

CITY COUNCIL – 10 DECEMBER 2012

REPORT OF THE DEPUTY LEADER

TREASURY MANAGEMENT STRATEGY 2012/13 – REVISED INVESTMENT STRATEGY

1 SUMMARY

- 1.1 This report details changes to the City Council's 2012/13 investment strategy, approved by the Section 151 Officer under delegated authority on 18 September 2012.

2 RECOMMENDATIONS

- 2.1 It is recommended that Council approve the action of the Section 151 Officer in authorising the changes to the 2012/13 investment strategy as detailed in section 6.4.

3 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

- 3.1 To ensure compliance with the Code of Practice on Treasury Management in Public Services (the Code), adopted by the City Council in February 2002.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

- 4.1 Options for management of the Council's debt and investment portfolio are continually reviewed as part of the treasury management operation.

5 BACKGROUND

- 5.1 Treasury management is the management of the Council's cash flows, including borrowings and investments. It is regulated by the Code.
- 5.2 Treasury management is subject to robust governance arrangements including legislation, government guidance, codes of practice and financial regulations. The approval of a strategy relating to treasury management by a meeting of full Council, including a

strategy for debt repayment and investment, is good practice and ensures that the City Council complies with the governance framework. Any changes to the strategy during the year should also be reported to a meeting of the full Council and approved.

6 INVESTMENT STRATEGY 2012/13

6.1 The investment strategy for 2012/13 was approved at the City Council meeting on 5 March 2012. The Council has adopted specific investment criteria, including formal credit ratings of financial institutions and a range of other relevant information. Based on those criteria, a list of approved counterparties for investment is compiled, with maximum sums and period limits applied.

In conjunction with our appointed treasury advisors, Council officers monitor and evaluate changes in credit ratings and other adopted criteria and take appropriate action which may include the suspension of counterparties, reductions in the maximum sum or period for deposits or requests for repayments of deposits, where terms allow.

6.2 The continued turmoil in global financial markets in 2012/13 (and in particular the problems for banks and sovereign governments within the Euro-zone), has led to the downgrading of a number of financial institutions since the Council's investment strategy was developed and approved. As a consequence of this, and other concerns about the viability of these institutions, changes to the approved investment counterparty list have been introduced in the current financial year, including:

- the suspension of all Euro-zone banks for future deposits, pending a resolution of Euro-zone problems;
- the recall of existing deposits and the suspension of future deposits with Santander (UK) and Royal Bank of Scotland (RBS), following a downgrading by one of the credit rating agencies;
- the reduction of the maximum period of investment for term deposits from 364 days to 6 months, 100 days or even 1-day deposits for some institutions.

These changes have been made at a time when the level of surplus cash within the Council has remained high, with a consequent pressure on available eligible counterparties for the investment of such monies.

6.3 In order to respond to these pressures, treasury officers have adopted a number of measures, within the existing strategy, in recent months:

- placing new deposits with eligible Australian banks (relatively protected from the Euro-zone crisis, with high credit ratings retained as a consequence);
- using alternative instruments such as Certificates of Deposit, to enable deposits to be placed with other UK banks with higher ratings (e.g. Standard Chartered);
- using surplus cash to repay maturing debt, rather than for investment purposes.

Notwithstanding these actions, it was considered appropriate to review the Council's existing investment strategy and propose a number of amendments, in anticipation of a possible worsening of the global economic situation in the near future.

6.4 Following an evaluation of available options in conjunction with our advisors, a number of strategy changes were drawn up:

- *the exclusion of short-term credit ratings for eligible financial institutions* – at present, the investment strategy criteria includes minimum levels for both the long-term and short-term credit ratings of eligible counterparties. Increasingly in capital markets, the long-term rating is becoming the principal driver which influences a bank's funding costs and perceived creditworthiness internationally and hence market sentiment towards that institution. It is therefore proposed to exclude the requirement for a minimum short-term rating for eligible financial institutions. The existing requirement for a minimum long-term rating from all 3 major rating agencies of A- (FITCH), A- (S&P) and A3 (Moody's) will be retained. This will enable the re-instatement of RBS on the eligible counterparty list. RBS is a state-owned UK bank considered 'systemically important' to the UK financial system and therefore likely to be in receipt of financial support from the Government, if required;
- *an increase in the maximum investment sum for individual UK banks* – at present, the limit for deposits with UK banks is £20m. It is proposed to increase this to £25m. With the current investment portfolio size, this sum represents a maximum of around 12.5% of the portfolio deposited with any one institution;
- *an increase in the maximum investment sum for individual non-*

UK banks – at present, the limit for deposits with non-UK banks is £5m. It is proposed to increase this to £10m. The existing restriction on the total sum invested with any one country will also be raised, from 10% to 15% at the time of investment. The overriding 25% limit for non-UK banks as a proportion of the total portfolio will be retained. This will provide potential further investment in eligible Australian and Canadian banks, which are currently considered more secure than their European counterparties.

- 6.5 These proposed changes were considered by Executive Board (18 September 2012) and Audit Committee (21 September 2012). In the absence of a City Council meeting for two months, the Section 151 Officer approved the changes, under delegated authority, with effect from 24 September 2012, on the grounds of financial benefit.
- 6.6 Appendix A provides details of the revised eligible counterparty list, following the changes. The position remains under review, with further changes considered, as appropriate.

7 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS, CRIME AND DISORDER ACT IMPLICATIONS AND EQUALITY AND DIVERSITY IMPLICATIONS)

- 7.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function. The adopted Risk Management Action Plan in respect of treasury management activity is included in the strategy documents.

8 EQUALITY IMPACT ASSESSMENT (EIA)

- 8.1 An EIA is not required as the report does not relate to new or changing services or policies.

9 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

- 9.1 Treasury management working papers.

10 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

- 10.1 Executive Board report and minutes, 18 September 2012.
Audit Committee report and minutes, 21 September 2012.

**COUNCILLOR CHAPMAN
DEPUTY LEADER**

APPENDIX A

REVISED TABLE - ELIGIBLE COUNTERPARTIES FOR INVESTMENT 2012/13					
INSTRUMENT	COUNTRY	COUNTERPARTY	MAX. SUM	MAX. PERIOD	
Term deposit / CD / call a/c	U.K.	Bank of Scotland / Lloyds TSB Bank	£25m	364 days	
		Barclays Bank	£25m	364 days	
		Co-Operative Bank	-	5 days	
		HSBC Bank	£25m	364 days	
		Nationwide Building Society	£25m	364 days	
		Royal Bank of Scotland / Nat West	£25m	364 days	
		Santander UK	£25m	364 days	
		Standard Chartered	£25m	364 days	
	Australia	Australia & NZ Banking Group	£10m	364 days	
		Commonwealth Bank of Australia	£10m	364 days	
		National Australia Bank Ltd	£10m	364 days	
		Westpac Banking Corporation	£10m	364 days	
	Canada	Bank of Montreal	£10m	364 days	
		Bank of Nova Scotia	£10m	364 days	
		Canadian Imp. Bank of Commerce	£10m	364 days	
		Royal Bank of Canada	£10m	364 days	
		Toronto-Dominion Bank	£10m	364 days	
	Finland	Nordea Bank Finland	£10m	364 days	
	France	BNP Paribas	£10m	364 days	
		Credit Agricole SA	£10m	364 days	
		Soc Gen	£10m	364 days	
	Germany	Deutsche Bank AG	£10m	364 days	
	Netherlands	Bank Nederlandse Gemeenten	£10m	364 days	
		ING Bank	£10m	364 days	
		Rabobank	£10m	364 days	
	Sweden	Svenska Handelsbanken	£10m	364 days	
	Switzerland	Credit Suisse	£10m	364 days	
	USA	JP Morgan	£10m	364 days	
	Term deposit	UK	Government Debt Management Account Deposit Facility	-	-
		UK	Other local authorities	£20m	2 years
UK		Government Treasury Bills	-	-	
Money Market Funds	World-wide	AAA-rated funds (Constant Net Asset Value)	£10m / fund	N/A	
Supranational Bonds	World-wide	E.g. European Investment Bank/Council of Europe/World Bank	£20m	2 years	
Government Gilts	UK	Bonds issued by the UK Government	£20m	2 years	

IMPORTANT NOTES TO TABLE:

Credit Rating Definitions

Fitch A-

High credit quality. 'A' ratings denote expectations of low credit risk. They indicate strong capacity for payment of financial commitments.

Standard & Poor's A-

An obligor rated 'A' has strong capacity to meet its financial commitments.

Moody's A3

Banks rated 'A' are considered upper-medium grade and are subject to low credit risk.

Limiting Factors

Co-operative Bank – *the Council's own bank does not meet the applied criteria. They are included on the counterparty list, with a maximum period of investment of 5 days, for cash flow purposes.*

Groups - *where more than one institution is included within a banking group, the individual limit will apply to the total investment in that group*

Countries - *a maximum of 15% of the investment portfolio to be invested in any one country (excluding the UK) at the time of investment, with a maximum of 25% of the portfolio, at the time of investment, in non-UK banks in total.*

Money Market Funds – *a limit of £80m in all MMFs is to be applied at all times.*

Supranational Bonds and UK Government Gilts – *a maximum sum of £20m*