



## Treasury Management Sub-Committee 20 January 2014

### Annual Treasury Management & Investment Strategy Statements 2014/2015

#### 1. Summary and Reasons for Recommendations

- 1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management requires that, prior to the start of the financial year, the Council formally approve an Annual Treasury Management and Investment Strategy which sets out its treasury management policy and strategy statements for the forthcoming year.
- 1.2 The purpose of this report is to:
- (a) Seek approval for the Annual Treasury Management and Investment Strategy Statements 2014/2015 (including treasury related Prudential Indicators)

#### 2. Recommendations

- 2.1 The Sub-Committee is asked to:
- (a) Make recommendations via the Performance and Audit Scrutiny Committee to Cabinet and Council regarding approval of the proposed Annual Treasury Management and Investment Strategy Statements 2014/2015 (attached in **Appendix 1**).

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### **3. Corporate Objectives**

3.1 The recommendations meet the following, as contained within the Corporate Plan:-

- (a) Working together for prosperous and environmentally-responsible communities; and
- (c) Working together for an efficient Council.

### **4. Key Issues**

4.1 Following the recent move to a West Suffolk shared finance service, including a shared treasury management function, between St Edmundsbury Borough Council (SEBC) and Forest Heath District Council (FHDC) we have taken this opportunity to align, where possible, the two Council's Annual Treasury Management and Investment Strategy Statements (Strategy) and Treasury Management Code of Practice (the Code is subject to another report on this committee agenda). The new Strategy and Code still recognise that the two Councils continue to have different investment criteria and limits due to the different size investment portfolios and different external advisors/fund managers.

4.2 The alignment of the Strategies has resulted in many wording and format changes within the documents but the meaning behind the words remains the same. The new Strategy is in line with the CIPFA Code of Practice on Treasury Management and the guidance issued from the Department for Communities and Local Government (CLG).

#### **Main Changes between the 2013/2014 and the new 2014/2015 Strategy**

4.3 Following the recent decision by the Treasury Management Sub-Committee, the new Strategy includes the ability for SEBC to utilise the services of an external fund manager.

4.4 Consequently, the following additional limit has been included:

- The total value of funds controlled by any individual advisor to the Council shall not exceed £30M.

4.5 All other investment limits and criteria remain the same except the following:

- The upper limit for fixed rate investments has been increased from 95% to 100% (due to the current economic climate the majority of the most advantageous rates from institutions on the Council's approved list relate to call accounts or notice accounts both of which are fixed rate investments).

4.6 Interest rate projections have been updated as follows:

	<b>Previous Strategy</b>	<b>New Strategy</b>
2013/2014	1.50%	1.50%
2014/2015	1.50%	1.50%
2015/2016	1.50%	1.50%
2016/2017	2.50%	2.25%
2017/2018		2.25%

4.7	The Council is changing its bank from 1 April 2014 to Lloyds Bank Plc, the Strategy has been updated to reflect this.			
4.8	The Strategy highlights that the Council is allowed to borrow funds if required (in accordance with the Council's Prudential Code).			
<b>5.</b>	<b>Other Options Considered</b>			
5.1	Options for the management of Council investments are formally considered within this Annual Treasury Management and Investment Strategy.			
<b>6.</b>	<b>Community Impact</b>			
6.1	None			
<b>7.</b>	<b>Consultation</b> ( <i>refer to the Consultation and Community Engagement Strategy</i> )			
7.1	Treasury management activities are currently undertaken in consultation with Sector (the Council's appointed Treasury Management advisers) and also take into account information obtained from investment brokers and other economic commentators. This committee provides for the scrutiny of treasury management strategies and performance, with changes in strategies and policies subject to approval by Cabinet and full Council.			
<b>8.</b>	<b>Resource implications</b> ( <i>including asset management implications</i> )			
8.1	Total budgeted interest receipts from investments, included in the MTFs, for 2014/2015 is £629k.			
<b>9.</b>	<b>Risk/Opportunity Assessment</b> ( <i>potential hazards or opportunities affecting corporate, service or project objectives</i> )			
	<b>Risk area</b>	<b>Inherent level of Risk</b> (before controls)	<b>Controls</b>	<b>Residual Risk</b> (after controls)
		High/Medium/Low		High/Medium/Low
	Fluctuations in interest rates or in projected cashflows having significant impact on budgeted investment income.	High	Spread of investments for periods of up to two years. Budget monitoring and quarterly performance reports. Use of interest equalisation reserve to smooth out year-on-year fluctuations.	Medium
	Bank / building society failure resulting in loss of Council funds.	High	Use of Sector advice on counterparty credit ratings (based on Fitch, S&P and Moody ratings) and the setting of lending limits. Use of non-rated building societies based on asset base and additional credit checks.	Medium
	<b>Ward(s) affected</b>	All		
	<b>Background Papers</b>	Treasury Management Performance and Annual Treasury Management and Investment Strategy –2013/2014 (D252)		

**ST EDMUNDSBURY  
BOROUGH COUNCIL**

***ANNUAL TREASURY  
MANAGEMENT AND  
INVESTMENT STRATEGY  
STATEMENTS  
2014/2015***

# **ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY STATEMENTS 2014/2015**

## **TREASURY MANAGEMENT POLICY STATEMENT**

1. The Council defines its treasury management activities as:

“The management of the organisation’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and pursuit of the optimum performance consistent with those risks”.

2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.
3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.
4. The Council’s policies for borrowing and investments are detailed in the Treasury Management Annual Investment Strategy below.

## **ANNUAL INVESTMENT STRATEGY 2014/15**

### **Introduction**

5. Guidance from the Department for Communities and Local Government (CLG) on Local Government Investments in England requires that an Annual Investment Strategy be set by the Council.
6. The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management also sets out various requirements for the Council to meet. The primary requirements of the Code are as follows:
  - Receipt by the full Council of Treasury Management Statements and Reports - including the Annual Treasury Management Investment Strategy Statement & Policy Statement, Minimum Revenue Provision Policy, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
  - Creation and maintenance of Treasury Management Practices (Code of Practice) which set out the manner in which the Council will seek to achieve those policies and objectives.
  - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For the Council this is the Treasury Management Sub-Committee.
7. The Council's general policy objective is to invest surplus funds prudently. The Council's investment priorities are; security and liquidity of the capital at an optimum yield which is commensurate with security and liquidity.

## **Risk Management**

8. The Council regards the successful identification, monitoring and control of risk to be prime criteria by which the effectiveness of its Treasury Management activities will be measured. The main risks to the Council's treasury activities are:
- Credit and Counterparty Risk – Security of the Council's Investments.
  - Market or Interest Rate Risk – Fluctuations in interest rate levels and thereby in the value of investments.
  - Liquidity Risk – Inadequate cash resources.
  - Inflation Risk – Exposure to inflation.
  - Legal and Regulatory Risk – Non compliance with Statutory and Regulatory requirements and the risk of fraud.
9. The above risks have been taken into account when setting the proposed Annual Treasury Management and Investment Strategy Statements. The risk that remains the Council's primary focus is that around the credit and counterparty risk and potential loss of its investments in a similar way to that following the Icelandic Banks collapse. The controls that the Strategy require are:
- credit worthiness checks of counterparties through the Council's external treasury advisor, Sector Treasury Services Ltd (now known as Capita Asset Services) or
  - Asset Value checks assisting the Council to manage this risk.
10. Officers also have access, through the Council's treasury advisor to real time market advice and expertise.
11. Further risk centres on the loss of interest receipts through decreased interest rates which have a direct impact on the Medium Term Financial Strategy (MTFS). Should the market move in an adverse direction, the actual receipts will be lower than forecast budgets and therefore have a detrimental effect on this significant revenue income stream to the MTFS. In the current climate this is a high risk for the Council but beyond its control. The position will be monitored and actual interest receipts against forecast will be reported through Joint Leadership Team and Performance, Audit and Scrutiny Committee, the outcome of which may require the Council to revise its MTFS accordingly.
12. Given the current volatility in financial markets and the performance of institutions, it is probable that status changes may occur during the next 12 months. Accordingly it may be necessary for Officers to update Members verbally as to the impact of these changes and, if appropriate, on alternative courses of action which may have to be considered in order for the Council to have worthwhile investment opportunities during the year.

## **Scheme of delegation and the role of the Section 151 officer**

13. The Section 151 Officer, or Deputy Section 151 Officer, has delegated responsibility under the Treasury Management Code of Practice for the execution and administration of treasury management decisions.
14. The Section 151 Officer or Deputy Section 151 Officer may delegate their treasury management responsibilities to members of their staff. The full scheme of delegation can be found in the Council's Treasury Management Code of Practice (in the section TMP5 – Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements).
15. Staff that have responsibility for the treasury function are required to have sufficient knowledge and expertise in treasury management to be able to understand and critically consider the advice provided by the Council's treasury consultants.
16. The training needs of staff are considered on a regular basis as part of the Council's appraisal process. The Section 151 Officer or Deputy Section 151 Officer will ensure that treasury management staff receive appropriate training and have the necessary skills to be able to undertake their duties effectively.

## **Use of External Brokers/Advisors/Fund Managers**

17. The Council has approval for the use of fund managers, brokers and/or advisors.
18. The Council will ensure, through regular meetings and discussions with their fund managers, brokers and/or advisors, that the service is tailored to the Council's needs and strategic aims, and that they appreciate the Council's position on the balance between risk and reward in its treasury activities. The Council has regard to all the advice and information provided by the external support, but responsibility for treasury decisions remains with the Council.

## **Creditworthiness Policy & Lending Criteria**

19. The Council needs to set investment criteria for its investments based on which is an appropriate institution to hold the Council deposits. Ideally any counterparty policy should spread investments over the maximum number of counterparties, who vary in type i.e. building societies or banks. However, the key concern of the counterparty policy is to manage risk in a practical way rather than stick to a theoretical ideal. Usually those organisations or types of investments with the lower risk (best credit worthiness) are those that pay the lowest returns, those with lower credit worthiness have to pay the higher returns to attract investors. Therefore the Council must strike a balance of risk and return.
20. The Council uses the creditworthiness service provided by Sector Treasury Services Ltd (now known as Capita Asset Services). This service uses a sophisticated modelling approach which uses all of the following to produce a colour coded rating for each institution:
  - credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poor

- credit watches and credit outlooks from credit rating agencies
- sovereign ratings to select counterparties from only the most creditworthy countries
- credit default swap (CDS) data

21. These colour codes are used by the Council to determine the creditworthiness of counterparties and the maximum duration and value of investments with individual banks and building societies. Where banks/building societies are part of a merged group structure, the limits are applied to the group as a whole.

22. Sector produces two colour codes for each counterparty. The first colour code is based upon the assessments of the credit rating agencies and takes account of rating watches and outlooks as well as changes in sovereign ratings. The second colour code also takes account of Credit Default Swap (CDS) data relating to individual counterparties, which can give an early warning of potential changes in credit ratings. The Council uses the first colour code to determine the maximum value and duration of investments, but remains mindful and takes into account CDS data provided by Sector (particularly where CDS spread is shown as "out of range" within the Sector model), together with other market data, when selecting the counterparties to use. Within this framework the Council will therefore use counterparties within the following colour coded bands:

### ***Lending Criteria - Rated Banks and Investment Scheme***

Sector Colour Code Key	Maximum Duration / Investment Values*
Purple	Max £10m for max of 2 years (subject to max 50% of portfolio)
Orange	£9m for max of 2 years (subject to max 40% of portfolio)
Red	£8m for max of 1 year (subject to max 35% of portfolio)
Green	£6m for max of 6 months (subject to max 30% of portfolio)
Blue (nationalised / substantially owned by the UK government )	£15m for max of 2 years

\* Note – This represents an adaption of the Sector approach

23. The lending criteria for rated building societies is based on the same Sector colour coding system as the rated banks.

### ***Lending Criteria – Rated Building Societies***

Sector Colour Code Key	Proposed Limits*
Red	£8m for max of 1 year (subject to max 35% of portfolio)
Green	£6m for max of 1 year (subject to max 30% of portfolio)

• Note – This represents an adaption of the Sector approach



24. All credit ratings will be monitored on an on-going basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use for new investments will be withdrawn immediately.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

25. Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information (for example, as provided by the Council's brokers), information on government support for banks and the credit ratings of that government support.

26. The majority of UK building societies do not obtain formal credit ratings and as such, investments with these organisations have to be treated with caution. In the absence of formal credit ratings Sector advises caution in the use of such counterparties, particularly in the current economic climate. The following credit criteria (based on asset values and other sources of financial and credit rating information) have been established by the Council in consultation with Sector and seek to limit the value and duration of investments with these organisations.

***Lending Criteria – Non Rated Building Societies(Asset Base Criteria)***

Asset Base	Maximum Duration / Investment Values
Asset base > £2,500m	£3m for max 6 months
Asset base > £1,000m	£2.5m for max 6 months

27. In addition to the above asset base criteria the following additional criteria are applied:

- A commercial credit rating organisation, Dun and Bradstreet, to be used to provide credit rating reports on building societies, prior to the placing of funds, to ensure that the proposed investment values are within recommended credit limits
- Latest available accounts to be obtained and reviewed by in-house staff to establish key trends and to ensure that Dun and Bradstreet recommendations are based on latest available financial results
- Review of available media coverage for any advance negative warnings regarding the stability of individual building societies.

28. The Head of Resources and Performance, in consultation with the Portfolio Holder for Performance and Resources, will continue to monitor the adequacy of the above lending criteria and make changes as necessary to respond to the changing economic climate and external advice. Details of any changes made will be included within the next treasury management reporting cycle to the Performance and Audit Scrutiny Treasury Management Sub Committee, Cabinet and full Council.

29. In looking for security and a return on smaller investments the Council will continue to use deposit /call accounts with major banks and building societies on its approved counterparty list. In parallel with this option, and to deal with any further uncertainties in the financial markets, it is proposed that, should the need arise the Council will place investments with the Debt Management Office through the Debt Management Agency Deposit Facility or with Local Authorities direct. Whilst the rates of interest earned are below market rates the Council's capital investments will be protected.

### **Investment Security - Specified and Unspecified Investments**

30. The Secretary of State requires that the Council identifies institutions which will be used for specified and unspecified investments.

31. The definitions of specified and unspecified investments are shown below:

- An investment is a *specified investment* if all of the following apply:
  - (a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
  - (b) the investment is not a long-term investment (1 year or more)
  - (c) the making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 [SI 3146 as amended];
  - (d) the investment is made with a body or in an investment scheme of high credit quality (see below); or with one of the following public sector bodies:
    - i. the UK Government
    - ii. a local authority in England & Wales (as defined in section 23 of the 2003 Act) or similar body in Scotland or Northern Ireland
    - iii. a parish or community council.
  
- An *unspecified investment* is any other investment that does not meet the definition of a specified investment. Basically these are investments with maturity dates greater than 1 year, or where no credit ratings have been awarded to the organisations concerned.

32. The criteria set for the use of specified and unspecified investments are set out below:

**Specified Investments** - All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable.

	<b>Minimum 'High' Credit Criteria</b>
Debt Management Agency Deposit Facility	--
Treasury Bills	--
Term deposits – local authorities	--
Term deposits – banks and rated building societies (see separate table for credit criteria re non-rated building societies)	Based on Sector's Colour Code system
Bonds issued by a financial institution which is guaranteed by	AAA

the UK government	
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A, Individual C, Support 2
Sovereign bond issues (non-UK)	AAA
Money Market Funds	Short-term F1, Long-term A, Individual C, Support 2

**Non-Specified Investments** - All such investments will be sterling denominated, with maturities over 1 year, meeting the minimum 'high' rating criteria where applicable, or with non rated organisations – ie non rated building societies.

A maximum of 90% will be held in aggregate in non-specified investments

	<b>Minimum Credit Criteria</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Term deposits – other LAs with maturities >1yr	-	50	2 years
Term deposits – non-rated building societies	See table at 5.7 above	90	1 year
Term deposits – banks and rated building societies with maturities >1yr	Based on Sector's Colour Code system – see tables at 5.3 & 5.4 above	90	2 years
	<b>Minimum Credit Criteria</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Bonds issued by multilateral development banks with maturities >1yr	AAA	25	2 years
Bonds issued by a financial institution which is guaranteed by the UK government with maturities >1yr	AAA	25	2 years

### **Investment Liquidity - Longer Term Investments**

33.The following longer term investment restrictions will apply:-

- No more than £20M (nominal) can be invested for periods of 1 year or longer.
- No investments can be made for periods longer than 5 years.
- The total value of funds controlled by any individual advisor to the Council shall not exceed £30M (nominal).

On any day:

- No more than £15M (nominal) in total shall be held in investments where the remaining term up to the date of maturity is at least 4 years but not exceeding 5 years.
- No more than £20M (nominal) in total shall be held in investments where the remaining term up to the date of maturity exceeds 1 year.

- No more than 60% of the total value of investments held will be subject to a variable rate of return.

### **Borrowing/External Debt**

34. The option of short or long term borrowing is available to the Council. However the Council must have regard to the Prudential Code when setting borrowing limits and must ensure that any borrowing is sustainable and affordable.

35. The Council's external debt as at 31 December 2013 was as follows:-

	£
Public Works Loan Board	0
Mortgages	0
Bonds	0
Temporary Loans	0
Long Term Loans	0

### **Council's Banker**

36. Following a recent Tender process, from 1 April 2014 the Council's bank will be Lloyds Bank Plc. On adoption of this strategy, the bank meets the credit criteria of F2 or above for short term investments. It is the Council's intention to use deposit and / or call accounts provided by Lloyds for short term liquidity requirements (e.g. overnight and weekend investments) and business continuity arrangements.

### **Balanced Budget Requirement**

37. The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

### **Future Interest Rates**

38. The Bank of England continues to hold the Official Base rate at 0.5%. It has remained at this rate since 5 March 2009.

39. Given the current economic situation it is difficult to forecast when the base rate will increase. The Council is working with its external fund managers and advisors to ensure that it maximises all of its returns on investments in line with the latest information available.

40. The average investment interest rates which are expected to apply to the Council's investments have been determined in consultation with the external advisors and have been included in the MTFS interest projections as follows:

- 2013/14 – 1.50%
- 2014/15 – 1.50%
- 2015/16 – 1.50%
- 2016/17 – 2.25%
- 2017/18 – 2.25%

41. Although the governments 'funding for lending' scheme has started to be scaled down, cheap funding for banks and building societies continues to be available. The effects of this funding is still having major effects on the rates of return, especially for longer term investments. Consequently the Council's interest projections have reduced.

### **Total Investments**

42. The following table gives full details of the investments held by the Council as at 31 December 2013.

<b>Counterparty Name</b>	<b>Value £</b>	<b>Interest Rate %</b>	<b>Date Loaned</b>	<b>Date of Return</b>
<b>BANK OF SCOTLAND ACCOUNT</b> Bank of Scotland Call Account	1,750,000	0.400		
<b>NATWEST ACCOUNTS</b> NatWest Call Account	2,000,000	0.500		
NatWest 95 Day Notice Account	10,000,000	0.600		
<b>BARCLAYS ACCOUNT</b> Barclays Reserve Account	6,000,000	0.650		
<b>SANTANDER ACCOUNT</b> Santander UK Business Reserve Account	350,000	0.400		
<b>TEMPORARY INVESTMENTS</b> Nationwide Building Society	2,000,000	0.500	02/07/2013	02/01/2014
Bank of Scotland	4,500,000	1.100	13/02/2013	12/02/2014
Bank of Scotland	1,500,000	1.100	11/04/2013	11/04/2014
Ulster Bank	3,000,000	0.950	01/05/2013	30/04/2014
Bank of Scotland	2,000,000	1.010	04/07/2013	04/07/2014
Bank of Scotland	2,000,000	1.030	31/07/2013	01/08/2014
Bank of Scotland	1,500,000	3.200	04/09/2012	04/09/2014
Bank of Scotland	1,750,000	2.150	01/11/2012	03/11/2014
<b>TOTAL VALUE OF INVESTMENTS HELD</b>	<b>38,350,000</b>			

### **Capital Finance**

43. The financing of the Council's capital programme is considered by Cabinet and is ratified by Council. External financing is required to be in line with the Council's approved Treasury Management and Investment Strategy and approved Prudential Indicators.

### **Treasury Management Code of Practice**

44. The Treasury Management Code of Practice is the subject of a separate report. The Code of Practice underpins the Strategy and provides further details regarding the operational requirements and processes regarding treasury management.

## **Prudential Indicators**

45.The Council's overall Treasury Management Strategy and Code of Practice links into the Council's Prudential Indicators and Minimum Revenue Provision Policy which are subject to separate reports to Council. A summary of the treasury related indicators is as follows:

	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>
<b>TREASURY MANAGEMENT PRUDENTIAL INDICATORS</b>	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
<b>Authorised limit for external debt -</b>	<b>Approved</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
Borrowing	£5,000,000	£5,000,000	£5,000,000	£5,000,000
Other long term liabilities	£0	£0	£0	£0
<b>TOTAL</b>	<b>£5,000,000</b>	<b>£5,000,000</b>	<b>£5,000,000</b>	<b>£5,000,000</b>
<b>Operational boundary for external debt -</b>				
Borrowing	£0	£0	£0	£0
Other long term liabilities	£0	£0	£0	£0
<b>TOTAL</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>
<b>Maturity Structure of Borrowing</b>				
Upper Limit for % of borrowing maturing in:				
• Under 12 Months	33%	33%	33%	33%
• 1 - 2 years	0%	0%	0%	0%
• 2 - 5 years	0%	0%	0%	0%
• 5 - 10 years	0%	0%	0%	0%
• Over 10 years	100%	100%	100%	100%
The lower limit for all periods	0%	0%	0%	0%
<b>Upper limit for fixed interest rate exposure</b> expressed as a % of total investments	95%	100%	100%	100%
<b>Upper limit for variable rate exposure</b> expressed as a % of total investments	60%	60%	60%	60%
<b>Upper limit for total principal sums invested for over 364 days</b> (per maturity date)	£20,000,000	£20,000,000	£20,000,000	£20,000,000