoring investments must act in accordance with this rule. The “Prudent Person Rule” is derived by legislation and under case law to obligate the trustee to exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.

24) The concept of “prudent person” or “prudent investor” is similar in nature in tort law to a reasonable person by attempting to create an objective standard of behaviour.

25) A council officer must act with the care, prudence, skill and diligence that a prudent person acting in like capacity under similar circumstances would act.

26) Acting prudently applies to selecting investments for proposal to council, and requires an individual to consider diversification, appropriateness of the product, risk and anticipated return, liquidity, independent financial advice and to have a clear understanding of the product. The objective is to observe how a person of prudence, discretion and intelligence manages financial affairs, not in regard to speculation, but in regard to the permanent disposition of funds.

27) **AASB 139 – Financial Instruments: Recognition and Measurement**

AASB139 prescribes the recognition and measurement requirements for financial instruments in financial reports.

28) **AASB 136 – Impairment of Assets**

AASB 136 prescribes the disclosure requirement for impairment losses. An impairment loss occurs when an asset’s book value exceeds the amount able to be recovered through the use or sale of the asset.

29) For the current version of the above Standards, go to website: http://www.aasb.com.au.

4.6 Council policy and resolution

30) Investments must not be made unless in accordance with council policy and council resolution.

5. INVESTMENT POLICY

5.1 Introduction

31) An investment policy is a document designed to provide direction on various matters to be considered when investing surplus monies required for the future. A council may invest money surplus to its immediate requirements, in the following ways:

a) at interest with the Territory Insurance Office, with an ADI or with a financial institution guaranteed by the Commonwealth or Territory;

b) in debentures or securities guaranteed by the Commonwealth, or of a State or Territory of the Commonwealth; or

c) at interest in the short-term money market through a licensed financial services institution with a current Australian Financial Services Licence issued by the Australian Securities and Investment Commission.

32) The decision to use a particular approach on how a council structures its policy will depend on the particular circumstances of each council. This includes an assessment of the scale of funds under management, safeguards in place to manage the investment portfolio, the level of risk aversion, the capability of management, systems capacity, internal procedures and controls to protect the investment and operational risk.

33) At a minimum, a council investment policy must:

- include the investment objectives of the council;
- define the risk aversion of the council;
- preserve capital, provide liquidity and return the anticipated returns for the investment portfolio;
- comply with legislative requirements;
- prohibit the purchase of speculative financial instruments;
- prohibit the use of borrowing to invest;
- prohibit the use of the investment portfolio for speculation; and
- specify an acceptable instrument list.

In addition, the following should be considered by a Council for inclusion in its investment policy, particularly where the Council is involved in non-simple investments.

- require investments of the council to be regularly re-valued to reflect prevailing market prices;
- recommend independent financial assessments of the value of the investment portfolio for Council;
- require investments that are downgraded to below an acceptable rating benchmark to be liquidated;
- require the status and performance of a council's investment portfolio to be reported monthly to Council;
- where applicable, document the process to choose an external investment manager.

5.2 Risk and Return Objectives

34) Starting with a clear concept as to the purpose for investing the funds and then formulating clear and explicit investment objectives will ensure consistency in the development of a policy. This will guide informed decisions in regard to setting return objectives within acceptable risk parameters.

5.2.1 Assessment of Risks

35) All investments entail some risk. Generally, the higher the expected rate of return of an investment, the higher the risk and the greater the variability of

returns. It is important that a council recognises all risks in its investments and effectively communicates its understanding of, and tolerance to, its risk exposures in its investment policy.

36) Examples of the more common types of risk that council must be aware of include, but are not limited to:

Market Risk;

Maturity Risk;

Liquidity Risk;

Credit Risk; and

Leverage Risk.

Refer to 5.3.2 for an expanded discussion on these risks and how they impact on the value of a portfolio.

5.2.2 Complex and Structured Instruments Increase Risk

37) Complex and structured instruments can obscure their true risk characteristics, hiding a multiple of different types of risk. These products may incorporate embedded options or have contingent payoffs. There may be exposure to multiple counterparties, and they may be highly leveraged. Due to the difficulty in understanding, determining and quantifying the true risks associated with these instruments, the expected return of these products may not be sufficient or commensurate with their higher risk. If the risk and price of an instrument cannot be reliably measured it must not be considered acceptable for inclusion in an investment portfolio.

38) Also, complex and structured instruments can incur very large leakage in value due to issues such as:

- Products passing through a chain of intermediaries and several levels of structuring with fees being incurred at each step;
- The complexity involved and associated overheads such as the additional time and effort required to package and distribute the deal;
- The fact that these products are often traded as Over The Counter (“OTC”) products with limited secondary markets and poor liquidity;
- They may consist of non standardised products that lack well established market conventions;
- Large buy/sell spreads due to limited liquidity; and
- The fact that large financial institutions will have greater expertise in assessing the true risks of complex products and thus have significant pricing advantages in transacting in such instruments.

39) Complex financial instruments do not fit within the context of risk aversion and therefore are not congruent with a conservative appetite for risk.

Refer to Appendix C for an expanded discussion of complex and structured products.

5.2.3 Rate of Return Expectations

40) The investment policy must specify what the expectations are in regard to the return to be achieved by the investments. These expectations will need to be tempered by the amount of risk that the council is willing to face.

41) A solid foundation for sound investment strategies is to prima facie disregard any perception that any financial instrument or asset class can provide an enhanced return without a substantive increase in risk. The adage that greater returns are only achievable at the cost of greater risk invariably applies in highly-traded and well-understood financial markets. In the absence of market distortion, such as an incorrect price, it is not possible to earn a higher return without incurring a commensurately higher level of risk.

5.2.4 Tolerance to Volatility of Returns

42) The riskiness of an investment is often equated to the notion of how likely or probable there will be a loss of capital. It is incorrect to simply gauge the riskiness of an investment by the likelihood of capital loss as this ignores the contribution of earnings to the return of the investment portfolio. As the time period over which the investment is held grows, the contribution of earnings becomes proportionately greater and can be of more significance than preservation of capital. It is the preservation and growth in value of the investment portfolio that matters.

43) The investment policy must be very clear in regard to both:

- the tolerance to capital loss; and
- the tolerance or degree to which a loss in the value of the investment portfolio can be accepted.

44) This information will then guide decisions about which instruments and which counterparties can be included within the investment portfolio.

5.3 Defining Investment Types

45) Having specified the purpose, objectives and expectations in regard to investment returns and tolerance for risk, the council is then in a good position to consider the range and allocation for the investment assets.

46) The range and allocation, or limits, of investments should also aim to produce a well diversified portfolio. Diversification is a risk management technique that involves spreading investments both between different asset classes and within an asset class. The risk of the resulting investment portfolio will be reduced without necessarily reducing return. Portfolio risk may be smoothed as the strong performance of some investments offsets the poor performance of others.

5.3.1 Security Types and Limits

47) A Council must not acquire shares in an unlisted company, or contribute capital to an unlisted trust, unless the Minister, in consultation with the Treasurer, approves the acquisition of such shares. A company is unlisted unless its shares are listed on a recognised stock exchange.

48) The types of assets in an investment portfolio can have very different risk characteristics that will need careful evaluation as to suitability. The investment policy must specify an acceptable range of instruments based on the risk appetite of the council, the various different ways that risk can arise and recognition that the full risk implications inherent in some products are not always transparent.

49) The investment policy must also specify maximum and minimum investment limits for acceptable security types to ensure diversification between investment classes. The degree of diversification benefit between two investment classes is dependent on the strength and direction of the relationship between them, as measured by correlation.

50) While diversification between investment classes is important, it must be performed within the constraints of acceptable security types. That is, the risk of all assets included in the investment portfolio must be known, measurable and acceptable to the council.

5.3.2 Counterparty Limits Manage Credit Exposures

51) The purpose of diversification of counterparties is to ensure that no single counterparty would undermine the capital preservation objective of the portfolio. An investment policy must outline diversification requirements and avoid high concentrations in relation to any one issue, issuer, industry or geographic area.

52) Grouping or categorizing counterparties based on broad external characteristics or credit ratings and ignoring risk may result in the inappropriate allocation of limits. For example, despite being monitored by the Australian Prudential Regulatory Authority (APRA), Authorised Deposit Taking Institutions (ADIs) are comprised of a large number of entities that may not all share the same credit risk.

53) Not only is there diversity in the credit quality of the institutions within this group, there are also differences in the nature and characteristics of the instruments issued by the institutions. For example, the senior debt instrument of a major bank will be very different to a subordinated debt instrument of a regional bank. Ratings may help, but will not give a full reflection of risk on their own.[2] Amongst other things, it is necessary to examine all the risk characteristics of the instruments such as liquidity, maturity, the degree of options and other structuring embedded in the instrument.

54) In order to set minimum standards for the credit quality of counterparties and ensure diversification of credit exposures, the investment policy must provide a list of acceptable counterparties and appropriate investment limits. Limits may be set for individual counterparties or counterparty categories.

55) Investment counterparties must be defined by prescribing the types of institutions acceptable to the council and, for each, minimum credit rating requirements. Entities without a credit rating must not be considered an acceptable counterparty.

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[2] Care should be taken to look at the rating of the debt instrument not the issuer. While a particular entity may have a rating, it can issue a debt instrument that is not rated.

56) While explicit reliance will be placed on credit ratings, on their own they may not adequately describe credit risk for the purpose of setting limits. The council must also consider:

- The type of institution within a credit rating band. For example, the four major Australian banks, ANZ Bank, Commonwealth Bank of Australia, National Australia Bank and Westpac Bank, may be allocated higher limits than similarly rated institutions because of the significant share they have of the Australian market and financial market activity;
- The types of credit rating applicable in the investment policy. That is, whether rating types such as long-term senior unsecured debt ratings and structured issue ratings are considered the same for the purpose of setting limits in the investment policy;
- Limits for related counterparties. Exposures for related counterparties (i.e., those with parent/ subsidiary relationship, common parent or guarantee from the parent) must be aggregated for counterparty investment limits; and
- Capitalisation restrictions limiting investments to the lesser of an approved proportion of a counterparty's capital funds or the limit prescribed by the policy for its rating and type, for example, limiting investments to no greater than 5% per counterparty.

5.3.3 Maturity Limits

57) The investment policy must also specify maturity limits to ensure credit exposure and liquidity risks are maintained within the risk tolerance of the council.

58) The risk of default of an investment increases with its term to maturity. Separate maturity limits may be required for different types of investment securities and different counterparty categories according to their inherent risk. For example, the investment policy may prescribe a maturity limit of ten years for Australian Commonwealth Government securities, while setting a maturity limit of three years for an A/A2 rated bank.

59) In setting maturity limits, the full exposure of the council is directly related to the length of time until the council is entitled to regain full control of the invested funds. If option features are included in the investment product, the counterparty may have the ability to lengthen the investment contract with the council. The investment policy must be clearly worded so that maturity limits are applied to the actual maturity of investment products and are not applied to option call or put dates, or interest rate reset dates.

60) Liquidity requirements must also be reflected in the investment policy maturity limits. Sufficient funds must be invested in short-term investment securities to meet the cash flow requirements of the council.

5.4 Benchmarks

61) A council must use an appropriate investment benchmark. This is the starting point for evaluating investment outcomes against investment objectives. The benchmark communicates important information on how well investments are

matched to risk and return expectations of the council and helps to ensure that expectations are reasonable.

5.4.1 Benchmark Must be Congruent with the Degree of Risk

62) The benchmark must encompass both risk and return. A good benchmark does not consider performance in isolation but is concerned with maximising return for a level of risk acceptable to the council. The benchmark must therefore be constructed to reflect the risk tolerance position of the council and any critical requirements of the investment policy such as maturity structure, appropriate allocations to investment classes and liquidity requirements. This enables assessment of the additional return earned for the level of risk undertaken.

5.4.2 Benchmarks Can Send Perverse Signals

63) Great care must be taken in setting benchmarks as arbitrary performance hurdle rates can have a perverse impact. Setting inappropriate benchmarks and performance hurdles will send incorrect signals about the types of investments that should be included in an investment portfolio and can encourage risk taking behaviour that is not in line with the investment objectives stipulated.

64) Setting benchmarks that do not reflect the risk in the class of instruments to be held within an investment portfolio can lead to potentially distorting behaviour. Take, for example, a performance target of 0.50% above a bank bill index. Now consider what is required to achieve this target. Quite clearly it will require the injection of quite a degree of risk into the portfolio. It is not possible to achieve the additional return with the instruments that form the benchmark and thus the benchmark will force investments in instruments that fall outside the benchmark. Setting performance hurdles above an accurate benchmark will force additional risk taking if the benchmark is to be met.

5.4.3 Characteristics of a Benchmark

65) The characteristics of a good investment benchmark are as follows[3]:

- Representative of investment asset class or mandate;
- Investable;
- Constructed in an objective manner;
- Formulated from publicly available information;
- Acceptable to council as the neutral position; and
- Consistent with underlying investor status (for example, time horizon).

66) The benchmark will generally be constructed from one, or a combination, of[4]:

- A well-recognised published index;
- A tailored composite of assets or indices; or
- A peer group (“universe”) of similar funds or portfolios.

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[3] AIMR Benchmark and Performance Attribution Subcommittee Report, 1998.
[4] AIMR Benchmark and Performance Attribution Subcommittee Report, 1998.

67) While published indices are preferred, the constructed benchmark must be consistent with the investment asset. For example, it is not adequate to benchmark investment returns against the returns on a short-term bank bill index when the risk characteristics of the investment portfolio differ dramatically. For investment assets with unique or structured elements, a widely recognised comparable index is unlikely to exist. It will be necessary to set the benchmark as a universe benchmark or a target return level relative to an index (or composite) with an acceptable level of variation around that target as a proxy risk measure. Difficulties arise as there is no established oversight process for determining whether the universe or variation measure accurately represents the risk of the investment asset.

68) Benchmarks can be misused. Poorly constructed benchmarks can undermine the effectiveness of investment objectives. If an appropriate benchmark cannot be constructed for a particular investment asset, it is unlikely to be suitable for council investment objectives.

See Appendix A for an example of a council investment policy. Appendix B is a checklist of questions which must be asked when making investment decisions.

6. GOVERNANCE

69) Corporate governance for a council includes ensuring that the actions of the council are directed at securing the best outcomes for its residents and ratepayers. Good governance strengthens credibility and confidence. In order for a Council to fulfil its statutory duties it needs to ensure there are proper policies and procedures in place to safeguard council's resources in accordance with Local Government (Accounting) Regulations, Regulation 10.

70) A central tenet of good corporate governance is the role of the Council in the protection of the interest of the residents and ratepayers. It is essential that the Council monitors the pursuit of self interest by corporate insiders and ensures that management and other corporate insiders do not pursue pet projects to the detriment of the organisation. This stewardship also encompasses guarding against the incentives of other "non-equity" shareholders such as banks, advisors and others.

71) Good governance is about ensuring that the appropriate checks and balances are in place. Councils must have in place robust and transparent financial governance policies and procedures directed to the oversight of the financial management responsibilities identified in the investment policy.

72) Paramount to good governance is the independence of the Council. The Council must remain vigilant to ensure that it does not become a "corporate insider".

6.1 Reporting

73) Council has a responsibility to measure the performance of its investments and to report its position to its residents and ratepayers. All reporting must be transparent to both the Council and the residents and ratepayers and must comply with the legislative framework.

74) Monthly reporting of investment activity to council must include, but not be limited to, the following:

- a list of securities by maturity date;
- the percentage of the portfolio held by investment type and by counterparty[5];
- the value of the investment portfolio;
- reporting on investment category and disclosure of market value, par value and maturity dates;
- where applicable, the comparison of performance against anticipated return and reference against benchmarks; and
- a note on compliance with investment policy or explanation of breaches.

See Appendix E for a sample monthly investment report.

6.2 Monitoring

75) Constant review and monitoring of investment portfolios help to ensure the Council's intended outcome can be achieved. The following are the principal goals of monitoring an investment's performance and must be included in the content of the reporting.

- assess the extent to which each individual or pooled investment objectives are being achieved;
- monitor exposures against acceptable benchmarks by investment type, counterparty, credit rating and by investment maturity;
- monitor the movements in market values for valuation purposes;
- certify that investments are in accordance with Council policy and legislative requirements;
- compare the performance of the appointed managers against the performance of other relevant professional managers and market related indices; and
- continually assess the ability of each manager and their investment portfolio to successfully meet each investment objective.

76) Monitoring is not limited to the above and may extend to the undertaking of a review of the council's own performance in respect of its governance of its investment portfolio.

77) Council and/or responsible staff must review the investment strategy at least once a year. An annual review allows Council to reassess its position and revise its strategy. Where the investment strategy is complex, the review should involve an independent investment adviser.

7. AUDIT AND EXTERNAL REVIEW

7.1 Audit Scope

78) The scope of the external audit is prescribed by legislation and is principally a review of the annual financial statements. It does not include reviews of accounting systems and procedures, internal control and council policies.

[5] Other parties in the agreement or contract.

Councils must, however, have mechanisms to review accounting systems and procedures, internal controls and council policies.

79) Legislation requires the auditor to form an opinion on whether:

- The annual financial report:
  - complies with the requirements of the *Local Government Act,* the *Local Government (Accounting) Regulations*, *Guidelines* and applicable Australian Accounting Standards;
  - is prepared in accordance with the financial records; and
  - represents fairly the results of the operations of the council and its financial position at 30 June.

80) Where it is considered appropriate to do so, the auditor is to prepare a management report to accompany the auditors report.

81) The minimum audit requirement prescribed by legislation may be extended to include other matters recommended by the audit committee and adopted by Council.

7.2 External Independent Review

82) A well constructed investment policy with clear objectives will facilitate an external review. The review must act as an intermediary to confirm that the investments explicitly align with the investment policy.

83) Council staff must ensure that before new investments are made by council, it is established whether a product complies with the investment policy and where it is not a simple investment, obtain independent financial advice in writing on the nature and risk of the financial product.

84) If the investment portfolio contains investments which are not simple, then regular valuations of the investment portfolio must be undertaken by an independent financial expert who does not have a conflict of interest in providing advice to the Council.

85) Regular reviews must be undertaken by an independent financial advisor on the performance and value of the investment portfolio and conformity with the investment policy if the investment portfolio contains investments which are not simple. Reports must be prepared and sent to the audit committee and Council as required under the audit scope. If the portfolio consists only of simple investments, it may not be necessary to involve an independent financial advisor. Regular reports on the performance and value of the investment portfolio and conformity with the investment policy must be sent to the audit committee and Council as required (regardless of whether it is a simple or complex investment portfolio).

Appendix A – Sample Investment Policy

XXXX Council Investment Policy

Council resolved to adopt this policy on (date), resolution number xxxx

Objectives

To invest the council's surplus funds, with consideration of risk and at the most favourable rate of interest available at the time, for that investment type, while ensuring that council's liquidity requirements are being met. While exercising the power to invest, consideration is to be given to preservation of capital, liquidity, and the return of investment.

- Preservation of capital is the principal objective of the investment portfolio. Investments are to be made in a manner that seeks to ensure the security and safeguarding of the investment portfolio. This includes managing credit and interest rate risk within identified thresholds and parameters.
- The investment portfolio must ensure there is sufficient liquidity to meet all reasonably anticipated cash flow requirements, as and when they fall due, without incurring significant costs due to the unanticipated sale of an investment.
- The investment is expected to achieve a predetermined market average rate of return that takes into account the Council's risk tolerance. Any additional return target set by Council must also consider the risk limitation and prudent investment principles.

Legislative Requirements

All investments are to comply with the following:

- *Local Government Act*
- *Local Government (Accounting) Regulations*
- *Australian Accounting Standards*

Other Requirements

Prudent Person Standard

The investment will be managed with the care, diligence and skill that a prudent person would exercise. Staff are to manage the investment portfolios to safeguard the portfolios in accordance with the spirit of this Investment Policy, and not for speculative purposes.

Ethics and Conflicts of Interest

Staff shall refrain from personal activities that would conflict with the proper execution and management of Council's investment portfolio. This policy requires staff to disclose any conflict of interest to the CEO.

Approved Investments

Without approval by resolution of Council, investments are limited to:

- State/Commonwealth Government Bonds;
- Interest bearing deposits such as bank accounts and term deposits;
- Bank accepted/endorsed bank bills;
- Commercial paper (a loan of less than 270 days backed by assets such as loans or mortgages;
- Bank negotiable Certificate of Deposits; and
- Managed Funds with a minimum long term Standard & Poor (S&P) rating of "A" and short term rating of "A2".

Prohibited Investments

This investment policy prohibits any investment carried out for speculative purposes including:

- Derivative based instruments;
- Principal only investments or securities that provide potentially nil or negative cash flow; and
- Stand alone securities issued that have underlying futures, options, forwards contracts and swaps of any kind.

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

Risk Management Guidelines

Investments obtained must comply with key criteria as indicated below relating to:

a) Portfolio Credit Framework: limit overall credit exposure of the portfolio

b) Counterparty Credit Framework: limit exposure to individual counterparties/institutions

c) Term to Maturity Framework: limits based upon maturity of securities.

d) Protection of Principal: investments entered into must be structured to minimise risk of loss of principal.

e) Grant Funding Conditions: conditions related to grant funding available to invest must be complied with.

a) Overall Portfolio Limits

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	Direct Investment Maximum %	Managed Fund Maximum %
AAA	A-1+	100%	100%
AA	A-1	100%	100%
A	A-2	60%	80%

b) Counterparty Credit Framework

Exposure to an individual counterparty/institution will be restricted by its 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	Direct Investment Maximum %	Managed Fund Maximum %
AAA	A-1+	45%	50%
AA	A-1	35%	45%
A	A-2	20%	40%

If any of the council's approved investments are downgraded such that they no longer fall within approved credit rating category documented within the investment policy, they must be divested as soon as practicable. Investments fixed for greater than 12 months are to be approved by Council and reviewed on a regular term and invested for no longer than 5 years.

c) Term to Maturity Framework

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

Overall Portfolio Term to Maturity Limits	
Portfolio % < 1 year	100% Max; 40% Min
Portfolio % > 1 year	60%
Portfolio % > 3 year	35%
Portfolio % > 5 year	25%
Individual Investment Maturity Limits	
ADI	5 years
Non ADI	3 years

Investment Advisor

The council's investment advisor must hold an Australian Financial Securities Licence issued by the Australian Securities and Investment Commission and their appointment as advisor must be approved by resolution of Council. The advisor approved by council resolution must be an independent person who has no actual or potential conflict of interest in relation to investment products being recommended and is free to choose the most appropriate product within the terms and conditions of the investment policy. The advisor must be representative of a recognised reputable firm of investment advisors.

Measurement

The investment return for the portfolio is to be annually reviewed by an independent financial advisor by assessing the market value of the portfolio. The market value is to be assessed by Council at least once a month to coincide with monthly reporting.

Benchmarking

Performance benchmarks (*must be established here in this policy*).

Investment	**Performance Benchmark**
Cash	Cash Rate
Enhanced/Direct Investments	UBSWA Bank Bill
Diversified	CPI + appropriate margin over rolling 3 year periods (depending upon composition of fund)

Reporting and Review

A monthly report must be provided to Council in support of the monthly statement of activity. The report must detail the investment portfolio in terms of performance, percentage exposure of total portfolio, maturity date and changes in market value.

An Investment Strategy must run in conjunction with the investment policy. (The Investment Policy and Strategy may be presented as one document). The investment strategy must be reviewed by an independent investment adviser every six months with a more formal review once a year. The Strategy must outline:

- Council's cash flow expectations;
- Optimal target allocation of investment types, credit rating exposure, and term to maturity exposure and;
- Appropriateness of overall investment types for Council's portfolio.

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

Documentary evidence must be held for each investment and details thereof maintained in an investment Register.

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.

Appendix B – Investment Policy Check List

This check list provides a series of questions which must be considered by council staff responsible for investment activity. Answers to these questions must be recorded in writing, signed and dated by the relevant officer before staff or council consider any particular investment. These questions are intended to act as a comprehensive but not all inclusive guide.

This check list is comprised of three components:

- Part A - General Products Check List

  General questions which must be considered when investing in simple or 'vanilla' products that are straight forward such as bank deposits, commercial paper, bills of exchange, bonds, promissory notes etc.

- Part B - Structured Products Check List

  Questions which must be considered when investing in pre-packaged products that bundle different investment instruments together. These products are more complex in nature compared to the 'vanilla' products. Be aware that a structured product could contain credit derivatives, options, and swaps, together with more simple instruments.

- Part C - Investment Policy Check List

  Includes general items that should be incorporated into the council's investment policy.

Part A - General Products

1) Have you found out how the funds will be invested, how will it generate returns and how will these be paid to the council? (Could you describe to others how this product works?)

   Yes ☐ No ☐

2) Are you clear on the conditions associated with this type of investment and their level of risk?

   Yes ☐ No ☐

3) Does the investment meet the council's financial objective and comply with its investment policy?

   Yes ☐ No ☐

4) Are your product issuers licensed by the Australian Security and Investment Commission?

   Yes ☐ No ☐

5) Do you know if/how the investment may be affected by a major shift in the economy and market sentiment?

Yes ☐ No ☐

6) Could the investment be liquidated in a timely manner without loss or penalty? i.e. Can the council quickly get its money back out of this product if it needs to? Are there any fees to get out early?

Yes ☐ No ☐

Note: If you answered No to any of the above questions, do your research and consult your financial adviser. If necessary, review your investment decision. Yes answers should contain an explanation or detail where appropriate eg a “yes” answer to question 5 should detail factors taken into account.

Part B - Structured Products

In addition to the general items, below are some additional questions that must be considered when dealing with structured products.

1) Do you thoroughly understand this product?

Yes ☐ No ☐

Structured products may have embedded risks that are not readily evident such as embedded derivates, options, formulas or other contingent payoffs.

2) If you are exposed to derivatives, do you understand (can you explain) how derivatives are used?

Yes ☐ No ☐

3) For a product that contains more than one instrument, do you fully understand the nature of the risk in all the instruments?

Yes ☐ No ☐

4) Have you assessed and documented these risks?

Yes ☐ No ☐

In addition to market risk (the potential movement in price), there are many other risks that are often not readily apparent including pricing risk, liquidity risk, credit risk and maturity risk.

5) Do you understand the degree of leverage in the product and the impact of this on your risk exposure?

Yes ☐ No ☐

Many derivatives and structured products have significant leverage to risk. You must know your tolerance and your exposure before engaging in any structured products.

6) Have you assessed and documented the pricing of the investment product?

Yes ☐ No ☐

Do you understand how products are priced? Can you get a similar price from a number of different sources? Can you get a firm price at which you can actually transact? How often can you get a firm or live price?

7) Have you assessed and documented the liquidity of the product?

Yes ☐ No ☐

How quickly can you sell the product at a market price? Is there a ready market to sell this product to another party?

8) Have you obtained and documented independent advice?

Yes ☐ No ☐

Ensure you seek independent advice. Advice from the bank or firm that sells you a product is not independent. Get as much advice as necessary until you are satisfied that you fully understand the risks.

Be aware of any equivocal advice and evaluate on the basis of what an advisor is prepared to commit to in writing.

9) Have you assessed and documented ratings from rating agencies?

Yes ☐ No ☐

Ratings are not a sufficient guide for a full and thorough risk assessment. Ratings issued by rating agencies for different types of assets have different meanings. They do not inform the user about the possibility and impact of a change in rating.

Explanations must be included in answers where appropriate.

Part C - Investment Policy Check List

Have you included the following as part of your investment policy?

1) Clearly stipulated the investment objective?

Yes ☐ No ☐

2) Specified the level of risk the Council is prepared to accept?

Yes ☐ No ☐

3) Prohibited the i) purchase of speculative financial instruments & ii) use of leveraging of an investment portfolio?

Yes ☐ No ☐

4) Identified the legislative requirements?

Yes ☐ No ☐

5) Listed the allowable investments and/or prohibited investments?

Yes ☐ No ☐

6) Specified investment parameters including the overall portfolio limits, counterparty credit framework and term to maturity framework?

Yes ☐ No ☐

7) Required independent valuation of investments in order to reflect the current market prices?

Yes ☐ No ☐

8) Required investments that are downgraded to below an acceptable rating benchmark to be liquidated?

Yes ☐ No ☐

9) Stated the appropriate benchmarks for evaluating investment performance?

Yes ☐ No ☐

10) Required a monthly report of the status and performance of investment portfolio?

Yes ☐ No ☐

11) Required independent financial assessments of the value of the investment portfolio?

Yes ☐ No ☐

Appendix C – Risk And The Value Of An Investment Portfolio

All investments entail some risk. Generally, the higher the expected rate of return of an investment, the higher the risk and the greater the variability of returns. It is important that a council recognises all risks[6] in its investments and effectively communicates its understanding of, and tolerance to, its risk exposures in an investment policy. The following discussion provides a sound background to understanding the nature of the risk exposures that must be recognised in the development of sound investment guidelines.

Risk Arises in Many and Diverse Ways

It is important to recognise that risk arises in many ways, not simply market risk, and to be aware of at least the following risks.[7]

Market Risk

One of the most prominent exposures recognised by councils is the exposure to market risk. More specifically, the exposure resulting from the changes in market prices, which includes changes in interest rates, currency and other prices (for example, commodity prices).

Maturity Risk

Term to maturity impacts the investment's exposure in two ways: through maturity risk and liquidity risk.

Maturity risk identifies the impact of maturity on the valuation of the investment. The longer the term to maturity the greater the length of exposure.

The other aspect of maturity risk is the impact of term to maturity on the valuation of an investment. That is, an increase in term to maturity leads to an increase in the impact of changes in market prices on the present value of the investment.

Both of the above effects are important and both need to be considered when assessing the impact of the term to maturity on the risk exposure to an investment.

Liquidity Risk

Liquidity risk usually arises if there is a lack of market depth for the investment; for example, the investment has unique or structured elements, is traded in low-volume or non-standardised markets or is not regularly priced by independent market dealers. Standardised instruments in well-traded markets will reduce the exposure to liquidity risk.

However, investing solely in liquid assets is not enough as liquidity risk may also be caused by a market disturbance that leads to a "flight to quality" - an environment where a rapid decline in demand for low credit quality instruments exists. As a result an investor may be affected by credit spread risk where a decline in the perception of

[6] While some common risks are defined in the Glossary to this guideline, this list is not exhaustive.
[7] This section does not purport to be a fully comprehensive inventory of all risks, rather it is intended to convey that risk can arise in many guises and is not necessarily transparent.

the credit worthiness of a particular sector or class of instruments leads to a fall in the value of the corresponding class of investments.

Leverage Risk

Another exposure that is not often readily apparent but still needs consideration is the effect of leverage on an investment. Leverage increases the potential return of an investment, but also increases the potential loss as an increase in leverage has a multiplicative effect on the exposure. Leverage risk usually arises through investment in structured products or derivatives, which can potentially be used to create leveraged positions where the exposures obtained are greater than the value of assets required to support them.

Complex and Structured Instruments Increase Risk

Straightforward financial instruments are referred to as “vanilla instruments”. These are the most basic or standard version of a financial instrument and can be contrasted with “exotic instruments”, which alter the components of a traditional financial instrument, resulting in more complex securities.

There are significant benefits in transacting in vanilla instruments. As these instruments are more transparent, generally well-established, more readily understood and financially less complicated the risks are more easily assessed. Vanilla instruments are generally traded in liquid markets, with standardised contracts and conventions. Independent and fair market values are readily available and instruments are more readily traded in times of market stress.[8]

Structured products combine elements of vanilla products. Bundling a number of characteristics into an investment product usually heightens risk and reduces transparency. This obscurity can mask elements of risk and make it difficult to assess the true risk in the product. It is also often difficult to ascertain independent and fair market values due to the uniqueness of products and thin market trading.

Consequently, it can be difficult to assess whether such investments meet risk and return objectives. If the risk and price of an asset cannot be reliably measured it must not be considered an acceptable security type for inclusion in an investment portfolio.

Some examples of structured products include investment products with embedded formulae[9], payoffs contingent on other underlying instruments or events, or exposure to multiple counterparties. Embedded formulae, contingent payoffs and multiple exposures will often act to leverage the exposure to risk. While these products can offer enhanced returns, council should recognise that the risk may be leveraged and assess the potential downside against its risk tolerance.

Councils must also consider option features that may be packaged within a complex product and the distinction between purchasing and selling an option.[10]

The purchase of an option entails the payment of a premium to cover a specified exposure. Once the premium is paid there is no further obligation on behalf of the

[8] Liquid instruments will generally trade in markets having greater depth or “liquidity”. The benefits of more observable prices and sufficient trading volume also translate into lower buy/sell spread (the difference between buying and selling prices).

[9] While perhaps not readily apparent, embedded formulae will significantly alter the risk.

[10] These comments also apply generally to option products not only when they are packaged within another instrument. However, when packaged within other features of a product, the option can be overlooked.

buyer. In contrast, the seller of an option receives a premium in return for covering a specified exposure. The potential obligation can be unlimited. Thus the sale of options does not have a place in an investment portfolio.

While a single risk measure is easier to understand than a multi-dimensional measure, the reality is that risk cannot be adequately captured in a single measure such as a credit rating. Ratings need to be supplemented by other risk measures that portray a true picture of the prospect of loss, in all its manifestations, including extreme or tail events.[11] In complex products the risk of tail events can be several times greater than for a similarly rated bond or loan.

Complex financial instruments do not fit within the context of risk aversion and therefore are not congruent with a conservative appetite for risk.

Deadweight Costs

The major consideration in the evaluation of any candidate security is that the return is sufficient and commensurate with the risk of the security. Each time that fees are deducted as investment products pass through the various financial intermediaries there is a leakage of value or "deadweight costs". These deadweight costs subtract from the return you receive so that you may well end up not being adequately compensated for the level of risk that is being passed through to you.

Complex instruments and structured products can incur very large leakage in value because of issues such as:

- Products passing through a chain of intermediaries and several levels of structuring with fees being incurred at each step;
- The complexity involved and associated overheads such as the additional time and effort required to package and distribute the deal;
- These products are often traded as Over The Counter ("OTC") products with limited secondary markets;
- Non-standardised products that lack well-established market convention; and
- Large buy/sell spreads due to limited liquidity.

Significant leakage of value through fees may mean the final investor's return is not sufficient and commensurate with the risk of the security. It is essential to check the levels of fees that will be incurred on each investment.

Pricing Advantages

The fair price of a security can be considered to be the price that will earn just enough to cover the additional risk of the security.[12] If priced correctly the expected return of an investment will fully reflect the amount of risk in the investment. For standardised instruments trading in highly liquid markets the fair price will be uncontentious and readily observable.

As the instruments become more complex and less liquid, determining the fair price becomes increasingly difficult. Furthermore, to the extent that uncertainty exists in

[11] Tail events are the low-probability or rare events that occur at the extremes of a distribution, that is, away from the mean or median events.
[12] The additional earning as compared to investing in a "risk free" asset will fully compensate for the risk in the security.

determining this price it can be expected that the financial institution structuring the product will incorporate this uncertainty into the price.

Large financial institutions will also be better placed to assess the riskiness of complex financial instruments and thus have significant pricing advantages in these products.

Put simply, there is no basis for an assumption that the price paid for a product will more than compensate for the risk in the product.

If anything, especially in regard to structured, opaque or complex instruments it is quite likely that the converse will be true.

Market Value

An essential requirement for establishing the validity and credibility of an asset in an investment portfolio is the ability to measure its value.

The Australian Accounting Standards prescribe the reporting and valuation requirements for financial instruments.

The value of a financial instrument is initially recognised at its fair value plus any related transaction costs. Fair value can be established from quoted prices in an active market.

For standardised instruments trading in highly liquid markets there is usually little difficulty in determining a good indication of fair value. For these instruments the market price will be transparent and readily determinable. The costs involved in regular valuations will also be relatively small.

Caution must be exercised in valuing those instruments that are thinly traded, and where reliable market estimates are not readily available. The problem of obtaining good estimates of fair value becomes increasingly complicated for non-standardised instruments and particularly difficult (and costly) in the case of complex financial instruments. Similarly, if the instruments are not traded in regular markets the illiquidity will make fair valuation difficult. For example, for instruments sold in OTC Markets[13] the only price available may be from the counterparty that sold the instrument in the first place.

[13] Over the Counter Markets ("OTC") can generally be described as markets where financial instruments are exchanged directly between two parties rather than through the mechanism of an organised market or centralised exchange.

Appendix D – Ratings Agencies' Credit Ratings

The table below details three ratings agencies' credit ratings for short and long term investments.

http://www.standardandpoors.com

http://www.moodys.com

Moody's		Standard & Poor's			Fitch
Long Term	**Short Term**	**Long Term**	**Short Term**	**Long Term**	**Short Term**
Aaa	Prime 1	AAA	A1	AAA	F1+
Aa1	Prime 1	AAA-	A1	AA+	F1+
Aa2	Prime 1	AA+	A1	AA	F1+
Aa3	Prime 1	AA	A1	AA-	F1+
A1	Prime 1	AA-	A1	A+	F1 or F1+
A2	Prime 1 OR 2	A+	A1	A	F1
A3	Prime 1 OR 2	A	A2	A-	F2 or F1
Baa1	Prime 2	A-	A2	BBB+	F2 or F1
Baa2	Prime 2 OR 3	BBB+	A2	BBB	F3 or F2
Baa3	Prime 3	BBB	A2	BBB-	F3 or F2
Ba1	Not Prime	BBB-	A3	BB+	B
Ba2	Not Prime	BB+	A3	BB	B
Ba3	Not Prime	BB	B	BB-	B
Caa1	Not Prime	BB-	B	B+	B
Caa2	Not Prime	B+	B	B	B
Caa3	Not Prime	B	B	B-	B
Ca	Not Prime	B-	B	CCC	C
C	Not Prime	CCC+	C	CCC	C
		CCCC	C	CCC	C
		CCC-	C	RD/D	D
		CC+	C		
		CC			
		CC-			
		C+			
		C			

RISK SCALE					
Least Risky			Most Risky		
Investment Grade			Not Investment Grade		

Appendix E – Sample Monthly Investment Summary Report To Council

Part (A)

Summary

Through the use of a variety of investment products, Council has been able to obtain investment returns comparable to the benchmark established by Council. This was achieved with a high quality, low risk investment portfolio.

Background

The investment policy requires Council to review the performance of its investment on a monthly basis. In accordance with the policy, a report of investments is presented to Council, which provides a summary of investments.

This report provides a summary of investment movement (See Report Part B) of the past month, to determine if the investment strategy met the objective of Council, in terms of maximising investment returns and maintaining an acceptable level of risk.

Report

During the year, Council funds were invested in six products, which have been rated by Standard and Poor's as follows.

Investments	
ADI issued	**S&P Ratings**
Security 1	AA-
Security 2	AAA+
Security 3	AA+
Security 4	AAA
Non-ADI issued	
SecA	A
SecB	AAA

ADI Authorised Deposit-Taking Institution*

At all times during the year the designated investment exposure limits were adhered to.

Performance

The attached Summary of Portfolio Movement identifies Council's investment type, term to maturity, volume held, percentage to total portfolio, monthly price and monthly variation. The portfolio comprised of four ADI issued interest bearing securities and two Non-ADI issued securities. The total portfolio returns in September were positive overall. There were 2,100,000 units held at a market value of $2,221,958. Total monthly gain was $35,479, representing a 1.6% increase in market value compare to the previous month. This is higher than the 0.53% UBSWA bank bill benchmark performance in September.

Monthly Economic Update

Australian and US government bond yields rose in September as investors viewed the Fed's bigger than expected 50 basis point cut to 4.75% as likely to prevent the US economy from sliding into recession. US economic reading during September were predominately soft, notably the August reading of housing starts, new home sales and existing home sales. August non-farm payrolls also surprised on the weak side of market expectations showing a small fall and calling into question whether consumption spending would hold up given weak housing activity and soft employment.

In contrast, Australian economic readings were predominantly strong through September with very strong August employment and July retail sales and international trade. The Reserve Bank held its cash rate at 6.5% but further liquidity hoarding saw the 90 day bank bill yield push up to 7.1% early in the month. While short-term money market rates came below 7.0% later in the month.

Monthly Economic Updates can be obtained from:

http://www.commbank.com.au/business/campaigns/economic-update.aspx

http://www.nab.com.au/wps/wcm/connect/nab/nab/home/Business_Solutions/10/1/?ncID=ZBA

http://www.anz.com/corporate/economics-markets-research/

http://www.westpac.com.au/about-westpac/media/reports/australian-economic-reports/

Recommendations

That the report be received.

Part (B)

Financial Report

The financial report is to include (by investment):

- description
- credit rating
- maturity/conversion date
- volume held
- % of total portfolio
- unit price for the last four months
- market value for the last four months
- monthly variation