

Report

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Report to:	Finance and Information Technology Resources Committee
Date of Meeting:	9 November 2010
Report by:	Chief Executive

Subject:	Treasury Management – Use of Treasury Bills
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1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ Provide an explanation of Treasury Bills and how they can be used as a means of managing cash flow
- ◆ Provide details of how South Lanarkshire Council can invest in Treasury Bills.

2. Recommendation(s)

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

- (1) that approval is given for Treasury Management to use Treasury Bills as a means of managing the cash flow requirements of South Lanarkshire Council
- (2) that approval be given for Finance and Information Technology Resources to appoint custodian services

3. Background

- 3.1. South Lanarkshire Council's Annual Investment Strategy for 2010/11 was approved by full Council on 23 June 2010. Treasury Bills are included in the Annual Investment Strategy as a permitted investment but to date have not been used.
- 3.2. The Council's Treasury Management advisors Arling Close have recommended using Treasury Bills as a means of investing in the UK Government while achieving a higher yield than simply placing funds in the Debt Management Account Deposit Facility.

4. Treasury Bills

- 4.1. Treasury Bills are bonds issued by HM Treasury. Purchasing these bonds is a means of investing in the UK Government. The UK Government has never failed to make interest or principal payments on these bonds.
- 4.2. Treasury Bills are issued by the Debt Management Office (DMO) and are an eligible sovereign instrument meaning that they have an AAA rating. Treasury Bills are issued on a zero-coupon which means they are issued at a discount to their nominal value. On maturity the holder is repaid the nominal value which is higher than the purchase price reflecting an income return alongside the return of the initial capital outlay.

- 4.3. Treasury Bills are issued at weekly tenders held by the DMO on Fridays. They are typically issued for 1, 3 or 6 month periods and although the DMO can issue 12 month Treasury Bills they have not as yet done so. The minimum purchase of Treasury Bills is £0.5m
- 4.4. Treasury Bills are actively traded on a secondary market meaning that they can be acquired and sold on a daily basis.
- 4.5. Treasury Bills are *secure* with an implicit AAA rating; are *liquid* with an active secondary market and pay a *yield* that is currently around 0.5% that compares very favourably with the Debt Management Deposit Facility account rate of around 0.25%. It is proposed that the Council start to use Treasury Bills as an investment tool when managing its cash flow.

5. **Acquiring Treasury Bills**

- 5.1. The acquisition of Treasury Bills has to be done through a Primary Participant. Primary Participants are banks that have agreed, subject to their own due diligence, to bid at Treasury bill tenders on behalf of investors. They are registered financial institutions that are regulated by the Financial Services Authority (FSA) and subject to its rules and guidance in their activities.
- 5.2. In order to acquire Treasury Bills, South Lanarkshire Council would have to ask one of the Primary Participants to purchase them on our behalf and for these to be held in a custodian account.
- 5.3. There are many Primary Participants which act as custodians. Arling Close provide recommendations on Custodians based on their other clients' experiences and their professional knowledge. Finance Services will, in conjunction with Procurement Services, commence the selection and engagement of Custodian Services.
- 5.4. Custodians charge for their services by taking a share of the yield of the bond - typically 0.03% to 0.04%. Therefore if we purchase a bond with a return of 0.5%, after custodians costs of 0.03% we would be left with a return of 0.47%

6. **Risk**

- 6.1. As with any Treasury Management activity, it is recognised that risk cannot be removed completely, but steps can be taken to reduce or mitigate the risk.
- 6.2. **Counterparty Risk** - Treasury Bills are bonds issued by HM Treasury. Purchasing these bonds is a means of investing in the UK Government. The UK Government has never failed to make interest or principal payments on these bonds. The counterparty risk of investing in the UK government is considered to be minimal.
- 6.3. There is no counterparty risk through using a custodian. Under FSA CASS (Clients Asset Sourcebook) Rules, South Lanarkshire Council at all times retains beneficial ownership of the securities. It would be our name on the Bill, and the securities are never considered to be the assets of the custodian.

- 6.4. **Liquidity Risk** - In the unlikely event that a custodian was to fail, and the business to collapse, there may be a short period of time during which another custodian would pick up the Bills held by the failed company. Therefore, there may be a couple of days where we would not be able to trade our Bill, or receive payment if maturity of the Bill was due. If SLC was relying on the funds from a maturing bill that was delayed, we could borrow on a temporary basis from the market (current cost for £10m per day - £80)
- 6.5. **Market Risk** – Bills are purchases at a fixed rate of return. The Bills are tradable and, therefore, at any point in time we are able to obtain a price to sell the Bills. The price of Bills on the secondary market will move as the price of Government Debt moves. As the proposal is to hold Bills to maturity, there is no market risk that returns will go down.
- 7. Employee Implications**
- 7.1. There are no employee implications.
- 8. Financial Implications**
- 8.1. Any return made from depositing or investing surplus funds offsets Loan Charges made to the Council's Revenue budget.
- 9. Other Implications**
- 9.1. Section 6 of this report provides details of risks associated with Treasury Bills and their mitigation.
- 10. Equality Impact Assessment and Consultation Arrangements**
- 10.1. 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 carry out any consultation in terms of the content of this report.

Archibald Strang
Chief Executive

12 October 2010

Link(s) to Council Values/Improvement Themes/Objectives

- ◆ Accountable, effective and efficient

Previous References

- ◆ South Lanarkshire Council of 23 June 2010

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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