

WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

1 JULY 2009

REPORT OF THE DIRECTOR OF FINANCE

RISK AND RETURN - ENGLISH LOCAL AUTHORITIES AND THE ICELANDIC BANKS

1. EXECUTIVE SUMMARY

1.1 This report summarises the key messages from the Audit Commission report Risk and Return - English Local Authorities and the Icelandic Banks. It takes the recommendations of the report and evaluates how Wirral performs against each of them. Finally, it restates the background to the £2 million investment with Heritable Bank and updates Members on the latest news from the Bank Administrators.

2. INTRODUCTION

2.1 On 26 March 2009 the Audit Commission published a report on treasury management in Local Authorities in light of the economic downturn and the deposits tied up in Icelandic banks. In total 127 English Local Authorities have deposits of more than £953 million with Icelandic banks.

2.2 Before I summarise the key messages of the Audit Commission report it is important to understand why Local Authorities, and in particular Wirral Council, has money available to make investments.

2.3 The money that the Council invests is money that has been allocated for a particular need but is not necessarily needed today. Examples of the type of money that the Council has available for investments are:

- Grants received from the Government to fund Council services that are not required immediately.

- Reserves which are set aside for future spending plans or as a contingency against future funding requirements. Examples of the types of reserves the Council has:
 - Insurance Fund - money set aside to cover the cost of third party claims which are pending but yet to be settled or for future claims which may be made against the Council.
 - Schools Balances - money set aside by individual schools to fund future plans.
 - Capital Receipts - money received from the sale of Council assets which will be used to fund future capital schemes.

- Money borrowed for capital schemes in advance of need - if the Council is planning a large capital project over the next few years it is prudent to borrow the money to fund the project at a time when interest rates are low which is not necessarily when the money is needed for the project.

2.4 All the money which is received by the Council is not necessarily spent on the first day of the year but rather is spent on Council services throughout the financial year. Rather than just leaving money in the current account I invest the money until it is required so that it can earn interest for the Council. In this way the Council maximises the benefits of the money it receives to help fund Council services and lower the Council Tax requirement.

3. KEY MESSAGES FROM THE AUDIT COMMISSION REPORT

3.1 The Audit Commission report gave five key messages on the investment activities of Local Authorities. These messages were:

1. Local Authorities have used interest from cash deposits as a valuable source of income.
2. The sums of money involved are large and invested widely. On 7 October 2008 451 Local Authorities had invested £31 billion, more than 40% of it overseas.
3. Almost 3.1% of all deposits were made in Icelandic banks. One hundred and twenty-seven Local Authorities held deposits, but delivery of services has not been affected.
4. Nationally the treasury management framework is broadly right but weaknesses in the detail have contributed to poor practice. In particular, there is little recognition that the risks associated with placing deposits with different banks may be highly correlated because they are in the same group, country or sector. Additionally, Government investment guidance gives too much weight to credit ratings at the expense of using a range of information sources.

5. Local treasury management arrangements vary. The best organisations balance risk and reward and arrangements include: regular review and scrutiny of policy and procedure: appropriately trained staff and engaged Elected Members; and the use of a wide range of information including, but not limited to, credit ratings.

4. CURRENT INVESTMENT POLICIES

4.1 The Audit Commission found that the majority of Councils had acted properly in managing their investments and were alert to the risks. Wirral Council was visited as part of their study and is considered to have acted properly.

4.2 Their report did however make a number of specific recommendations for Local Authorities to help strengthen investment policies and further limit the risk of exposure to any future banking failures. By taking each of the recommendations in turn current investment policies can be assessed.

4.3 Recommendation 1

4.3.1 ***Set the treasury management framework so that the organisation is explicit about the level of risk it accepts and the balance between security and liquidity and the yield to be achieved. At the highest level, the organisation should decide whether it has:***

- ***Appetite and capability to be able to manage risk by placing funds with financial institutions; or***
- ***No appetite and/or insufficient capability to manage the risk of placing funds in the market, and should instead place funds with the UK government's Debt Management Office;***

4.3.2 Each year I report to Cabinet to set out the Treasury Management and Investment Strategy (Cabinet 19 March 2009 for the latest strategy statement). This report states that the general policy objective is to invest surplus funds prudently. The investment priorities are; the security and liquidity of the invested capital and to generate an optimum yield which is commensurate with security and liquidity.

4.3.3 Strict minimum credit criteria are defined for counterparties with whom the Council will invest and these criteria have recently been tightened in light of the economic uncertainty. During the last quarter of 2008, when great economic uncertainty existed, the Council did take the decision to only invest funds with the Government Debt Management Office until the situation became more stable. This is just one example of how the Treasury Management Team, with the help of external advisers Arlingclose, constantly assesses risk and makes changes to activities, when necessary, to safeguard taxpayers money. Over the past three years the Treasury Management Team has generated approximately £12m of income from investments.

4.4 **Recommendation 2**

4.4.1 ***Ensure that treasury management policies:***

- ***Follow the revised CIPFA code of practice***
- ***Are scrutinised in detail by a specialist committee, usually the audit committee, before accepted by the authority***
- ***Are monitored regularly***

4.4.2 The Council has always adhered to the CIPFA code of practice and will continue to adhere to any revisions that CIPFA may propose following the Audit Commission report.

4.4.3 The treasury management and investment strategy statement is reported to Cabinet each year for approval.

4.4.4 Treasury Management activities are monitored regularly by officers and a quarterly monitoring report forms part of the General Financial Matters report taken to the Finance and Best Value Overview and Scrutiny Committee.

4.5 **Recommendation 3**

4.5.1 ***Ensure elected members receive regular updates on the full range of risks being run***

4.5.2 As stated above, every quarter the General Financial Matters report, taken to the Finance and Best Value Overview and Scrutiny Committee, includes updated details on the Treasury Management activities. A Treasury Management Annual report is reported to Cabinet at the end of each financial year summarising the annual performance.

4.6 **Recommendation 4**

4.6.1 ***Ensure that the treasury management function is appropriately resourced, commensurate with risks involved. Staff should have the right skills and have access to information and external advice.***

4.6.2 The Treasury Management Team consists of a CIPFA qualified accountant, a CIPFA finalist and two qualified Accounting Technicians.

4.6.3 Each member of the Team attends internal training courses on treasury management as well as courses organised by CIPFA and Arlingclose.

4.6.4 Each of the Team can speak to Arlingclose at any time for advice and all of the Team receive the Arlingclose e-mails with notification of any economic or financial changes which may require changes to investment activities.

4.6.5 The achievements of the Treasury Management Team in 2008 were also recognised by the Local Government Chronicle (LGC) who awarded the Group Accountant the title of Investment Officer of the year.

4.7 **Recommendation 5**

4.7.1 ***Train those elected members of authorities who have accountability for the stewardship of public money so that they are able to scrutinise effectively and be accountable for treasury management function***

4.7.2 Members receive financial training when they are first elected which includes an overview of the treasury management activities. Treasury management training for Members is included as part of the Finance training course for Members which I provide annually.

4.8 **Recommendation 6**

4.8.1 ***Ensure that the full range of options for managing funds is considered and note that early repayment of loans, or not borrowing money ahead of need, may reduce risks***

4.8.2 The Treasury Management Team, through meetings with Arlingclose, attendance at CIPFA courses and monitoring of all relevant marketing information, ensures that all options for managing funds are considered. It should also be noted that the current borrowing strategy has been to avoid borrowing money ahead of need, to limit the amount of money that is available for investment and thereby reduce risk.

4.9 **Recommendation 7**

4.9.1 ***Use the fullest range of information before deciding where to deposit funds***

4.9.2 The Council does not solely rely on credit ratings as a means of assessing the security of investments. The Council also takes into account information on corporate developments, market sentiment towards investment counterparties and any other advice at its disposal. This fact was demonstrated by the move away from investments in Icelandic Banks after December 2007 even though for most of 2008 Icelandic Banks retained a strong credit rating and received favourable press coverage.

4.10 **Recommendation 8**

4.10.1 ***Be clear about the role of external advisors and recognise that local authorities remain accountable for decisions made;***

4.10.2 The Treasury Management Team is clear about the relationship it has with the external advisors. Arlingclose provides market and economic expertise and information to help inform decisions.

4.11 **Recommendation 9**

4.11.1 ***Look for economies of scale by sharing resources between authorities or with pension funds, while maintaining separation of those funds.***

4.11.2 The Treasury Management Team and the Merseyside Pension Fund (MPF) regularly communicate and share information and ideas about investment activity. MPF is an important and valued source of information and one which the Team will continue to use. I continue to look at ways in which sharing resources can create benefits but the practical differences in the types of business undertaken by the General Fund and the MPF and the varied cashflows will always dictate the separation of the funds.

5. HERITABLE BANK

5.1 On 30 November 2007 the Council invested £2 million with Heritable Bank, a UK bank but a subsidiary of the Icelandic bank Landsbanki. The investment was a fixed term deposit for a period (or term) of 364 days paying an interest rate of 6.22%. At the time Heritable Bank was rated as 'A' by the credit ratings agency Fitch and was on the approved list of counterparties. The investment was also within the limit for investments with a single institution of £15M.

5.2 Following the appointment of Arlingclose a revised counterparty list was drawn up on 12 December 2007 which removed all Icelandic related banks from the approved counterparty list. This decision was taken despite Icelandic Banks retaining a high credit rating and paying attractive rates of return.

5.3 On 7 October 2008 Heritable Bank entered Administration, 52 days before the £2 million investment was due to mature on 28 November 2008. The Council has since submitted an insolvency claim to the Administrator of Heritable Bank, Ernst and Young.

5.4 Ernst & Young, has begun the process of identifying and recovering assets and reimbursing the banks creditors, of which Wirral Council is one. It has reported that the assets exceed the liabilities and has forecast that a material dividend will be payable in the near future. On 17 April 2009 Ernst and Young reported that it hoped to be able to pay 15% of amounts due in July 2009 and a minimum of 70% - 80% by 2012.

6. CONCLUSIONS

6.1 Wirral Council has acted, and continues to act, prudently and properly in all its investment activities. The recommendations proposed by the Audit Commission have already been undertaken at Wirral Council.

6.2 The Treasury Management Team adds immense value to the Council both in financial terms, by enhancing investment income and in non financial terms, through the strengthening of control procedures. The findings of the Audit Commission and the success at the LGC awards in 2008 provide clear independent evidence of the excellent work.

7. FINANCIAL IMPLICATIONS

- 7.1 Approval and implementation of any recommendations following the Audit Commission report will further limit financial risks.

8. STAFFING IMPLICATIONS

- 8.1. There are none arising out of this report.

9. EQUAL OPPORTUNITIES IMPLICATIONS

- 9.1. There are none arising out of this report.

10. COMMUNITY SAFETY IMPLICATIONS

- 10.1. There are none arising out of this report.

11. LOCAL AGENDA 21 IMPLICATIONS

- 11.1 There are none arising out of this report.

12. PLANNING IMPLICATIONS

- 12.1. There are none arising out of this report.

13. ANTI-POVERTY IMPLICATIONS

- 13.1. There are none arising out of this report.

14. SOCIAL INCLUSION IMPLICATIONS

- 14.1. There are none arising out of this report.

15. LOCAL MEMBER SUPPORT IMPLICATIONS

- 15.1 There are none arising out of this report.

16. BACKGROUND PAPERS

- 16.1 Risk and Return: English Local Authorities and the Icelandic Banks – Audit Commission, March 2009.
- 16.2 Treasury Management and Investment Strategy 2009 to 2012 – March 2009
- 16.3 Code of Practice for Treasury Management in Public Services – CIPFA 2002

17. RECOMMENDATION

- 17.1 That Members note the Audit Commission conclusion that the Council acted, and continues to act, properly in the management of its investments.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/126/09