

Report to the Cabinet

Report reference: C-049-2008/09
Date of meeting: 20 October 2008



Portfolio: Finance and Performance Management
Subject: Council's Investments
Responsible Officer: Bob Palmer (01992-564279).
Democratic Services Officer: Gary Woodhall (01992-564470).

Recommendations/Decisions Required:

- (1) To note the report on the Council's investments and agree that the report also be submitted to Council; and**
- (2) To note that Internal Audit will be bringing forward the Treasury Management audit and examining ways of enhancing controls in the current environment.**

Executive Summary:

Financial markets are experiencing unprecedented turbulence. Across the globe stock markets have suffered dramatic falls and numerous banks and insurance companies have had to be rescued by their governments or have gone into administration. Given the current state of markets, it was felt appropriate to update Members on the Council's Treasury Management Strategy, investment position and the risks currently being faced.

Reasons for Proposed Decision:

Members are not being asked to make any decisions, only to note the report and agree that it should also go to the wider audience of Council.

Other Options for Action:

Members could ask for additional detailed information on the Treasury Management Strategy and the Council's investments. Alternatively, Members might not feel it appropriate that the report is presented as an information item to Council.

Report:

1. The Treasury Management Strategy is approved annually as part of the budget setting process. Currently the strategy allows up to £12 million to be invested with banks that have a short-term rating of F1+ and a long-term rating of AA-. Whilst a maximum of £5 million can be invested with banks having a short-term rating of F1 and a long-term rating of A.
2. The credit ratings are provided by three agencies, Fitch, Moody's and Standard & Poor, and are then consolidated by the Council's advisers (Butlers) into a list of approved counter parties. This list shows the various financial institutions whose credit ratings meet the Council's requirements and, based on their credit ratings, the amount and the length of loan

that the Council will enter into with them.

3. Given the increasing size of the investment portfolio, and the need to ensure an adequate diversification of risk, Council decided to expand the counter-party list to include building societies and foreign banks in February 2005. This was in line with Government guidance and took place as part of the implementation of the Prudential Code. The additional financial institutions were subject to the same credit rating requirements and limitations.

4. Icelandic banks were included on the expanded counter-party lists as their credit ratings were good. The rates of interest offered by the Icelandic banks were competitive and a number of loans were entered into with them. In the seven-month period from 19 April 2007 to 15 November 2007 some twelve loans with a cumulative value of £17 million were transacted. All of these loans were repaid without problems on their due dates. However, concerns raised informally by Members late in 2007 meant that no new loans were entered into with banks based in Iceland after 15 November 2007. When considering these comments the status of Heritable Bank was reviewed and given the greater degree of confidence in it, as a bank registered and regulated in the United Kingdom, it remained on the counter-party list. This view was based on the strength of the credit ratings awarded to Heritable and the monitoring and regulation undertaken in the United Kingdom by the Financial Services Authority.

5. Heritable Bank had an "A" rating and so, in accordance with the Council's Treasury Management Strategy, could be lent up to £5 million. On 10 September a loan of £1.5 million was made to Heritable, the loan is due for repayment on 18 May 2009. This was followed on 15 September with a loan of £1 million, due for repayment on 18 June 2009. On 25 September the Fitch credit rating agency issued an update confirming the status of Heritable as "A" rated.

6. On 7 October, due to the difficulties being experienced by its Icelandic parent company, Heritable Bank was placed in administration. The ordinary savers accounts were transferred to the ING bank. However, the wholesale deposits were retained and form part of the administration that Ernst & Young have been appointed to manage. As more information emerged it became clear that over 100 authorities have deposits that have been affected by the collapse of the Icelandic banking industry. The LGA are lobbying both the government in this country and the administration in Iceland to try and safeguard the £1 billion that is at stake. It will probably be some time before a clear picture emerges of any outcomes from the LGA campaign.

7. Some favourable comments have been made about the asset base of Heritable and the early comments of the Administrators support that view. A clearer picture is unlikely to be available until mid-November but the following joint statement was issued by the LGA and Ernst & Young on 14 October:

"In broad terms, the Administrators considered that the value of the book value of the assets of each business appeared to be of the same magnitude as the liabilities but that the recoveries for the Local Authorities would be dependant on the final level of actual realizations."

8. The Council's treasury advisers (Butlers) are providing regular updates to our approved counterparty list as the different financial institutions have their credit ratings amended. We continue to adhere strictly to our policies and new loans are only entered into with those meeting our requirements. It was previously felt that the benefit of investing with highly rated counterparties was that these institutions would be of sufficient size that their governments would not let them fail. This has proved to be the case with both Northern Rock and Bradford and Bingley where the Government has intervened to ensure that both private

and corporate deposits have been safeguarded. The money that the Council had invested with Northern Rock was returned on the due date. There is still a loan of £1.5 million with Bradford and Bingley, due for repayment on 18 March 2009, which is covered by the Government guarantee.

9. The largest exposure in the investment portfolio is with Halifax Bank of Scotland (HBOS), which currently has £12 million of the Council's money. HBOS are subject to a Government sponsored take over by Lloyds TSB and as long as this transaction takes place the Council's funds will be safe.

10. On 30 September the Irish Government put in place a guarantee of both retail and wholesale deposits for two years. The Council had previously invested with Irish institutions and is now doing so more actively. The investment portfolio currently totals £63 million and of this £11.5 million is currently spread between four different Irish institutions.

11. The extraordinary events of recent times are still producing dramatic surprises and on 13 October it appeared that the Royal Bank of Scotland (RBOS) was going to be nationalised. Whilst the Government may not now take a controlling interest, their support provides additional confidence in RBOS and the Council will consider making additional investments with it. One deposit of £5 million is already with RBOS and, after allowing for the £2 million of funds kept in an account for instant access, up to a further £5 million could be placed with them.

12. Treasury Management is audited annually by Internal Audit and the work done in 2007/08 provided satisfactory assurance in the system. However, in order to assist with the development and implementation of additional controls the Director of Finance & ICT has requested that the audit of the system for 2008/09 be brought forward.

13. Further reports will follow as necessary until the financial markets have regained some degree of stability.

Resource Implications:

The exact resource implications are not yet clear. The Council is a creditor in the administration of the Heritable Bank. Until the LGA campaign and the administration are concluded the extent of any losses cannot be stated with any degree of certainty.

It is anticipated that the money with Bradford & Bingley and HBOS will ultimately be returned to the Council.

Legal and Governance Implications:

In the interests of good governance it was felt appropriate to report this matter to both Cabinet and Council.

Safer, Cleaner and Greener Implications:

None

Consultation Undertaken:

None

Background Papers:

Report to Council 19 February 2008 that set the Treasury Management Strategy for 2008/09.
Report to Cabinet 1 September 2008 detailing the Treasury Outturn and Prudential Indicators for 2007/08.

Impact Assessments:

There are no equalities impacts.

The state of near chaos in financial markets is a risky environment in which to manage an investment portfolio of £63 million. The Council seeks to mitigate risks by having a Treasury Management Strategy and a counter-party list based on credit ratings.