ANGLICAN FUNDS
Grafton Diocese

CASH AND LIQUIDITY POLICY

Anglican Fund Grafton Diocese

Cash and Liquidity Policy

A. CASH POLICY

1. Taking into account any material forecast cash inflows and outflows, the level of cash held is at all times to be at least 10% of the liabilities of the Fund. Excluding any liabilities for which there are no offsetting assets (eg, loans backed by a deposit). This level of cash holding is consistent with the APRA prudential standard APS 210 – Liquidity.

2. Cash includes deposits at call, bank paper, government issued securities, negotiable certificates of deposit and term deposits issued by an ADI and having a duration to maturity of less than 12 months.

3. All counterparties will have the equivalent of a Standard and Poors short term rating of A2 or greater.

   All ratings are short term ratings by either Standard and Poors, Moody's or Fitch. Where an organisation has multiple ratings, then the lowest rating is to be used.

4. The policy should be reviewed within a period of not greater than two years following its approval.

Refer DFAG Minimum Standards 4.1

B. BACKGROUND

Purpose of the Cash Policy

The purpose of the cash policy includes the management of the following risks:

- Liquidity risk of the “banking” activities and the concept of “borrowing short” and ‘lending long’ This will include having sufficient liquidity to meet:

  1. Expected cash outflows eg, those expected in a cash flow forecast.
  2. Unexpected cash outflows

- Counterparty risk i.e., not having an excess exposure to a counterparty
- Solvency risk i.e., cash flow management and the ability to pay debts “as and when they fall due”.

Management is to report to the Board at each meeting of the liquidity risk, counterparty risk, and solvency risk measures affecting the fund, and any actual and likely breaches of these risk measures.

Organisational Capacities

As recent history has shown (eg, the Collaterised Debt Obligations Market) significant specialists skills are needed in (i) credit risk assessment/management and (ii) understanding product structures if you are to manage a complex cash portfolio. This is against the current background of a difficult economic climate and credit market.

The size and complexities of Funds cash holdings do not cost justify the hiring of staff with specialised skills to manage a “cash portfolio”.

What is Cash

For the purpose of this policy, cash is defined as any holding with an APRA approved deposit-taking institution where the holding is either:

- Cash at bank
- Deposits at call
- Term Deposits, bank bills and negotiable certificates of deposit, where the duration of the deposits is 12 months or less (ie, current asset)
- Securities issued by the Commonwealth government or any state or territory government

Any new product under this policy needs to be approved by the Anglican Fund Grafton Diocese Board before being introduced.

Benchmark Standards

Liquidity Risk
The deposit taking and lending aspects of the Fund are considered similar to an ADI.

APRA have issued a number of standards for an ADI to follow.

Although the Fund is exempt from the Banking Act, some relevant standards have been considered as benchmarks for the operations.

Prudential Standard APS 210 – “Liquidity” provides a guidline as to how APRA consider liquidity risk management for an ADI (see attachment A) Paragraph 9 of this standard states that:

> “An ADI…will be required to maintain a minimum holding of 9% of its liabilities in specified high quality liquid assets at all times”.

Paragraph 12 states that “high quality liquid assets” must be free from encumbrances and include:

- Cash
- Government issued securities (i.e., securities eligible for repurchase transactions with the reserve bank
- Bank bills and certificates of deposit with investment graded banks
- Deposits at call (they are readily convertible into cash within 2 days) held with an ADI

The above definition of high quality liquid assets assumes an organisational ability to trade in bank bills and government paper.
Refer Risk Management Policy 4.1, 4.2, 4.3, 4.4, 4.5
The characteristics of a cash policy are as follows:

- Any cash forecast for the Fund which is likely to materially impact cash flows eg, future Synod payments, expected withdrawals, deposits, loan draw downs or repayments should be considered.
- Should maintain the 10% minimum holding required by APRA for an ADI
- Should apply the 10% benchmark to the current broader definition of cash instruments to include term deposits with a maturity of less than 12 months. (NB: generally you are able to break the term deposit term for either no or a minimal interest penalty).
- Should use a credit rating to determine the acceptable counter parties
- Should apply the 10% rule to all liabilities of the Fund excluding any liabilities in which there are offsetting assets.

Counterparty Risk

The issue of counterparty risk is dealt with by APRA in a number of areas including the management of superannuation business (eg, asset concentration) and banking business (counterparty risk).

The common limits for counterparty risks are either 5% or 10% of certain benchmarks. For banking business, it tends to be 10% of net assets (capital).

Common practice recommends using the net assets of the Fund as the benchmark and limiting the counterparty risks as follows:

- A1 rated or better 10% of net assets
- A2 rated or better – 5% of net assets

The rating agency is to be the three ratings agencies currently recognised i.e., S&P, Moodys; Fitch. The comparison of the ratings agencies, as per the APRA Prudential Practice Guide APG 112- Standardised Approach to Credit Risk (January 2008) is as follows (refer page 10 of the guide).

Table 2: Recognised short-term ratings and equivalent credit rating grades			
Credit rating grade	Standard & Poor's Corporation	Moody's Investor Services	Fitch Ratings
1	A-1	P-1	F-1
2	A-2	P-2	F-2
3	A-3	P-3	F-3
4	Others	Others	Others

Where there is no short term rating, a long term rating can be applied (using the S&P ratings) as follows

a) A long term rating of AA- or greater is considered to be equivalent to a short term rating of A1+.
b) A long term rating of A or A+ is considered to be equivalent to a short term rating of A1.
c) A long term rating of A- or BBB+ is considered to be equivalent to a short term rating of A2
d) A long term rating of less than BBB+ is not considered to be of credit quality.

If there is any conflict in any rating, then the lower rating level will be used.

Loan and Deposit Offset Arrangements

Consistent with the Capital Adequacy Policy where a loan has collateral of deposits with the Fund and there is an unfettered right to access these deposits if there is a default on the loan, then only the net amount of the loan should be included in the calculation of the capital adequacy amount.

For the same reasons, where a deposit is securing a loan, and the expectation is that the deposit will be used to repay the loan, then the balance of the deposit that is expected to be used to repay the loan should not be included in the calculation of the liabilities.

Contingency Plan

The Board is responsible for defining and implementing a contingency plan to ensure the Fund can meet its liquidity obligations.

In the event of liquidity problems arising from a breach or potential breach of the liquidity limits the Fund Manager must advise the Board and arrange for a draw down against the contracted 3rd party bank under the authority of the Board.

In the event of a run on funds, the Fund Manager will consult with the Board to develop a strategy to counter any negative community concerns, and use the existing line of credit with the 3rd party bank to meet withdrawals.

Emergency Liquidity

The Fund Manager must put in place financial stand-by facilities (overdraft facilities, line of credit facilities) to guard against anticipated or real funding and liquidity shortfalls.

Attachment A

APRA Prudential Standard APS 210 – Liquidity

Responsibility for liquidity management

1. The Board of directors and management of an ADI shall implement and maintain a liquidity management strategy that is appropriate for the operations of the ADI to ensure that it has sufficient liquidity to meet its obligations as they fall due.
2. An ADI shall adhere to its liquidity management strategy at all times and review it regularly (at least annually) to take account of changing operating circumstances.
3. An ADI shall inform APRA immediately of any concerns it has about its current or future liquidity, as well as its plans to address these concerns.

Liquidity management strategy

4. APRA will review and agree with an ADI the adequacy and appropriateness of the ADI's liquidity management strategy, having regard to the ADI's size and nature of operations. The ADI shall consult APRA prior to making any material changes to the agreed liquidity management strategy.
5. An ADI's liquidity management strategy shall include the following elements:

   (a) a liquidity management policy statement approved by the Board or a Board committee. For foreign ADI's the policy statement should be approved by an appropriate senior officer from outside Australia.
   (b) A system for measuring, assessing and reporting liquidity
   (c) Procedures for managing liquidity
   (d) Clearly defined managerial responsibilities and controls, and
   (e) A formal contingency plan for dealing with a liquidity crisis.

6. An ADI's liquidity management strategy shall cover both the local and overseas operations of the ADI, as well as all related entities which have impact on the ADI's liquidity. Where an ADI manages liquidity on a group basis, the strategy shall cover both the ADI and the group as a whole. The strategy shall address all on and off balance sheet activities of the ADI and, where relevant, the ADI group as a whole across all currencies.

Scenario analysis

7. An ADI's liquidity management strategy should, where appropriate, include scenario analysis of domestic and foreign currency liquidity to ensure that the ADI can operate under a wide range of operating conditions. At least two scenarios are to be addressed.

(a) “going concern” refers to the “normal” behaviour of cash flows in the ordinary course of business; and
(b) “name crisis” refers to the behaviour of cash flows in adverse operating circumstances specific to the ADI, where it has significant difficulty in rolling over or replacing its liabilities.

8. The ADI’s scenario analyses performed under paragraph 7 shall demonstrate:

(a) how obligations and commitments are met on a day-to-day basis; and
(b) that there is sufficient liquidity available to the ADI to keep it operating for at least five business days in a name crisis.

9. An ADI should undertake scenario analysis on a regular basis as per paragraph 7 except where APRA accepts, after discussion with the ADI concerned, that the nature and scale of its operations do not warrant employing sophisticated liquidity management strategies. Instead, the ADI will be subject to APRA’s minimum liquidity holdings requirement as stipulated in paragraph 10 below. APRA may also require an ADI to maintain minimum liquid holdings where it assesses that the ADI’s capacity to carry out scenario analysis is adequate.

Minimum liquidity holdings

10. An ADI exempted from scenario analysis under paragraph 9 will be required to maintain a minimum holding of 9% of its liabilities in specified high quality liquid assets at all times.
11. “Liabilities”, for the purpose of this Standard, is defined as total on-balance sheet liabilities (including equity) and irrevocable commitments, less the capital base defined in accordance with Prudential Standard APS 111 Capital Adequacy: Measurement of Capital.
12. For the purpose of APRA’s minimum liquidity holdings requirement, “high quality liquid assets” must be free from encumbrances (except where approved for a prudential purpose by APRA) and include:

- Cash
- Securities eligible for repurchase transactions with the Reserve Bank
- Bank bills and CDs issued by ADIs provided the issue is rated at least “investment grade” as set out in Prudential Standard APS 116 Capital Adequacy: Market Risk
- Deposits (at call and any other deposits readily convertible into cash within two business days) held with other ADIs net of placements by the other ADIs; and
- Any other securities approved by APRA.

13. notwithstanding paragraphs 7 and 10, Apra may, where it is not satisfied with the adequacy of an ADI’s liquidity management strategy, or where it has particular concerns about an ADI’s liquidity, direct the ADI to hold specified amounts of high quality liquid assets as defined in paragraph 12 above.

14. An ADI shall inform APRA immediately when in danger of breaching the minimum requirement and the remedial action taken/planned to avert any breaches.

Reporting arrangements

15. An ADI must provide APRA each quarter (or more frequently if required by APRA) with liquidity reports as agreed.