ITEM NO: 9

BRENT COUNCIL	**Audit Committee** 16th June 2009 **Report from the Director of Finance and Corporate Resources**
For Action	Wards Affected: ALL

Treasury Management – Icelandic Banks

Developments since the last meeting of the Audit Committee

1. SUMMARY

1.1 This report looks at developments since the last meeting of the Audit Committee. In particular, the Audit Commission has reported on the lessons to be learnt from the collapse of Icelandic banks with which local authorities had deposits.

2. RECOMMENDATIONS

2.1 Members are asked to note and comment on the steps taken either previously or in response to the Audit Commission report.

3 DETAIL

Developments since the last meeting of the Audit Committee

3.1 Members will be aware that Brent deposited £15m with Icelandic banks in 2008. It would appear that the £5m deposit with Glitnir bank is likely to be regarded as a preferential creditor and repaid in full. Interest is likely to be paid at the agreed rate (5.85%) up to 14th November, rather than to maturity date (11th December). Interest due after 14th November is likely to be ranked as an ordinary creditor. Repayment is ‘expected’ by 31st March 2010. Although full repayment is regarded as ‘likely’, there are also likely to be legal actions and other obstacles.

3.2 The administrator for Heritable Bank, where Brent deposited £10m, has reported that local authorities are likely to receive around 70% - 80% repayment of cash and interest. The actual recovery will depend on patience, as a rapid sale of assets will generate poor returns, and the state of the property market. The repayments are expected to be staggered over a period to 2012.

3.3 Members will be aware that a Members' Training session on Treasury Management was arranged for May 6th. Feedback for the event, attended by nineteen members, has been good and the session will be repeated if there is further demand.

3.4 Other developments include:-

a) The council made an early repayment of £64.75m PWLB debt at the end of March. The repayment will reduce costs (around £2m / £2.5m in 2009/10), at a time when interest earned is historically low, and risk because there will be lower balances available to lend.
b) The Brent lending list has been reduced further to exclude building societies, following the sale of Dunfermline building society to Nationwide. It has become apparent that the Financial Services Agency has not monitored societies very closely – Dunfermline was allowed to build up exposure to commercial property loans at the height of the market, and to purchase sub prime debt. Although the current lending list is very short, there is evidence that the wholesale inter-bank lending market is recovering. Rates for inter-bank loans have reduced considerably, and the spread over base rate has reduced sharply.
c) A list of deposits as at 31st May 2009 is attached as Appendix 1. Most of the cash deposits, excluding those with money market funds that support cash flow requirements, are long-term at high interest rates.

AUDIT COMMISSION REPORT

3.5 In March 2009, the Audit Commission issued its report 'Risk and Return: English local authorities and the Icelandic banks', looking at the lessons to be learnt from the collapse. As part of its report, the Commission found that local authority investments had grown from £15b in March 2000 to £29b in March 2008, fuelled in part by drawing down PWLB loans early and by the additional costs that arise from the early repayment of debt. The Commission set out three main areas for recommendations – Central government, CIPFA (the local government accountancy body), and local authorities.

3.6 Central government was advised that it should review and revise the national framework for public lending, and require the Debt Management Office (DMO) to make it easier for public authorities to make secure deposits. Central government was also asked to review the charges for early repayment of debt to the PWLB, so that local authorities were encouraged to repay debt and reduce balances available for lending.

3.7 CIPFA was advised to revise its code of practice for treasury management, and to improve training and qualification in treasury management. The risks involved in drawing down loans in advance of actual spending should also be made clear.

3.8 The Audit Commission also made a number of recommendations that local authorities should:-

a) 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. If the organisation has no appetite for risk, it should place funds with the DMO.
b) Ensure that treasury management policies follow the CIPFA Code of Practice for Treasury Management, are scrutinised by a specialist committee and monitored regularly.
c) Ensure that members receive regular updates on risk, and receive training so that they can scrutinise the treasury management function.
d) Ensure that the treasury function is appropriately resourced and trained.
e) Ensure that the full range of options for managing funds is considered, and note that the early repayment of loans, or not borrowing money ahead of need, may reduce risks.
f) Use the fullest range of information before deciding where to deposit funds.
g) Be clear about the role of external advisers, and recognise that local authorities are accountable for decisions made.
h) Look for economies of scale by sharing resources between authorities or with pension funds.

Actions taken previously, or in response to the report

3.9 Members will be aware that officers have taken and planned a number of actions in response to the Icelandic bank collapse. It is important to recognise that there will be periodic bank crises, and that these will take different forms. However, local authorities must ensure that their policies and practices are as sound as possible so that risks are appropriate. Responding to the report:-

a) (Paragraph 3.8.a) The annual Treasury Strategy report discusses the relationship between risk and return, and the factors considered in establishing the council's lending list. The lending list has been constructed on the basis of high quality credit ratings. For example, a review in 2006 examined the option of reducing the quality of the credit ratings used so that additional interest could be earned – the option was not pursued because it was felt that the risks outweighed potential benefits. The Treasury Strategy report will be expanded in 2010 so that members are made more aware of the trade-off between risk and return. Members will be given the specific choice of the current low risk approach or the risk-free option of deposits with the DMO.

b) (3.8.b) Brent has previously adopted the CIPFA Code of Practice, putting in place policies, practices and reports to members on treasury management. Since the Icelandic banking collapse, members have received reports on the background to the crisis, current lending, training and proposals to review and change practices. It is proposed that the Audit Committee continues to receive regular reports on treasury issues, in particular any proposals to amend the approach to lending.

c) (3.8.c) As stated above, nineteen members attended the training session arranged with an independent training organisation.

d) (3.8.d) The treasury team is well resourced, experienced and enjoys regular training opportunities. There is access to information from economists, CIPFA and the treasury adviser. Further meetings with other experts are also planned to assess the opportunity to supplement information in key areas. In particular, improved information on country risks may be important.

e) (3.8.e) The current lending list has been very restricted since October 2008, and has been further restricted since the recent exclusion of the building societies. When the current problems with lending between banks (known as the wholesale market) have eased, a new list will be introduced that has been subject to member scrutiny and includes additional controls and indicators – for example, there are group limits for banks under common ownership, sovereign ratings have been adopted, and more stringent credit ratings are to be used. On early repayment of debt, in March the council repaid £64.75m in PWLB loans early, reducing interest payments and lending risks. However, great care must be taken over the early repayment of loans, as such action often gives rise to additional penalties that need either to be paid in the year of repayment or spread over the period of the new loans taken out as replacements. Again not borrowing ahead of need avoids lending risk, as the money will be deposited until it is needed, but may lead the council to borrow when rates have increased, raising long term costs.

f) (3.8.f) Treasury officers use a wide range of information before deciding where to deposit funds. For example, officers have access to medium and long term interest rate forecasts to support duration decisions. On a day to day basis, decisions on where to deposit funds are supported by conversations with brokers.

g) (3.8.g) The treasury team seeks advice from a variety of sources – economists and pension fund managers, as well as our treasury adviser, Butlers. When advice is given, it is tested and discussed before any implementation. For example, the main area of activity for Butlers has been debt restructuring. Before any decision to implement is taken, proposals are checked by the treasury team and senior managers. Officers are currently investigating other potential sources of independent credit rating advice.

3.10 The Audit Commission report also raises a number of other issues that Brent has previously addressed. These include recognising if individual banks are part of a wider group, recognising country issues, the use of a number of risk indicators and the risks involved in making long-term deposits.

4. FINANCIAL IMPLICATIONS

These are covered in the report.

5 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 STAFFING IMPLICATIONS

None

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8 BACKGROUND

Audit Commission report – Risk and Return: English local authorities and the Icelandic banks
Annual Treasury Strategy – Report to Full Council as part of the Budget Report – March 2009

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, on 020 8937 1472/74 at Brent Town Hall.

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Brent treasury lending list – Icelandic banks

1 The current loans outstanding **as at 31st May 2009** are:

Name	**Amount £m**	**Yield %**	**Lending Date**	**Maturity Date**
Cheshire Building Soc	5.0	6.59	30.07.07	30/07/09
Global Treas. Fund (RBS)	10.9	Var.	Call	
Gartmore cash reserve	6.9	Var.	Call	
Cheshire BS	5.0	2.6	07.05.08	07/05/10
Heritable bank	10.0	5.85	15.08.08	14/11/08
Glitnir	5.0	5.85	15.09.08	12/12/08
Northern Trust global fund	0.1	Var.	Call	
Dunfermline BS	5.0	5.99	04.02.08	04/02/10
Newcastle BS	5.0	6.05	28.04.08	28/04/10
Derbyshire BS	5.0	6.4	16.06.08	16/06/10
Dunfermline BS	5.0	5.9	01.07.08	01/07/10
Skipton BS	5.0	6.48	01.07.08	01/07/11
RBS	5.0	7.0	22.09.08	22/09/11
Total	**72.9**			

Brent has also invested £22.9m with an external manager, Aberdeen Asset Manager, which has placed the fund in a mixture of certificates of deposit (CDs) and cash. The list of investments held by Aberdeen (as at 31st May) is as follows:-

Nationwide BS CD	2.1	1.10		23.06.09
Alliance & Leics CD	1.8	1.41		06.08.09
RBOS CD	2.0	1.63		25.11.09
Barclays Bank CD	2.6	1.64		30.11.09
Nationwide BS CD	2.2	1.64		30.11.09
Clydesdale Bank CD	2.4	1.64		02.12.09
Lloyds TSB CD	2.1	1.67		21.12.09
Lloyds TSB CD	1.0	1.73		04.02.10
Barclays Bank CD	1.5	1.77		25.02.10
RBOS CD	2.3	1.67		07/05/10
Abbey National CD	2.3	1.67		10/05/10
Accrued interest	0.6			
	22.9			