

# Report

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Report to:	<b>Finance and Information Technology Resources Committee</b>
Date of Meeting:	<b>19 May 2009</b>
Report by:	<b>Executive Director (Finance and Information Technology Resources)</b>

Subject:	<b>Review of Investment Risk Management Framework</b>
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## 1. Purpose of Report

1.1. The purpose of the report is to:-

- ♦ advise of the recent PricewaterhouseCoopers (PWC) report on South Lanarkshire Council's Investment Risk Management Framework.

## 2. Recommendation(s)

2.1. The Committee is asked to approve the following recommendation(s):-

- (1) that the PWC report on South Lanarkshire Council's Investment Risk Management Framework is noted
- (2) that the suggestions included in the PWC report be considered along side existing treasury practices.

## 3. Background

- 3.1. The Treasury Management activities of the Council are controlled through the Treasury Management Strategy. This strategy defines how the Council's debt and deposits are managed, and is underpinned by statute and professional code of practice (the CIPFA Treasury Management in Public Services Code of Practice).
- 3.2. The Strategy states that the main consideration when depositing funds is to ensure the security of our deposits. Only after security will liquidity and yield be examined. A counterparty policy is held which restricts the institutions with which we deposit funds to those with a high credit rating. The amount which can be deposited with any institution is linked to their credit rating.
- 3.3. During 2008 there were a number of much publicised collapses and takeover of banking institutions. In October 2008 a number of Icelandic banks failed despite rating agencies assigning strong credit ratings to these banks. Now the financial strength of the banking industry as a whole has come under greater scrutiny, and we are operating in a much more uncertain banking climate than we have enjoyed in previous years.

- 3.4. The Council had deposits of £7.5m in Icelandic banks at the time of their collapse and work is ongoing to recover these funds. An internal review of our processes has been undertaken and shows that all deposits made were in line with the Council's Treasury Management Strategy.
- 3.5. To provide further comfort that our Treasury Strategy provides an acceptable approach to managing the risks when depositing funds during these very uncertain times, PWC, our external auditors, were engaged to undertake an assessment of our Investment Risk Management Framework. A final report was presented in March 2009, and this is attached at Appendix 1, and summarised below.

#### **4. Report on Investment Risk – General Overview**

- 4.1. The report considered security, liquidity and yield of our treasury activities in the context of the Council's overall risk appetite.
- 4.2. The review has been carried out over seven headings listed below:-
- ◆ Policy and Objectives
  - ◆ Identification of funds to invest
  - ◆ Liquidity risk
  - ◆ Counterparty risk
  - ◆ Interest rate Risk
  - ◆ Management information
  - ◆ Practical application
- 4.3. The report itself gives a positive view on the Council's approach to managing investment risk. The report states that there are a number of areas where they consider the risk management framework to be in line with good practice.
- 4.4. The areas of good practice are detailed in the body of the report, and include :-
- ◆ No significant gaps identified in policies and procedures
  - ◆ Council has relatively robust cash flow forecasting – overdraft facility available but rarely used
  - ◆ Good analysis of treasury activity reported to senior managers
  - ◆ Assessment of counterparties is consistent with good practice relevant to scale and complexity of operations. There are limited additional sources of assessment available to the Council.
- 4.5. Areas where improvement and efficiencies could be made have been proposed. These are discussed in full in the report, and are summarised in sections 5 to 7 below.
- 4.6. The suggestions included in the PWC report will be considered along side existing practices to ensure that our Treasury Strategy continues to provide a sufficiently robust risk management framework.

#### **5. Counterparty Risk**

- 5.1. The report acknowledges that the Council has adopted a more cautious approach to depositing funds in light of recent market turmoil. Recognition is made of good management information being provided to senior management analysing deposits by counterparty, yield and maturity.

- 5.2. Enhancements to the reporting of deposits are suggested in the report. These include analysing deposits by ratings, duration of deposit, geography of institution, investments type and industry type.
- 5.3. On counterparty limits a suggestion is made that the deposit limits within the Strategy are assessed to ensure they continue to reflect the risk appetite the Council holds. Some suggestions are made on techniques which could be adopted to establish limits.
- 5.4. Acknowledgement is made in the report that the Council is now including further criteria in addition to credit ratings to assess counterparties i.e. Share prices, credit default swap data, research and advice from our Treasury Advisers. This is noted as consistent with good practice and that there are limited additional sources of assessment available to the council. PWC do advise that we use the expertise of our Adviser to assist in interpretation of this enhanced criteria.

## **6. Interest Rate Risk**

- 6.1. The report discusses the Council's approach to borrowing for capital expenditure. Deposit interest rates are at an all time low. Any unused borrowing at the end of the year through slippage in capital projects that is deposited with a counterparty results in a cash drain to the council. This is because as we are paying higher interest costs on the borrowing than we are getting back from depositing the funds.
- 6.2. The report suggests we consider repayment of any unused debt to reduce this drain. The report acknowledges that between drafting of the report and final publication of the report the Council has repaid back £18m of unused borrowing, effecting 2008/09 slippage in the Capital Programme.
- 6.3. Further suggestions made include consideration of Forward Starting Interest Rate Swaps. This allows borrowing to be drawn down when needed, but at a pre determined interest rate. Currently such activity would not be permissible under existing legislation. However, it is expected that Investment Regulations which are due to be issued late summer will allow such instruments to be considered.

## **7. Management Information**

- 7.1. The report comments on the good analysis of treasury activity that is included in management information provided to senior management. Additional elements of information are suggested which may be of benefit SLC in managing and reviewing the investment strategy. Also it is suggested that it may be of benefit to provide information to members on a more regular basis to provide assurance and to allow members to better govern the decision making process.

## **8. Employee Implications**

- 8.1. There are no employee implications.

## **9. Financial Implications**

- 9.1. The revenue budget includes provision for loans charges which encompasses interest paid and received. Any changes in loan charge figures will be reflected in the Council's revenue budget.

## **10. Other Implications**

- 10.1. None.

## **11. Equality Impact Assessment and Consultation Arrangements**

- 11.1. This report does not introduce a new policy, function or strategy or recommend a change to an existing policy, function or strategy and, therefore, no impact assessment is required.
- 10.2. There is no requirement to undertake any consultation in terms of the information contained in this report.

**Linda Hardie**

**Executive Director (Finance and Information Technology Resources)**

17 April 2009

### **Link(s) to Council Values and Objectives**

- ♦ Value: Accountable, Effective and Efficient

### **Previous References**

None

### **List of Background Papers**

None

### **Contact for Further Information**

If you would like to inspect the background papers or want further information, please contact:-

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