

## Agenda Item 18

**Cabinet**

**2 November 2011**



### Treasury Strategy Exemption

#### Exempt Information

Para 3 Schedule 12A Information relating to the financial or business affairs of any particular person (including the authority holding that information)

#### Summary

The credit ratings agency's have recently downgraded several UK banks and building societies resulting in investments being held that now contravene our investment criteria as laid down in the 2011/12 Treasury Management Strategy.

#### Recommendation

That the current investment in Lloyds is kept until maturity or it is sold as part of normal trading.

That the limit for savings held in our Bank of Scotland instant access account be reduced to £2 Million, pending a full review of our internal lending criteria and savings arrangements.

#### a) Reasons for Recommendation

Lloyds and Bank of Scotland are now rated at F1 in the short term and A long term; this is still considered a reasonable high credit rating and is one down from our current threshold. Although below our originally set threshold, the markets have changed and to have a small percentage of our investment at a slightly lower credit rating for a determined period is considered an acceptable risk. This like all our investment will be kept under review.

Switching investment will result in interest loss of around £11,000 for the Lloyds investment. If we were to retract monies from Lloyds or Bank of Scotland in full this would give us difficulty in placing the investment elsewhere whilst keeping within our investment criteria.

A review is required of our Strategy in light of proposed legislation to treat corporate bonds as proper investments for local authorities, this does open up some opportunities.

**b) Alternative Options**

To sell the investment in Lloyds resulting in a loss of income of £11,000 and to withdraw all monies from the Bank of Scotland, resulting in loss of income and short term cash flow management capabilities.

**c) Risk Considerations**

The risk that both Lloyds Bank and Bank of Scotland will cease trading and default on the monies owed to the council.

**d) Policy and Budgetary Considerations**

These are outlined in the reason for recommendation

**e) Date for Review of Decision**

A further report will be presented to Cabinet Review of our Treasury Management Strategy

**1 Introduction**

Two of the three main credit rating agencies - Fitch and Moody's, have downgraded several UK banks and building societies, resulting in investments made by both the internal & external investment teams falling outside the rules of the treasury management strategy.

**2 Credit Ratings**

Both Fitch and Moody's have reviewed and downgraded the ratings of several UK banks and building societies as a result of a reduction in the likelihood of further UK Government support for the banking sector. Below is a list of the main changes

	Old Rating			New (current) Rating		
	Fitch Short Term	Fitch Long Term	Moody's Long Term	Fitch Short Term	Fitch Long Term	Moody's Long Term
Lloyds Bank	F1+	AA-	Aa3	F1	A	A1
Bank of Scotland	F1+	AA-	Aa3	F1	A	A1
Santander UK PLC	F1+	AA-	Aa3	F1+	AA-	A1
Royal Bank of Scotland	F1+	AA-	Aa3	F1	A	A2
National Westminster Bank	F1+	AA-	Aa3	F1	A	A2
Co-operative Bank	F2	A-	A2	F2	A-	A3
Nationwide Building Society	F1+	AA-	Aa3	F1+	AA-	A2
Leeds Building Society	F1	A	A2	F1	A	A3

Barclays Bank has also been placed on negative ratings watch by Fitch.

**3 Investments**

As a result of these changes in ratings a couple of our investments no longer meet the counterparty selection criteria set in the 2011/12 Treasury Strategy which are as follows:

- External Investment Fund  
Only institutions active in the UK Sterling Markets with a ratings greater than or equal to F1+ in the short term and AA- in the long term.

These institutions must also have minimum capital balances as below:

United Kingdom Banks	- minimum capital* US\$2000 million
Building Societies	- minimum capital base US\$2000 million
Overseas Banks	- minimum capital* US\$2,500 million

Based on the strict definition of Tier One capital originated by Basel's Bank for International Settlements. This definition of capital is used to compile the list of top 1,000 banks that appears annually in The Banker.

\* Estimated position based on Tier One capital

- Short term cash flow activities

Institution Type	Criteria	Lending Limit
Top 20 UK Building Society	Asset bases >£5 billion	£3 million
	Asset bases >£1 billion	£2 million
Bank of Scotland Account	Main UK Banks with a short term Fitch rating of F1+ or higher	£3 Million
Banks		£2 million
Local, Fire or Police Authority	N/A	£2 million

As a result of the downgrades two of our investments breach this criteria:

External (Investec Investment) - £2.7 Million in Lloyds Bank at 1.56% until 9<sup>th</sup> May 2012

Cash Flow (Internal Investment) - £3 Million in Bank of Scotland instant access account.

#### 4 Way Forward

As a result of discussion between the Section 151 officer Simon Davey, Chief Executive Mark Williams and the Finance Portfolio Holder Councillor Cox, it is recommended that the investment in Lloyds Bank, be allowed to mature. The Cabinet are being asked to agree this exception to the lending rules applied to the external fund on this one investment.

By allowing the investment to mature we will earn around £11,000 more interest than if we sold the investment on the market and purchased another deposit to cover six months

The facility we have with the Bank of Scotland is an instant access account (agreed investment limit of £3 million under the current strategy) which provides us with interest on deposits of 0.75%. Having such a facility is an essential part of our short term cash flow management options. As a result we have taken immediate action to reduce our exposure to only £2 million.

We recommend that use of this facility be allowed to continue at the reduced limit, while we look into other accounts on offer.

We will review the whole investment strategy in light of recent legislation on the use of corporate bonds by local authorities and the retendering of the external fund contact, reporting back to members in due course.

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### **Legal Implications**

There are no legal implications to report.

### **Financial Implications**

These are contained in the report

### **Consultation on Reports to the Cabinet**

### **Background Papers**

- ❑ Emails from Brokers regarding the changes in credit ratings made by Fitch & Moody's
- ❑ Investec Monthly Valuation
- ❑ Internal investment records
- ❑ Discussions with Investec on the Lloyds Investment and alternatives.

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Claire Read, Accountant

Cabinet  
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