

COMMITTEE: Audit Committee	DATE: 29th September 2009	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources		TITLE: Treasury Activity for Period Ending 31st May 2009		
ORIGINATING OFFICER(S): Alan Finch		Ward(s) affected: N/A		

1. SUMMARY

- 1.1 The Audit Commission have issued a report on Local Authorities investments in Icelandic Banks and made a number of recommendations to prevent a recurrence of the situation.
- 1.2 This Council did not at any time have any direct exposure to Icelandic Banks and a high proportion of the recommendations which principally relate to ensuring that existing best practices are applied are not relevant for this Council.
- 1.3 The report does however recommend that elected Members should be involved in the risk assessment process, to scrutinise the treasury policy and to receive regular updates on the risk profile of the treasury portfolio.
- 1.4 The report details the current credit criteria adopted by the Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

2. RECOMMENDATIONS

- 2.1 Members are recommended to note the contents of this report.

3. BACKGROUND

- 3.1 The Audit Commission have issued a report on Local Authorities investments in Icelandic Banks which makes a number of recommendations to prevent a recurrence.
- 3.2 The recommendations principally relate to ensuring that existing best practice is adhered to and this Council already complies with the majority of these.
- 3.3 The Commission have however recommended a strengthening of the reporting arrangements for elected members and in particular the need for them to be involved in the risk assessment process, to scrutinise the treasury policy and to receive regular updates on the risk profile of the treasury portfolio.
- 3.4 This report addresses these issues and details the current credit criteria adopted by the Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

4 THE AUDIT COMMISSION REPORT

- 4.1 The Audit Commission have issued a report on the investments by English local authorities in failed Icelandic banks.
- 4.2 The report indicated that 127 Councils had deposits in failed Icelandic banks with a total value of £954 million. In addition there were a number of other public sector bodies which had exposure to the failed banks.
- 4.3 The Commission concluded that the situation had a number of implications for the participants in Councils treasury activities which may be summarised as follows:
 - **Central Government:** Provide a secure deposit facility for public bodies and review the provisions relating to early repayment of debt.
 - **The Chartered Institute of Public Finance and Accountancy (CIPFA):** revise and strengthen the Code of Practice on Treasury Management to address the Icelandic situation and develop training and information sharing for Councils.
 - **Local Authorities:** Set explicit risk parameters for treasury policy, establish adequate monitoring arrangements to involve elected members in risk assessment, ensure members and officers receive appropriate training and that treasury is adequately resourced, consider shared services for treasury activities, control external advisors and use the fullest range of information when depositing funds.
 - **Audit Commission:** Work with CIPFA to strengthen treasury control framework and follow up report as part of use of resources work for 2008/09 and future years.
- 4.4 A preliminary assessment of the implications of the immediate proposals for this Council are that they have limited applicability apart from recommendation to involve Members directly in risk assessment. This is however subject to any detailed proposals resulting from the CIPFA review of the Treasury Code of Practice.

- 4.5 Currently member involvement in the treasury process is limited to approving the statutory Investment Strategy as part of the annual budget setting process and considering the treasury outturn report at the end of the financial year.
- 4.6 To comply with the Audit Commission proposals it is necessary to provide a regular monitoring report which “ensures that treasury management policies follow the revised CIPFA code of practice, are scrutinised in detail by a specialist committee, usually the audit committee and are monitored regularly”.
- 4.7 CIPFA and the Audit Commission have not yet completed the review of the Treasury Code and proposals for the format of the monitoring report may emanate from this exercise. Any such proposals will be incorporated into subsequent reports.

5. TREASURY ACTIVITY FOR PERIOD 1ST APRIL to 31ST MAY 2009.

- 5.1 This section of the report sets out:
- The current credit criteria being operated by the Council.
 - The treasury strategy for the current financial year and the progress in implementing this.
 - The transactions undertaken in the period and the investment portfolio outstanding as at 31st May 2009.

5 CREDIT CRITERIA

- 6.1 The credit criteria for investment counterparties were established by the Council in February 2009 as part of the budget setting exercise.

Table 1: Credit Rating Requirements

	UK Institutions Up to £25 Million	UK Institutions Up to £10 Million	Overseas Institutions Up to £10 million
Short term	F1+	F1+	F1+
Long term	AA-	AA-	AA-
Individual	B	BC	AB
Support	2	3	2

- 6.2 In response to the current instability in capital markets and the banking sector the Corporate Director of Resources has restricted the approved investment list to institutions which have guaranteed support from

national governments who are assessed by the rating agencies as having the financial capacity to provide such support.

Table 2: Lending List

Institution	Country of Incorporation	Active in Market
Australia and New Zealand Banking Group Ltd	Australia	N
Commonwealth Bank of Australia	Australia	N
National Australia Bank Ltd	Australia	Y
Westpac Banking Corporation	Australia	N
Dexia Bank Belgium	Belgium	Y
Oversea-Chinese Banking Corporation Ltd	China	N
United Overseas Bank Ltd	China	N
DBS Bank Ltd	Singapore	N
Abbey National plc	UK	Y
Bank of Scotland plc	UK	Y
Barclays Bank plc	UK	Y
HSBC Bank plc	UK	N
Lloyds TSB Bank plc	UK	Y
National Westminster Bank	UK	Y
Nationwide BS	UK	Y
Royal Bank of Scotland	UK	Y

- 6.3 A number of governments had introduced similar measures notably Ireland but the rating agencies are not satisfied that the national government has the financial capacity to provide the necessary support.

6 INVESTMENT STRATEGY

- 7.1 Sector were appointed on a trial basis in February 2009 to provide a Cash Management Service for the Council. This encompassed developing and implementing an investment strategy within risk parameters specified by the Council and negotiating terms with counterparties for the short term deposits of funds.
- 7.2 These functions were previously undertaken in-house but the Corporate Director of Resources considered it to be appropriate to trial external provision for the following reasons:
- To determine if there was scope to obtain higher returns on cash balances without increasing the associated risk.
 - To establish if the information flows on credit risk improve as a result of Sectors higher level of involvement in the market.
 - To provide a more structured approach to treasury strategy and risk assessment.
 - To achieve efficiency savings.
- 7.3 It should be emphasised that the Council retains control of the credit criteria and the investments. Sector's role is purely advisory.
- 7.4 Sector's interest rate projections are that base rate will remain static at 0.5% for the current financial year with no movement in rates until an

increase of 0.5% in September 2010. Against this macro-economic perspective Sector have developed a strategy which delivers enhanced performance through maximising the investment term of the portfolio. This will enable the portfolio to obtain exposure to the higher rates associated with investment in the longer terms. Restricting the maximum term to one year will also enable investments to mature before the anticipated increase in rates in 2010.

- 7.5 Sector have calculated that the Council on the basis of cashflow projections will have an effective investment balance of £100million for 2009/10. The investment strategy within the constraints of the Councils credit criteria and liquidity requirement is as set out below.

Term	Projection		Actual Deal			
	Amount £M	Rate %	Counterparty	Maturity Date	Amount £M	Rate %
Overnight	15	0.75%	Abbey National plc	Call	10	
			National Australia Bank Ltd	Call	5	
			Alliance & Leicester	Call	10	
			Bank of Scotland plc	Call	5	
1 month	5	0.70%				
2 months	10	1.30%	Dexia Bank Belgium - London Branch	15 Jul 2009	10	1.10%
3 Months	30	1.30%	The Royal Bank of Scotland PLC	15 Jul 2009	10	1.40%
			Nationwide	21 Aug 2009	10	1.30%
			Dexia Bank Belgium - London Branch	27 Jul 2009	10	1.40%
6 Months	5	1.60%				
9 Months	10	1.70%	Barclays Bank PLC	11 Feb 2010	5	1.80%
12 Months	25	2.00%	Barclays Bank PLC	27 Apr 2010	10	2.15%
			Cater Allen (Abbey)	14 May 2010	5	3.00%
					<u>£100</u>	<u>£90</u>

- 7.6 The full implementation of the strategy will be determined by the Council's actual cash profile during the year and Sector's assessment of when the market is offering the best returns for term deposits. This is exemplified by the current £10M difference between the projected effective investment balance and actual and the high level of funds held on call pending term investment.

- 7.7 The deals effected in the period are as set out in appendix 1. These comply with the counterparty credit criteria as set out in table 1. The actual deals include deals effected in periods prior to the introduction of the revised criteria.

- 7.8 The Council's bankers the Co-operative Bank plc are used as depositors of the last resort for investment of additional funds received after the treasury transactions have been completed and the money markets closed. The alternative would be to have the funds effectively deposited with the Co-operative Bank but with nil interest.

8. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 8.1. The comments of the Corporate Director Resources have been incorporated into the report.

9. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

- 9.1 The Committee is asked to note the information in the report concerning the Council's treasury transactions undertaken by the Corporate Director of resources under delegated powers.

10. ONE TOWER HAMLETS CONSIDERATIONS

- 10.1 Interest on the Council's cash flow has historically contributed significantly towards funding the Council's budget.

12. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 12.1 There are no Sustainable Action for A Greener Environment implications.

13. RISK MANAGEMENT IMPLICATIONS

- 13.1 Any form of investment inevitably involves a degree of risk.
- 13.2 To minimise risk the Investment Panel attempts to achieve a diversified portfolio. This diversification relates to both asset classes and management styles.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"

Directorate Submissions

***Name and telephone number of holder
And address where open to inspection***

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Appendix 1: Investment Transactions

	Investments made before 1 Apr 2009 £M	Raised £M	Realised £M	Investments Outstanding 31 May 2009 £M
Australia and New Zealand Banking Group Ltd				
Commonwealth Bank of Australia				
National Australia Bank Ltd	12	65	-73	4
Westpac Banking Corporation				
Alliance & Leicester	5	10	-5	10
Abbey National plc	25		-15	10
Bank of Scotland plc	17	60	-71	6
Barclays Bank plc		15		15
HSBC Bank plc				
Lloyds TSB Bank plc				
National Westminster Bank				
Royal Bank of Scotland		10		10
Nationwide	5	35	-30	10
DBS Bank Ltd				
Oversea-Chinese Banking Corporation Ltd				
United Overseas Bank Ltd				
Dexia Bank Belgium - London Branch	10	65	-55	20
Co-Operative Bank		1	-1	
Cater Allen (Abbey)		5		5
	£74	£266	-£250	£90