WIRRAL COUNCIL

CABINET

9 DECEMBER 2014

SUBJECT	**AMENDMENT TO THE TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2014/15**
WARD/S AFFECTED	**ALL**
REPORT OF	**DIRECTOR OF RESOURCES**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR PHIL DAVIES**
KEY DECISION	**YES**

1.0 EXECUTIVE SUMMARY

1.1 The original Treasury Management and Investment Strategy 2014/15 was approved by Cabinet as part of the Medium Term Financial Strategy 2014/17 on 12 February 2014. The UK is implementing the final bail-in provisions of the EU Bank Recovery and Resolution Directive to commence in January 2015, a year ahead of most other countries. Credit rating agencies have stated they plan to review EU banks' ratings in line with each country's implementation of the directive.

1.2 Many UK banks have standalone credit ratings in the "BBB" category with uplifts for potential Government support taking them into the "A" category. There is a realistic risk that some major UK banks' credit ratings will this financial year fall below our current minimum investment criteria rating of A-, if this uplift is removed. As a precursor to this the Investment element of the Strategy should be amended.

2.0 BACKGROUND AND KEY ISSUES

INTRODUCTION

2.1 The recent EU Bank Directives agreed in Brussels coupled with the Banking Reform Act 2014 are intended to shield taxpayers from another round of crippling bank bailouts of the kind that took place in 2008 and also avoid a re-run of the Eurozone crisis where troubled banks and heavily indebted governments have become inextricably linked.

2.2 Basically a "Bail-In" forces banks on the verge of collapse to require their shareholders, bondholders and biggest customers to contribute cash before falling back on taxpayer bailouts under this agreement.

2.3 Under the regime being created, a clear pecking order for this support is set out: shareholders are first; certain types of bondholders; and then customers who have deposits over the guaranteed level of €100,000 (£85,000). These three types of creditors would need to take minimum losses of 8% of a troubled bank's total liabilities.

2.4 Under the Deposit Guarantee Directive 2014/49/EU it has been deemed that "Public authorities have much better access to credit than citizens, so should not be eligible for protection".

2.5 Secured bonds are exempt from bail-in. However, traditional local authority term deposits and call accounts do not fall under this category.

2.6 The loss incurred by creditors depends on the bank's actual losses and the proportion of secured bonds and other liabilities that are exempt from a bail-in. The greater these elements, the higher the loss to the creditor.

2.7 The Council's Treasury management advisors have suggested 2 alternative courses of action:

Option 1 – the preferred option is to amend the Treasury management Strategy to allow investment in lower rated banks; or

Option 2 – prepare to invest without using any of the major UK banks.

2.8 Conducting Treasury Management investment activities without using major UK banks would lead to a number of practical difficulties. Given the Deposit Scheme Directive is European wide there is a risk of there being be insufficient foreign banks meeting the investment criteria. There may also arise a need to utilise/increase use of non-bank deposit sources of investment such as covered bonds, repurchase agreements and non-financial corporate bonds. These may contain risks of their own including reduced liquidity resulting in increased likelihood of temporary borrowing costs being incurred.

2.9 A credit rating within the 'BBB' range per the Fitch rating agency definition is an institution with 'good credit quality'. BBB+ is the highest rating in this class. The 'A' rating is defined as 'high credit quality' with A- the lowest rating in this class. The change in allowable investment criteria from an A- to BBB+ credit rating whilst a lower rating still allows for investment in banks with good credit quality and is a reduction of one 'notch' in the existing investment criteria.

2.10 The EU Bank and Recovery Directive does not increase the risk of a UK bank defaulting. The change only increases the potential loss to local authorities if a default occurs as losses will be borne by a smaller number of creditors.

3.0 RELEVANT RISKS

3.1 Treasury Management activities involve a degree of financial and reputational risk. The Treasury Management Strategy prioritises security, liquidity and yield in that order. The change in policy to invest in institutions with a minimum credit rating of BBB+ whilst involving some increase in risk still ensures the authority is investing in institutions of good credit quality. The authority continues to mitigate treasury management risk by placing counterparty limits on deposits, by using a range of suitably rated institutions and engaging advisors to assess market conditions and potential risks and opportunities.

4.0 OTHER OPTIONS CONSIDERED

4.1 The alternative option of retaining a minimum credit rating of A- is discussed in paragraphs 2.8 and 2.9 above.

5.0 CONSULTATION

5.1 There has been no specific consultation in respect of this report.

6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 Not applicable.

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising directly from this report.

8.0 RESOURCE IMPLICATIONS

8.1 The Council will continue to invest on the basis of security, liquidity and yield.

9.0 LEGAL IMPLICATIONS

9.1 There are none arising from this report

10.0 EQUALITIES IMPLICATIONS

10.1 There are no equality implications arising directly from this report so an Equality Impact Assessment (EIA) is not required.

11.0 CARBON REDUCTION IMPLICATIONS

11.1 There are none arising directly from this report.

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising directly from this report.

13.0 RECOMMENDATIONS

13.1 That Cabinet approve the amendment in respect of the Annual Investment Strategy in Appendix 1. This is the inclusion of a specific proviso relating to banks and other organisations with a long term credit rating of BBB+.

14.0 REASON FOR RECOMMENDATIONS

14.1 If the Strategy is not amended, in the event of Government support being withdrawn for failing banks thus affecting their credit ratings, the Council would not be able to make any further investments with any major UK bank which would limit the investment opportunities available.

REPORT AUTHOR: Reg Huyton
Designation Finance Manager
Telephone 0151 666 3415
Email reghuyton@wirral.gov.uk

APPENDICES
Revised table of non-specified investments

BACKGROUND PAPERS
CIPFA Treasury Management Code 2011 Edition.
EU Bank Recovery and Resolution Directive

REFERENCE MATERIAL / SUBJECT HISTORY

Council Meeting	Date
Cabinet - Treasury Management and Investment Strategy 2014/17	12 February 2014

APPENDIX 1

Non-Specified Investments

Instrument	Maximum maturity	Max %/£M of portfolio	Capital expenditure?
Term deposits with banks, building societies which meet the specified investment criteria (on advice from TM Adviser)	*2 years*	15% per Counterparty	No
Term deposits with local authorities	*5 years*	15% per Counterparty	No
CDs and other negotiable instruments with banks and building societies which meet the specified investment criteria (on advice from TM Adviser)	*5 years*	15% per Counterparty	No
Investments with organisations which **do not meet** the specified investment criteria (subject to an external credit assessment and specific advice from TM Adviser)	*3 months*	*£5m per counterparty*	No
	1 year	*£1m per counterparty*	No
	2 years	*£1m per counterparty*	Yes/no
Specific Proviso (for new investment) Banks and other organisations whose lowest long term credit rating from the 3 main agencies is BBB+	*100 days*	*10% of total investments per Counterparty*	*No*
Deposits with registered providers of Social Housing with a credit rating of BBB- or higher	*5 years*	15% per Counterparty	No
Gilts	5 years	25% per Counterparty	No
Bonds issued by multilateral development banks	5 years	15% per Counterparty	No
Sterling denominated bonds by non-UK sovereign governments	5 years	15% per Counterparty	No