

WYRE FOREST DISTRICT COUNCIL

CABINET
19th FEBRUARY 2009

Treasury Management Review Panel Recommendations

1. Summary

- 1.1.** This briefing paper details the recommendations of the Treasury Management Review Panel following its in depth look at treasury management activities at Wyre Forest District Council.

2. Introduction/Background Information

- 2.1.** The Review Panel was established by the Cabinet on 23rd October 2008 in order to conduct a cross party review of the Council's Treasury Management activities following the announcement on 7th October 2008 that the Council's investments of £9 million in Icelandic Banks had been placed at risk.

- 2.2.** The Membership of the Panel was as follows:

Councillor H J Martin (Chairman)
Councillor J-P Campion
Councillor P Dyke
Councillor M Kelly
Councillor Mrs F M Oborski

- 2.3.** The Terms of Reference of the Panel were as follows:

- To review the expediency of the Council's Treasury Management Policy and Investment Strategy with particular reference to:
 - The Council Policy and Government Guidelines in place when recent decisions relating to external investment decisions were taken.
 - The adequacy of existing procedures practices and processes that the Council uses to manage its financial investments.
 - The integrity and reliability of information relating to approved credit ratings and approved organisations including the professional financial advice and judgements applied to address financial risks.
 - The need to clarify the limits and conditions governing financial investments by the Council and to ensure that the quality range and depth of the Treasury Management function complies with

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accepted best practice in safeguarding the Council's financial resources whilst maximising the rate of investment return.

The Review Panel were able to ask any other members or officers of the council to attend to assist it with its discussions on any particularly matter.

The Review Group will report its findings and any recommendations to the Cabinet.

- 2.4.** A series of meetings have been held and the following witnesses interviewed:

Date of Meeting	Witnesses Interviewed
18 th November 2008	Head of Financial Services (i) to give an update on the current position (ii) To outline treasury management procedures and practices at Wyre Forest.
26 th November 2008	General discussion about: (i) Planning whom to interview (ii) Formulating questions for the interviews
3 rd December 2008	(i) Interview with Head of Financial Services to answer questions regarding treasury management. (ii) Interview with Head of Legal and Democratic Services regarding legal advice given regarding treasury management.
9 th December 2008	Interview with Chief Executive regarding his role in treasury management
7 th January 2009	Interview with Mr Vic Allison, Head of Financial Services, Wychavon District Council to compare what steps they have taken with regard to treasury management following the Icelandic Bank crisis.
20 th January 2009	Interview with representatives from Butlers, the Council's Treasury Management Advisers.
28 th January 2009	Meeting to formalise recommendations to Cabinet.

3. Key Issues

- 3.1.** The key priority for the Review Panel was to ascertain that all procedures and policies had been followed by the appropriate officers and to reassure the electorate that the Council had not been derelict in its duties in any way.
- 3.2.** During the interviews with witnesses the following points were clarified:

- 3.3.** From the Head of Financial Services the following points were ascertained:
- It was not possible to withdraw the deposits in the Icelandic Banks as they had been invested for a fixed term.
 - All treasury management procedures had been followed correctly.
 - A Treasury Management Strategy had been approved by Cabinet and Council and was followed accordingly.
 - The Corporate Management Team was informed about the position of the money in Icelandic Banks immediately the Head of Financial Services became aware of the position.
 - The comments circulated on the internet about treasury management were the views of individuals.
 - An independent report had been commissioned from Worcester City to ascertain that all treasury management procedures had been adhered to.
 - At the time of investing with the Icelandic Banks, Councils were encouraged to get the best return possible on their money. Wyre Forest, like other Councils had identified that Icelandic Banks gave a very good return on its investments. The Council were likely to have been criticised if they did not get a high rate of return on its investments. However, all investments were made with organisations which had the necessary credit ratings.
 - Money was invested on the advice of Butlers – the Council’s treasury management advisers.
 - The Council could not afford to employ officers with extensive treasury management experience and therefore had to rely on its treasury management advisers for advice.
- 3.4.** From an interview held with the Chief Executive it was ascertained that:
- The Chief Executive’s role was to ensure that mechanisms and procedures were in place in order to ensure that the treasury management role functioned properly. This involved discussions with the Head of Financial Services and taking these reports through the Corporate Management Team for approval by Members.
 - The decision making role as far as the investments were concerned rested with the Head of Financial Services.
 - The Chief Executive had been involved in considering contracts when the Council appointed Butlers as its advisers.
 - Members were involved in treasury management via reports that went to Cabinet regarding the Treasury Management Strategy.

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- The Chief Executive wondered why Butlers did not draw attention to the cautionary alerts regarding Icelandic Banks from Arlingclose.

3.5. From an interview conducted with the Head of Legal and Democratic Services the following was ascertained:

- The Head of Legal and Democratic Services stated that the involvement of the legal section centred on reports that had been presented to Cabinet/Council. It was a statutory obligation for the Council to receive reports that outlined what the Council's treasury management strategy was.
- If it had proved possible to withdraw the Council's investments it was likely that severe financial penalties would have resulted.
- Checks would have been undertaken on Butlers via the Financial Services Section and checks undertaken to ensure they had the required insurance.
- The Council had no legal right to require Butlers to attend a meeting of the Treasury Management Review panel as it was not a public body.
- It was confirmed that the contract with Butlers was for a fixed term and there was a notice period.

3.6. From an Interview with Mr Vic Allison, Head of Financial Services, Wychavon District Council the following was ascertained:

- It was confirmed that it was not possible to withdraw the investments from Icelandic Banks.
- Butlers had also advised Wychavon and many of the other authorities who had invested in Icelandic Banks.
- There was currently no mechanism in place for sharing information cross-county on treasury management.
- Wychavon had amended its treasury management policy to adopt a policy of spreading its investment risks and they now only invested with the 5 main High Street Banks and the top 10 building societies.
- Mr Allison was optimistic that the money invested in Icelandic Banks would eventually be returned though not with the interest that would have been accrued.

3.7. From an interview with Dan Willson and David Thomas of Butlers on 20th January 2009 the following was ascertained:

Butlers provided the Council with the following services:

1. A service overview of the Council's financial position
Interest rate and economic advice.

2. Technical advice on capital finance including the provision of model treasury management reports.
 3. Help with the revision of treasury procedures and practices. Training.
 4. Providing guidance on the Council's investment structure credit rating information from the three agencies: Fitch, Standards and Poors and Moodys.
- When an organisation was put on a negative rating watch it did not necessarily follow that their rating would be downgraded.
 - The ratings for the Icelandic Banks had changed materially on 30th September 2008. However, with regard to the massive rating changes that occurred Butlers were not party to how the banks were operating on a day to day basis.
 - Butlers were working with the Local Government Association (LGA) and the Council to recover the £9 million invested in Icelandic Banks.
 - Butlers emphasised that they did not give day to day investment advice.
 - Butlers did not advise on which products to invest in – the final decision rested with Council Officers.
 - Butlers helped the Council to create a list of counter parties that met their treasury management strategy but insisted they did not promote any of these in any way shape or form.
 - Butlers only took counter parties off the Council's criteria list if they were not in the sterling market.
 - In response to a question regarding how quickly after they received the information about the Icelandic Banks had they acted and communicated this to the Council, it was explained that Butlers had a contract to receive ratings and pass them on to their clients. ICAP had created a system so that Butlers had direct feed from all 3 rating agencies and this was transferred into the Butlers database and then the information was sent to their clients. These ratings could change hourly and there was therefore an issue about the timing of placing investments.
 - Butlers acted as the 'go between' between the ICAP dealing desk and officers.
 - Members of the Panel were concerned that ICAP and Butlers had the same Chief Executive. It was made clear that Butlers were a

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separate organisation within the ICAP group, with established 'Chinese Walls'.

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- Butlers advised 140 local authorities many of whom had investments with Icelandic Banks but only 13% of the deals had been done with the ICAP investment desk.
- The decision as to whether to deal with ICAP was a decision for each local authority and was not one which Butlers made.
- Members of the Panel were aware of information in the press from Arlington House that it was unwise to invest with Icelandic Banks. Butlers were asked if they had been aware of this advice. Butlers confirmed that they did not share information with other organisation.
- At the time the Council had invested with Icelandic Banks they had been triple A rated and the ratings for these banks had been stable for some time.
- Butlers commented that it had not been possible to foresee how badly the banks would be affected by the global credit crunch.
- It was confirmed that the Council would not have been able to cancel their investment contract as it had been made for a fixed term.
- As a small authority the Council could not warrant paying for two sets of treasury management advisers.
- It was impossible to second guess the outcome regarding the Council's investments. However, there was optimism as the balance sheets of the organisations concerned were good with enough assets to cover investments. The likely outcome would be clearer within the next 2 to 3 months.
- Butlers would in future be sending the Council additional information on a daily basis which would detail market indicators. This would assist the Council when making investments.
- Butlers were asked for an assurance that Butlers had recognised their shortcomings and officers could have confidence that any risk would be mitigated and that the Council's treasury management strategy was robust. Butlers responded that the Council could put their confidence in them. It was recognised that confidence in the credit ratings had been severely attacked and it was therefore necessary to look at other indicators for Councils when placing their money. They were also considering other information that could be added which would assist Councils when placing their money. A paper was to be circulated to the Council in the next few days which would identify items for Councils to include in their treasury management strategy.

- 3.8.** From an interview with Sally Dickson (Auditor Worcester City) and Jane Bramley (Chief Internal Auditor Worcester City)
- The Panel received an independent audit report from Worcester City Council. They had been tasked to carry out an independent examination of the circumstances leading to the potential loss of £9 million in investments. As they were already contracted to carry out internal audit work at Wyre Forest they were ideally placed to carry out this special audit.
 - A detailed audit was carried out and a copy of their report is appended to this report (Appendix 1).
 - In essence their report concluded that there had been complacency in the treasury management sector generally with an assumption having been made that money invested in banks was safe. However, the report stated that a considerable amount of local authorities had been affected by the collapse of the Icelandic Banks.
 - The report concluded that no Council Officers were to blame for the losses at Wyre Forest District Council and the Council had made use of the advice available to them from its Treasury Management advisers and the credit rating agencies.
- 3.9.** The Treasury Management Review Panel concluded its review on 28th January 2009 and met to make recommendations to Cabinet.
- 3.10.** At the meeting on 28th January 2009 the Panel received a report from the Head of Financial Services that commented on the Independent audit report that had been commissioned from Worcester City Council auditors. (This report is appended to this report (Appendix 2).
- 3.11.** The Panel concluded having received all the evidence from witnesses that the Council had acted appropriately according to adopted policies and guidelines at the time the investments were made. The Panel was also satisfied that the Council and the public could be reassured that the integrity of the decision to invest in the Icelandic Banks was made in the utmost good faith.
- 3.12.** It was agreed that a press release would be given when the report was released.

RECOMMENDED TO CABINET TO RECOMMEND TO COUNCIL:

- 1. The Council places an agreed limit on the amount of money it will invest with the institutions of any one national economy (either parent banks or their subsidiaries) except the British economy.**
- 2. That the Council changes its Treasury Management policy to ensure that all of its counterparties are rated by all three credit rating agencies and that it continues to use lowest common denominator as the basis for admittance to the Council's counterparty list.**

3. That the Council reviews and increases the minimum acceptable credit ratings for potential counterparties, taking detailed note of the definitions of each of the credit ratings, and continues to ensure that all credit ratings are used, not just the rating for the type of investments to be made. . This has already been implemented by Cabinet on 23rd October 2008.
4. That all changes in policy are reported to members with explanations, including changes in the counterparty thresholds, and details of the rating definitions are provided for reference.
5. That consideration is given to a more stringent policy for investment with subsidiaries which takes account of the credit ratings awarded to the parent body. As a minimum, both the parent and its subsidiary should have credit ratings within the Council's thresholds before an investment will be placed with the subsidiary.
6. The Council notes the recommendation of Worcester City and recommends that should there be any negative credit watches the counterparties be suspended on the list after consultation with the Chief Executive and The Leader of the Council. The impact on the Council's investments where dealings are suspended be communicated to Members.
7. Where a substantial investment (short or long term) is to be made by Council this will be made subject to what guidelines are recommended in the future.
8. The actual counterparty list is reported to Members once or twice a year as at a particular date and making it clear that it is under constant review (this to be done at the exempt part of a meeting). This could most usefully be done at the same time as the counterparty criteria are being considered for approval by Cabinet and Council e.g. in February when The Treasury Management Policy and Strategy Report is presented and in September when the Report on Treasury Management Service and Actual Prudential Indicators is presented.
9. That counterparty lists are examined for compliance with all criteria when they are received – for which an up to date list of the policies influencing the counterparty list will need to be kept, including the most recently approved threshold credit ratings, the decision to use ratings for Building Societies, the policy with regard to subsidiaries etc. – with a second person looking at the list when it is received as an independent review, with any unusual entries or other queries being raised and addressed immediately. Both the examination and review to be evidenced by signatures.
10. That the policy of using credit ratings for Building Societies is implemented, as intended and reported in September 2006, in order to help maximise the security of the Council's remaining funds.
11. That all communications with or received from the Council's Treasury Management advisers are discussed/reviewed at Treasury Management meetings and listed in the minutes with decisions/responses recorded. This should include the counterparty lists.

12. That decisions to make advance investment deals are carefully considered and the reasons fully recorded and that decisions take account of the current economic climate, e.g. advance deals should be generally avoided during a period of economic decline but could be advantageous during a period of economic buoyancy.
13. That the opportunity is taken to revise the specification for the Council's Treasury Management advisers and to retender the contract for the period starting September 2010 when the current contract will have expired.
14. That the Council is proactive in establishing and participating in a Local Authority Treasury Management group for Herefordshire and Worcestershire (subject to sufficient interest from other local authorities).
15. That there is much greater sensitivity to general economic performance built into the Council's Treasury management Strategy in future so that, for example, the first signs of an economic downturn will trigger a review of credit rating thresholds and ensure that they are tightened.

4. Resource Implications

- 4.1. The resource implications arising from these recommendations can be met from existing budgets.

5. Background Papers

Treasury Management Review Panel Minutes:

26th November 2008

3rd December 2008

9th December 2008

7th January 2009

20th January 2009

28th January 2009

Letter from Office of Deputy Prime Minister 12th March 2004 re: Local Government Investments

Treasury Management Annual Report 2003/2004 & Investment Strategy 2004/2005 (Cabinet 26th August 2004)

The Prudential System of Local Government Finance and the Treasury Management Policy and Strategy Report 2006/2007 (Cabinet 19th February 2006)

Report on Treasury Management Service and Actual Prudential Indicators 2005/2006 (Cabinet 28th September 2006)

Report on Treasury Management (Cabinet 23rd October 2008)

Treasury Management Report : Icelandic Investments (Worcester City Council Audit Department)

Response from Head of Financial Services to Internal Audit – Treasury Management Report on Icelandic Investments.