The Treasury

Treasury Circular

TC17-02
7 February 2017

Guidelines on Reporting of Investment and Liability Management Performance

This circular provides updated "Guidelines on Reporting of Investment and Liability Management Performance" for statutory bodies. It replaces the previous Treasury Circular NSWTC 14-31 issued in December 2014.

Summary:

The *Annual Reports (Statutory Bodies) Regulation 2015* requires guidelines to be issued by the Treasurer regarding investment and liability management performance, including benchmarking.

This Circular updates the criteria for determining the particular NSW Treasury Corporation (TCorp) investment facility (TCorpIM Funds, previously marketed as Hour-Glass Investment Facilities) that should be used as the benchmark for measuring the investment performance of agencies.

Where a statutory body is unclear on any aspect of the investment or liability performance measurement process, it is strongly encouraged to make enquiries with TCorp or a qualified financial adviser.

The attached "Guidelines on Reporting of Investment and Liability Management Performance" are to be used for financial years commencing on or after 1 July 2016.

This Circular replaces the previous Treasury Circular TC14-31 issued in December 2014.

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For Secretary
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Guidelines on Reporting of Investment and Liability Management Performance

1. Introduction

Clause 10 of the *Annual Reports (Statutory Bodies) Regulation 2015* ("Regulation") requires a statutory authority to include within its annual report details of its investment performance in respect of surplus funds compared with the appropriate TCorp investment facility (which are offered as TCorpIM Funds). Further under clause 10(3), the comparison must be made on the basis of the nature and term of the underlying liability in accordance with guidelines issued by the Treasurer.

The appropriate TCorpIM Funds against which performance should be benchmarked are shown in Table 1.

Table 1: Choice of TCorpIM Funds as Benchmark

Term of Underlying Liabilities ("investment horizon")	Appropriate TCorpIM Funds as Benchmark
0-1.5 years	Cash
1.5-3 years	Strategic Cash
3-7 years	Medium Term Growth
7+ years	Long Term Growth

In determining the appropriate TCorpIM Funds benchmark:

a) The TCorpIM Funds to be used as a performance Benchmark are determined by reference to the term of the underlying liabilities, not the existing investment in which the surplus funds have been placed. For example, provisions for long service leave payments currently invested in the Cash Facility but for which the term of the underlying liability is 7+ years, would be measured against the Long Term Growth Facility, not the Cash Facility.

b) A single benchmark can be used in cases where liabilities have varying investment horizons. This benchmark should be based on the average term of the underlying liabilities.

2. Surplus Funds

The surplus funds of the statutory body for which details of investment performance must be reported under clause 10(1) of the Regulation include:

a) cash and cash deposits, debentures, bonds, inscribed stock, registered stock, discounted securities, promissory notes and any other marketable security; and

b) any other assets held by the statutory body primarily for the accretion of wealth through appreciation in value and/or receipt of distributions (such as interest, royalties, dividends and rentals).

3. Calculations for investment or liability management performance comparisons pursuant to Clauses 10 and 11 of the Regulation

Daily Investment Return

All investment performance should be expressed as percentage returns, calculated by the following formula:

$$\text{Daily Return} = \frac{MV_E - MV_B - \text{Net Cashflow}}{MV_B + \text{Net Cashflow}} \quad \text{(the "Start of Day" formula)}$$

Where:

MV_E = Market Value of investments at the end of the day

MV_B = Market Value of investments at the end of the previous day

Market Value is the proceeds on sale of financial assets based on externally determined market yields (market "mid" rate for each security)

Net Cashflow is cash inflows less cash outflows and includes only those cashflows which relate to operational activities, ie originate from outside the portfolio. For example, injections of additional investment funds and withdrawals of funds are cashflows for the purposes of the calculation, whereas interest coupons or dividends received are not (provided they are reinvested and not taken out of the portfolio).

The TCorpIM Funds use the Start of Day formula in calculating returns, and investors' statements at the end of each month show the return for the month and the financial year to date on that basis.

Daily Debt Cost

All debt performance should be expressed as percentage costs. Daily costs are to be calculated by the following formula:

$$\text{Daily Cost} = \frac{MV_E - MV_B - \text{Net Cashflow}}{MV_B}$$

Where:

MV_E = Market Value of debt at the end of the day

MV_B = Market Value of debt at the end of the previous day

Market Value is the proceeds on sale of debt based on externally determined market yields (market "mid" rate for each security)

Net Cashflow is cash inflows less cash outflows

Table 2: Example Debt Cost Calculation

MVE – Closing	($111,000,000)
MVB – Opening	($100,000,000)
New Borrowing	($10,000,000)
Calculation	MVE -MVB - Net Cashflow / MV_B
	= (111,000,000) – (100,000,000)- (10,000,000) / (100,000,000)
	= (111,000,000) – (100,000,000) –(10,000,000) / (100,000,000)
	= (1,000,000) / (100,000,000)
Debt Cost %	= 1.00%

Monthly Investment Return or Debt Cost

The monthly performance, i.e. investment return or debt cost, is derived as follows:

Monthly Performance = $(1 + P_1)*(1 + P_2)*...*(1 + P_n) - 1$

Where:

P_1 is the performance for day 1 and P_2 the performance for day 2, with P_n being the performance for the last day of the month (or any other period if required) - with each daily performance figure being calculated as set out in the preceding sections.

Note: This method can be used to combine daily performance for any number of consecutive days.

Annual Investment Return or Debt Cost

Where the investment return or cost of debt is measured for each month of the year, the method for calculating annual performance is as follows:

Annual Performance = $(1 + P_1)*(1 + P_2)*...*(1 + P_{12}) - 1$

Where:

$P_1, P_2 ... P_{12}$ are the monthly performance figures calculated as above

Note: This method can be used to combine returns for any number of consecutive periods, including part months or periods of more than a month.

Annualisation of Part Year Return

Pursuant to clause 10(7) of the Regulation, the method for calculating annualised investment return where performance is available for part of the year is as follows:

$$\text{Annualised Return} = (1 + P)^{(365/y)} - 1$$
$$\text{or in a leap year, } (1 + P)^{(366/y)} - 1$$

Where:

P = performance for the relevant part-year period, measured using the calculation principles set out above

y = the number of days in that period

Note: The same method can be used for annualising debt costs which are available only for part of a year.

Other Matters

Benchmark returns or costs are to be calculated in the same manner as actual returns or costs. For investment benchmark calculations, TCorp can provide TCorpIM Funds unit prices on request.

Rates of return or costs calculated in accordance with this circular are time weighted rates, which are indices of performance commonly used in comparing returns or costs for a number of portfolios, in this case actual and benchmark portfolios, and are independent of the timing of cashflows and variations in portfolio volume.

4. Level of debt for inclusion under Clause 11(1)

Pursuant to clause 11(1) of the Regulation, the level of debt at, or above, which an authority is required to include a comparison of liability management performance in its report of operations is $20 million, as advised by NSW Treasury in the policy paper “Treasury Management Policy” (TPP 07-7) issued July 2007. The authority’s level of debt is taken to be the aggregate current capital value of all borrowings.

5. Advisory Assistance

Where a statutory body is unclear on any aspect of the investment or liability performance measurement process, it is strongly encouraged to make enquiries with TCorp or a qualified financial adviser. At TCorp, you may contact Rory Bridle from the General Government and Investors Sector on (02) 9325 9227.