REPORT TO:	Cabinet Council
DATE:	3 March 2011
SUBJECT:	Treasury Management Policy & Strategy 2011/12
WARDS AFFECTED:	All
REPORT OF:	Margaret Carney Chief Executive & Section 151 Officer 0151 934 2057
CONTACT OFFICER:	Jeff Kenah Corporate Finance Manager 0151 934 4104
EXEMPT/CONFIDENTIAL:	No

PURPOSE/SUMMARY:

To advise Cabinet of the proposed procedures and strategy to be adopted in undertaking the Treasury Management Function in 2011/2012.

REASON WHY DECISION REQUIRED:

To enable the Council to effectively manage its Treasury activities.

RECOMMENDATION(S):

Cabinet is recommended to

a) Agree the Treasury Management Policy Document for 2011/2012 (Annex A);
b) Agree the Treasury Management Strategy Document for 2011/2012 (Annex B);
c) Approve the amendment to Banking arrangements contained within the Financial Procedures Rules of the Constitution (Para 3);
d) Agree the Money Laundering Policy Document (Para 4 and Annex C);
e) Agree the basis to be used in the calculation of the Minimum Revenue Provision for Debt Repayment in 2011/2012 (Para 5);
f) Refer the report to Council for approval.

KEY DECISION:	No, this report does not represent a key decision in itself but forms part of the delivery of the 2011/2012 Budget, which is a key decision for the Council.
FORWARD PLAN:	No – see above.
IMPLEMENTATION DATE:	With effect from 1 April 2011.

ALTERNATIVE OPTIONS:

The Cabinet could decide not to comply with the CIPFA Code of Practice on Treasury Management that recommends production of Treasury Management Policy and Strategy Documents. Non-compliance with the Code would significantly increase the risks associated with this activity and would not be complying with best practice.

IMPLICATIONS:

Budget/Policy Framework:	Compliance with the Policy and Strategy Documents will enable the Council to secure the most favourable terms for raising funds, maximise returns on investments whilst at all times minimising the level of risk to which it is exposed.
Financial:	See above.

CAPITAL EXPENDITURE	**2011/ 2012 £**	**2012/ 2013 £**	**2013/ 2014 £**	**2014/ 2015 £**
Gross Increase in Capital Expenditure	N/a	N/a	N/a	N/a
Funded by:	N/a	N/a	N/a	N/a
Sefton Capital Resources	N/a	N/a	N/a	N/a
Specific Capital Resources	N/a	N/a	N/a	N/a
REVENUE IMPLICATIONS				
Gross Increase in Revenue Expenditure	N/a	N/a	N/a	N/a
Funded by:	N/a	N/a	N/a	N/a
Sefton funded Resources	N/a	N/a	N/a	N/a
Funded from External Resources	N/a	N/a	N/a	N/a
Does the External Funding have an expiry date? Y/N		When?		
How will the service be funded post expiry?				

Legal:	None.

Risk Assessment: The Policy and Strategy Documents minimise the level of risk to which the Council is exposed.

Asset Management: None.

CONSULTATION UNDERTAKEN/VIEWS

None.

CORPORATE OBJECTIVE MONITORING:

Corporate Objective		**Positive Impact**	**Neutral Impact**	**Negative Impact**
1	Creating a Learning Community		√	
2	Creating Safe Communities		√	
3	Jobs and Prosperity		√	
4	Improving Health and Well-Being		√	
5	Environmental Sustainability		√	
6	Creating Inclusive Communities		√	
7	Improving the Quality of Council Services and Strengthening local Democracy	√		
8	Children and Young People		√	

LIST OF BACKGROUND PAPERS RELIED UPON IN THE PREPARATION OF THIS REPORT

Treasury Management in the Public Services – Code of Practice CIPFA 2001.
The Prudential Code for Capital Finance in Local Authorities CIPFA 2003.

1. Background

1.1. The Council has previously adopted CIPFA's revised 2001 Code of Practice on Treasury Management in the Public Services which recommends the production of annual Treasury Management Policy and Strategy Documents, and the revision to The Code in 2009 following the Icelandic bank collapse.

1.2. In addition, the Council has also adopted, and incorporated into both documents:

a) The requirements of the 2003 Prudential Code for Capital Finance in Local Authorities; and,
b) An Investment Strategy produced in line with guidance from the then Office of the Deputy Prime Minister concerning the investment of surplus funds. This sets out the manner in which the Council will manage its investments, giving priority to the security and liquidity of those investments.

2. Treasury Management Policy and Strategy Documents

2.1. The Code requires the Council to produce:

a) A Treasury Management Policy Document – which outlines the broad policies, objectives and approach to risk management of its treasury management activities;
b) A Treasury Management Strategy Document – This sets out specific treasury activities which will be undertaken in compliance with the Policy in 2011/2012; and
c) Suitable treasury management practices, setting out the manner in which the organisation will seek to achieve these policies and objectives, prescribing how it will manage and control those activities.

The content of the policy statement and the treasury management practices will follow the recommendations contained in sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Codes key principles.

2.2. The proposed Policy and Strategy Documents are attached at **Annex A and B** respectively.

2.3. Economic conditions have been difficult since the onset of the credit crunch in August 2007. This caused all major economies to enter into recession caused by a reduction in lending as banks attempted to repair their balance sheets, with concerns being raised over the financial health of many institutions. The wider economic position has meant that a continuing review of the Treasury Management Policy and Strategy documents has been undertaken to identify whether any improvements can be made.

2.4. All investments are made in accordance with the Council's Investment Criteria. This takes account of market and risk conditions at the time the investment is made, with security being assessed over liquidity, and liquidity being assessed over return.

2.5. In view of the complex nature of Treasury Management, regular treasury update reports have not only be presented to Cabinet (who have the delegated responsibility), but also to Corporate Services Cabinet Member and the Audit and Governance Committee.

3. Financial Procedure Rules – Banking Arrangements

3.1. The Treasury Management Policy Document at **Annex A** delegates certain responsibilities to the Head of Corporate Finance and Information Services, including all executive decisions on borrowing, investment or financing, in line with the Constitution of the Council.

3.2. The Constitution (Financial Procedure Rules – Banking Arrangements Para 8.2) currently provides the following:

"No overdraft shall be permitted save on the general account, a maximum overdraft for which shall be fixed from time to time by the Council following recommendations by the Head of Corporate Finance and Information Services." In order to facilitate a "group" approach to the Council's bank account and related individual balances (a number of services provided by Sefton have bank accounts separate to the Council's main account), it is recommended that the paragraph be reworded as follows:

"On a day to day basis, no overdraft shall be permitted unless agreed by the Head of Corporate Finance and Information Systems. A maximum overdraft shall be fixed from time to time by the Council following recommendations by the Head of Corporate Finance and Information Services…."

4. Money Laundering Policy Document

4.1. The Money Laundering Policy Document is attached at **Annex C** for approval, which outlines the approach the Council will adopt to comply with its legal obligations.

5. Minimum Revenue Provision (MRP) for Debt Repayment Policy Document

5.1. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 introduced changes to the calculation of the MRP.

5.2. As a transitional arrangement for 2008/09, authorities were able to continue to calculate MRP as in previous years i.e. 4% of the underlying need to borrow for capital purposes, as measured at 31 March 2008. The Council's revenue budget for 2008/09 was constructed on this basis.

5.3. To comply with the legislative changes, the Council has, from 2009/10, retained this calculation for borrowing supported through the Revenue Support Grant but for unsupported prudential borrowing, MRP will be calculated using the estimated life method. This links the charges to revenue more closely to the life of the asset. The Council's Revenue Budget for 2010/11 and 2011/12 has been constructed on this basis.

5.4. The change in legislation also allows councils to apply an MRP "Holiday" on large projects, the costs of which span a number of financial years. Rather than starting to charge MRP as the expenditure is incurred, the option is given to apply MRP only when the scheme becomes operational. The total level of MRP remains unchanged, only the timing of the charge is altered. This option is considered to be the most appropriate for use within Sefton.

6. Recommendations

Cabinet is recommended to:

a) Agree the Treasury Management Policy Document for 2011/2012 (**Annex A**);
b) Agree the Treasury Management Strategy Document for 2011/2012 (**Annex B**);
c) Approve the amendment to Banking Arrangements contained within the Financial procedures Rules of the Constitution (Para 3);
d) Agree the Money Laundering Policy Document (Para 4 and **Annex C**);
e) Agree the basis to be used in the calculation of the Minimum Revenue Provision for debt repayment in 2011/12 (Para 5);
f) Refer the report to Council for approval.

ANNEX A

SEFTON COUNCIL

TREASURY MANAGEMENT

POLICY

2011/2012

CORPORATE FINANCE AND INFORMATION SERVICES

1. **Treasury Management Policy**

1.1. The Council defines Treasury Management as:

The management of the Authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2. The Council's Statement of Treasury Management Policy is:

a) Effective Treasury Management is acknowledged as providing support towards the achievement of the Council's business and service objectives. It is therefore committed to the principles of achieving best value in Treasury Management, and to employing suitable performance measurement techniques, within the context of effective risk management;
b) The successful identification, monitoring and control of risk is regarded as being the prime criteria by which the effectiveness of the Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the organisation.

1.3 A dedicated team of three officers carries out the day-to-day treasury management activities. Two of the current officers are qualified accountants, whilst the third is a qualified accounting technician. The Treasury Group Accountant has recently obtained the CIPFA/Association of Corporate Treasurers sponsored qualification CertITM-PF, which is aimed at giving a solid grounding in treasury management and which is tailored to the public sector.

1.3.1 Members should receive training in the Treasury Management function, in order to assist in the understanding of this relatively complex area. This will be addressed via the provision of regular reporting to Cabinet, Corporate Services Cabinet Member Meeting and the Audit and Governance Committee.

2. **Treasury Management Strategy**

2.1. The Annual Strategy Document sets out in detail how the Treasury Management Activities are to be undertaken in a particular financial year to comply with the Council's Policy. The strategy for 2011/2012 is attached at **Annex B**.

3. **Delegated Powers**

3.1. The Head of Corporate Finance and Information Services, under the Council's Constitution, is given the following authority:

a) All money in the hands of the Council shall be aggregated for the purposes of Treasury Management and shall be under the control of the

Head of Corporate Finance and Information Services, the Officer designated for the purposes of Section 151 of the Local Government Act, 1972;

b) All executive decisions on borrowing, investment or financing shall be delegated to the Head of Corporate Finance and Information Systems (or in his/her absence the Deputy Section 151 Officer) who shall be required to act in accordance with the Council's Treasury Policy, Treasury Management Practices and CIPFA's Standard of Professional Practice on Treasury Management.

4. Reporting Requirements/Responsibilities

4.1. Council

Council will approve, prior to each financial year, the Treasury Management Policy and Strategy Documents, and will also receive a mid-year review, as well as receiving an annual outturn report on Treasury Management activity before 30 June following the end of the previous financial year, which reports actual treasury activity in the year.

4.2. Cabinet

Cabinet will:

a) Consider, prior to each financial year, Treasury Management Policy and Strategy Documents and refer them to Council for approval;
b) Implement and monitor these documents, approving any in-year amendments (at least on a quarterly basis) necessary to facilitate continued effective Treasury Management;
c) Receive an annual outturn report on Treasury Management activity prior to the 30th June following each financial year; and
d) Receive a quarterly update of the treasury management activity.

4.3. Audit and Governance Committee

Audit and Governance Committee will:

a) Monitor these Documents on at least a quarterly basis necessary to facilitate continued effective Treasury Management;
b) Receive an annual outturn report on Treasury Management activity prior to the 30 June following each financial year; and
c) Will be responsible for ensuring effective scrutiny of the treasury management and policies.

4.4. Head of Corporate Finance and Information Systems

The Head of Corporate Services and Information Services will:

a) Draft and submit to Cabinet and Council prior to each financial year, Treasury Management Policy and Strategy Documents;

b) Implement and monitor these Documents resubmitting any necessary in-year revisions/amendments (at least on a quarterly basis) to Cabinet for approval;
c) Draft and submit an annual outturn report on Treasury Management activity to Council, Cabinet, and Audit & Governance by the 30 June following each financial year-end;
d) Maintain suitable Treasury Management Practices (TMP), setting out the manner in which the Council will seek to achieve its objectives. The TMP's will also prescribe how the treasury activities will be managed and controlled;
e) Be responsible for the execution and administration of treasury management decisions; and
f) Act in accordance with the Council's policy statement and treasury management practices, and also in accordance with CIPFA's Standard of Professional Practice on Treasury Management.

ANNEX B1

SEFTON COUNCIL

TREASURY MANAGEMENT

STRATEGY

2011/2012

CORPORATE FINANCE AND INFORMATION SERVICES

SEFTON COUNCIL

Treasury Management Strategy

1. Introduction

1.1. The Treasury Management Strategy Document sets out in detail how the Treasury Management Activities are to be undertaken in a particular financial year to comply with the Council's Treasury Management Policy.

1.2 The Strategy had been produced to incorporate the requirements of the CIPFA Code of Practice on Treasury Management and the 2003 Prudential Code for Capital Finance, and the revised Treasury Management in the Public Services code of Practice and Cross-Sectoral Guidance Notes (2009).

Economic Background

The economic background has been particularly turbulent over the last three years, and this has put treasury management within the authority under greater scrutiny.

Economic conditions have been difficult since the onset of the credit crunch in August 2007. GDP growth is likely to have peaked at 1.2% in quarter 2 of 2010. The outlook is for poor growth in 2011/12. The Consumer Price Index (CPI) has remained high during 2010, starting at 3.7% in April and then increasing to 4.0% in January 2011. Although this is above the Monetary Policy Committee's (MPC) target of 2%, the MPC predicts that inflation will fall back under target over the next two years. Sector, our Treasury Management Consultants, have suggested that an increase in the Bank of England base rate may occur in May 2011, however, such an increase is dependent upon the state of the economy.

The reduction in the base rate to 0.5% in March 2009 has caused investment income to be severely reduced in 2010/11, compared to the levels earned in, for example, 2008/09. Despite the potential for a small increase in Bank Rate later this year, it is expected to remain at a level significantly lower than experienced a few years ago. The budgeted investment returns for 2011/12 reflect this scenario.

2. **Treasury Management Strategy 2011/2012**

2.1. The Strategy for 2011/2012 covers:

a) Treasury Limits in force which will limit the borrowing activity of the Council (2.2);
b) Prudential Indicators 2011/2012 to 2013/2014 (2.3);
c) Interest Rates (2.4);
d) Capital Borrowing (2.5);
e) Debt Rescheduling opportunities (2.6);
f) Investment Strategy (2.8).

2.2. Treasury Limits for 2011/2012

The Treasury Limits set by Council in respect of its borrowing activities are:

The overall or Affordable Borrowing Limit.	Maximum £180.500m

It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. The Affordable Borrowing Limit takes into account the Council's current debt, an assessment of external borrowing to finance the Capital Programme in 2011/2012, the need to finance capital expenditure previously met from internal funding, and cash flow requirements.

The amount of overall borrowing, which maybe outstanding by way of short-term borrowing.	Maximum £15m

The Short – Term Borrowing limit takes into account an assessment of any potential short-term financing the Council may need (e.g. bank overdraft, short-term funding in anticipation of grant receipts). Short-Term Borrowing is defined as being for less than 12 months.

The proportion of external borrowing which is subject to variable rate interest.	Maximum 33%

The limit on variable rate borrowing gives the Council flexibility to finance expenditure at favourable market rates, but ensures Council exposure to variable interest commitments is within prudent levels.

2.3. Prudential Indicators

The following prudential indicators are considered relevant by CIPFA for setting an integrated Treasury Management Strategy.

2.5.1. Interest Rate Exposure Indicators

Fixed rate borrowing and investment has the benefit of reducing the uncertainty surrounding future interest rate changes. However, in looking to improve performance best practice recommends retaining a degree of flexibility through the use of variable rates on at least part of the Treasury Management Activity.

To ensure that the risk associated with improved performance which may be achieved by using variable loans and investments is minimised, it is necessary to establish indicators to control the position. The control is based on setting an upper limit for both fixed and variable interest rate exposures expressed as a percentage of the Council's net outstanding principal sum. The following indicators are to be used:

Upper Limit for Interest Rate Exposures	**2011/12 %**	**2012/13 %**	**2013/14 %**
Upper limit for fixed interest rate exposure expressed as a percentage of net outstanding principal sum	250	250	250
Upper limit for variable interest rate exposure expressed as a percentage of net outstanding principal sum	-50	-50	-50

This prudential indicator has been revised this year due to a number of breaches noted in 2010/11. This revision is because in order to protect the security and liquidity of the Counci's funds more cash deposits are being placed overnight rather than long term.

2.5.2. Non Specified Investment Indicator

The Investment Strategy (Para 2.7.4) allows non-specified investments to be made using funds managed by the Council. The indicator is designed to control the level of such non-specified investments when compared to the overall investments of the Council.

Upper Limit on Non-Specified Investments	2011/12 %	2012/13 %	2013/14 %
Upper limit on the value of non-specified investments as a percentage of total investments	40	40	40

2.5.3. Debt Maturity Indicators

The indicators are designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of high interest rates. The control is based on the production of a debt maturity profile, which measures the amount of borrowing that is fixed rate that will mature in each period as a percentage of total projected borrowing that is fixed rate. Any borrowing decision and related maturity dates will be taken by the Council mindful of maturity profile limits set out below to ensure large concentrations of debt do not fall due for repayment in any one future financial year. The profile reflects borrowing advice provided by Sector, the Council's Treasury Management Advisors, and has been agreed with them.

Maturity Structure of Fixed Rate Borrowing During 2011/2012	Upper Limit %	Lower Limit %
Under 12 month	35%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and above	90%	25%

Policy on the use of external service providers
The Council employs SECTOR as its treasury consultants. The Council recognises that responsibility for treasury management decisions rests with the Council at all times. It also recognises that there is value in such arrangements in order to acquire access to specialist skills and knowledge. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly documented, and subjected to regular review. The agreement with Sector is up for renewal at the end of March 2011. A quotation exercise will be undertaken in order to test the market at that point.

It should be noted that SECTOR, although regulated by the FSA, are unregulated in terms of the investment advice that they give to local authorities, because as an organisation it does not give advice in respect of *investments*, which is covered by the FSA, but it gives advice in respect of *deposits*. Under FSA regulations local authority cash balances placed with institutions are classed as deposits.

2.4. Interest Rates

2.5.4. Sector Treasury Services Ltd ("Sector") to provide regular forecasts of interest rates to assist decisions in respect of:

a) Capital Borrowings (2.5);
b) Debt Rescheduling opportunities, (2.6); and
c) Investments strategy (2.8).

2.4.2. **Annex B2** gives details of Sector's central view regarding Public Works Loan Board (PWLB) interest rate forecasts.

2.4.3. The advice from Sector takes into account financial activity both in the UK and world economies and the impact of major national and international events. It is essential that borrowing and investment decisions are taken mindful of independent forecasts as to interest rate movements. The Council will continue to take account of the advice of Sector.

2.5. Capital Borrowing

2.5.5. The Council's debt portfolio as at 31st January 2011 is as set out below:

Debt Portfolio	
Average Interest Rate	4.66%
Debt Outstanding – Fixed Rate	£m
PWLB	131.542
Other Borrowing	0.024
Other Long Term Liabilities	6.783
Total Debt	138.349

The category of other borrowing (£0.024m) represents counter bonds and mortgages.

Other long term liabilities (£6.783m) represent transferred debt from the Merseyside Residuary Body.

2.5.6. The Council will raise its required finance, following advice from Sector, from the Public Works Loan Board (PWLB).

The Council's borrowing requirement for 2011/2012 is as follows:

Borrowing Requirement	Estimate £m
New Borrowing	19.611
Replacement Borrowing	0.000
Total Borrowing	19.611

The new borrowing represents the unsupported borrowing as required by the capital programme in 2011/12. As noted in 2.5.4 below the Council is internally borrowed, and may take additional borrowing if required in order to reverse this position.

2.5.3. The Sector forecast for PWLB interest rates (as set out at **Annex B2**). This would suggest that the following strategy is followed:

- The cheapest borrowing will be internal borrowing, which involves running down cash balances and foregoing interest earned at historically low rates. Consideration will always be given to long term borrowing rates and the possibility of rates rising, which could mean borrowing at future higher rates which could erode the advantages of internal borrowing
- Temporary borrowing from money markets or other local authorities
- PWLB rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt.

2.5.4. The authority borrows from the PWLB in order to fund part of the capital programme, the maximum that we can borrow being the CFR. Current PWLB borrowing is £131.542m, as against a CFR of £182.4m for 2011/12. This position is classed as being internally borrowed which does have the advantage of reducing exposure to interest rate and credit risk. To be internally borrowed is a conscious decision to use cash balances to fund capital expenditure, rather than borrow from the PWLB. This position can be reversed at any time by borrowing from the PWLB.

2.5.5. 2011/12 is expected to experience a continuation of a low bank rate. Hence, internal borrowing is a sensible option where interest rates on deposits are much lower than the current PWLB borrowing rates.

2.5.6. However, as noted in 2.5.3, savings have to be weighed against the potential for incurring long term extra costs by delaying unavoidable new borrowing until later years when PWLB rates are forecast to be higher.

2.5.7. Against this background, caution will be adopted in undertaking borrowing in 2011/2012. The Head of Corporate Finance and Information Systems will monitor the interest rate market and following advice from Sector, adopt a pragmatic approach to changing circumstances during the year.

2.5.8. External v Internal Borrowing

2.5.9. The Council currently has a difference between gross debt and net debt (gross debt net of cash balances) of £50m. The general aim of the strategy would be to reduce the difference between the two in order to reduce the credit risk of holding investments.

2.5.10. As noted in 2.5.4 above the Council is internally borrowed. If this continues this will reduce the difference between gross and net debt. Early repayment of debt is, however, not a realistic option since the introduction by the PWLB of significantly lower rates on 1 November 2007, which has now been compounded since October 2010 by a considerable further widening of the difference between new borrowing and repayment has meant that large premiums would be incurred.

2.6. Debt Rescheduling Opportunities

2.6.1. As noted in 2.5.10 above, restructuring with the PWLB is now much less attractive than before due to the potentially large premiums that would be incurred.

As short term borrowing rates are likely to be cheaper than long term rates, saving could be made by changing to short term debt. However, this must be considered in the light of the likely financing costs once these loans mature. It is likely that this situation will be reviewed early in 2011/12 to see if there is any merit in following a restructuring of debt.

2.7 Borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment income made on the extra sums borrowed. However should a decision to borrow in advance of need will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether to borrow in advance of need the Council will;

- Ensure that there is a direct link between the capital programme and maturity profile of the existing debt portfolio which supports the need to borrow in advance of need;
- Ensure that the revenue implications of such borrowing have been considered in respect of future plans and budgets; and
- Consider the merits of other forms of funding.

2.8. Investment Strategy

2.8.1. The Council manages the investment of its surplus funds internally, and operates in accordance with the Guidance on Local Government Investments issued by ODPM in March 2004 and the 2009 CIPFA Treasury Management in Public Services and Cross Sectoral Guidance Notes.

2.8.2 The Council's investment priorities are, in order of priority:

- The security of capital
- The liquidity of capital

The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.8.3. Under the system of guidance investments are classified as Specified or Non Specified.

Specified Investments are those which satisfy the following conditions:

a) The investment and all related transactions are in sterling;
b) The investment is short-term i.e. less than 12 months;
c) The investment does not involve the acquisition of share or loan capital; Either:
   i) The investment is made with the UK Government or local authority; OR
   ii) The investment is made with a body or scheme, which has been awarded a high credit rating by a credit rating agency.

Non Specified Investments are those that do not meet the above definition.

2.8.4 The Council's investment portfolio as at 31st January 2011 is set out below:

Investments Portfolio	**£m**
Specified Investments	73.610
Non-Specified Investments	Nil
Total	73.610

2.8.5 The Council banks with National Westminster, which is part of the Royal Bank of Scotland Group. It is classed as a part nationalised institution.

2.8.6 The Council undertaken a tendering exercise in order to award the banking contract for a period of two years, with an annual option to extend for one year over a three year period.

2.8.7 The Council Strategy will be:

a) To make Specified Investments in line with the above conditions;
b) To make Non Specified Investments which satisfy all of the above with the exception of 2.8.6 a) which is extended to a period of less than 2 years;

It is suggested that the following investment vehicles should be made available to the authority:

Investment	Reason	Risk
Term deposits made with banks as listed in annexe B5, following the investment criteria as listed in annexe B4. Deposits also acceptable on an overnight call basis. Can also deposit with Local Authorities.	Certainty of rate of return and repayment of capital	Liquid, with potential for deterioration in credit risk. Local Authorities not credit rated.
Supra-national bonds	Greater levels of security of investment. A fairly liquid investment, though not as liquid as Gilts	High credit rating as placed with EIB and World Bank (AAA rated). Bond price may vary if sold early
Money Market Fund (MMF)	Similar or better rate than bank deposits, with no penalty charge for early redemption. Same day liquidity	High credit rating via the International Money Market Fund Association or IMMFA (AAA rated)
Gilts	Liquid and very secure. Interest paid every six months	High credit rating as Government backed (AAA rated). Bond price may vary if sold early
Treasury Bills	Liquid and very secure. Duration of < 1year	No interest paid – they are zero- coupon rated.
Debt Management Agency Account Deposit Facility (DMADF)	Secure investment	High credit rating as Government backed (AAA rated). Interest earned low. Investment cannot be repaid early

The maximum that can be invested in any of the above vehicles is £25m, except for term deposits and MMF's for which no limit is set. The maximum maturity period in any of the above is 1 year, apart from suitably creditworthy banks which can be invested in for up to 2 years, in line with advice from SECTOR.

It is NOT proposed that the Council will be making any Non Specified Investments in 2011/2012 that do not comply with the above, however, should the situation change, the Head of Corporate Finance and Information Systems will report to Cabinet requesting appropriate approval to amend the Strategy before any such investments are made.

2.8.8 The Bank of England Base Rate was reduced significantly in March 2009 to 0.5%. Sector's projections expect the rate to stabilise at 0.5% until starting to rise gradually with a potential increase in Q2 2011 to 0.75% and then up to 3.25% during Q4 2014. Sector's current interest rate view is outlined at **Annex B2**. Given the volatility of the market, the forecasts can only be used as a general guide to the future position. Consequently for 2011/12, the Authority has taken a prudent view and budgeted for an investment return based upon Sector's base rate projection during 2011/12.

2.8.8. In order to pursue the strategy of maximising returns from surplus funds at an acceptable level of security and liquidity, the following Brokers as suggested by Sector will be utilised for investments of over one month:

i) Sterling International Brokers Limited;
ii) Tradition UK Limited;
iii) Tullet Prebon Limited.

2.8.9 Virtually any investment involves risk. The Council will consider the credit ratings supplied by a variety of recognised money market organisations, as part of the process to determine the list of Banks where the level of risk is acceptable, with security, then liquidity, being the key aims.

SECTOR supplies a methodology which the Council uses as the basis for producing its counterparty list. It uses a simple mathematical calculation to produce a score which is then used to categorise an institution in terms of the duration of an investment, a spread of scores defining each duration period. Each duration period is classified by a colour as follows

- Green 3 months
- Red 6 months
- Orange 12 months
- Purple 24 months

The calculation involves taking a simple weighted average across the main three credit ratings agencies, for the key factors of long term ratings, short term ratings, individual support, and external support rating. This gives a final score attributed to the institution. Overlaid over this are rating watches, which can either improve or worsen the score, depending upon whether the rating watch is positive or negative.

Credit default swap data (CDS) is then taken account of as part of the process. If the CDS causes the institution to be classed as being monitored, it is dropped to the next shortest duration. If it is considered to be out of range, it will no longer be considered credit worthy.

The Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthiness of counterparties, as Moody's are currently very much more aggressive in giving low ratings. This would leave the Council with few banks on the approved counterparty list. The Sector creditworthiness service does however use ratings from all three agencies, but does not give preponderance to just one agency's ratings.

However, to ensure that risk is managed to a greater extent, layered onto the new Sector methodology of selecting institutions for the Council's approved counterparty list will be the previous methodology of firstly choosing institutions that have a scoring of Fitch rating F1+/AA-, with an individual rating of minimum C, and support rating of minimum 2, i.e. excellent credit rating. This will define the first group of institutions that will be reviewed for investment purposes. However, any other available institutions that are deemed creditworthy as per the Sector methodology can be used if no suitable institutions are available from the main list.

2.8.10 Information from other sources will also be used such as

- Background research in the financial press
- Discussion with our treasury consultants
- Internal discussion with Head of Corporate Finance and Information Services

As a means of clarifying the level of acceptable risk, the Risk Matrix at **Annex B3** will be used. The Council will only invest in Banks that have a Risk Matrix scoring of F1+, AA- and Buildings Societies with a score of F1 (i.e. low risk) using the Fitch scoring methodology.

The Council maintains a full record of each investment decision taken, each of which is authorised by an appropriate level of signatory.

2.8.11 As noted in last year's report, Cabinet agreed that the limit of investments that can be made to any UK or international banking institution or group was raised from £15m to £25m. This reflected the fact that our counterparty list became drastically reduced following the downgrading of many banks by the credit rating agencies following the credit crunch. However, now that stability has now entered the banking sector, on an operational basis we are using an institutional or group limit of £15m in order to increase security of capital by spreading risk. However, the overall limit of £25m will be maintained as a maximum, should conditions change.

2.8.12 The current list of Banks at **Annex B5** has been produced for information; this takes account of the most up-to-date credit ratings available in respect of the Banks and Building Societies named, and utilising Sector's creditworthiness service. It has also been rationalised to only include institutions that are backed by a sovereign rating of AAA, which implies that national Governments would support the Banks if they were facing financial difficulties. The organisations listed will be monitored daily with the assistance of Sector to ensure they continue to meet the requirements outlined at **Annex B4**. In the event of a change in credit rating or outlook, the Council, with advice from Sector, will evaluate its significance and determine whether to include (subject to Cabinet approval) or remove the organisation from the approval list.

2.8.13 **Nationalised banks** are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1. Hence on both counts they have the highest ratings possible.

2.8.14 **UK banking system support package.** Please note that the UK Government has NOT given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system by supporting eight named banks with a £500bn support package.

2.8.15 If any of the Council's investments appear at risk of loss due to default (ie this is a credit related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make an assessment of whether a revenue provision of an appropriate amount is required.

2.8.16 Performance monitoring

The performance of the Council's investment strategy will be assessed by monitoring the average interest rate earned against the average 7 day LIBID on a monthly basis. This will be reported to Cabinet on a quarterly basis.

ANNEX B2

SECTOR INTEREST

RATE FORECAST

Sector's Interest Forecast as at 21 February 2011

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%	3.00%	3.25%	3.25%
3 month LIBID	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.60%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.10%	3.20%	3.40%	3.70%	4.00%	4.20%
5yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.50%	4.60%	4.70%	4.80%
10yr PWLB rate	4.90%	4.90%	4.90%	4.90%	4.90%	5.00%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%
25yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%
50yr PWLB rate	5.40%	5.40%	5.40%	5.40%	5.40%	5.50%	5.50%	5.50%	5.50%	5.60%	5.60%	5.70%	5.70%

RISK ASSESSMENT MATRIX

DEFAULT

5	10	15	20	25
4	8	12	16	20
3	6	9	12	15
2	4	6	8	10
1	2	3	4	5

EXPOSURE

RISK TOLERANCE

LOW RISK	<2	24 months
MEDIUM RISK	3-9	12 months
HIGH RISK	>9 or =9	6 months and below

FITCH RATING EXPLANATION

Short term rating
This places greater emphasis on the liquidity necessary to meet financial commitments.

F1 – highest credit quality - + denotes exceptionally strong
F2 – good credit quality
F3 – fair credit quality

Long term rating
AAA – highest credit quality – lowest expectation of credit risk and exceptionally strong capacity to pay financial commitments
AA - very high credit quality – very low credit risk and very strong capacity to pay financial commitments
A - high credit quality – low credit risk and considered to have strong capacity to pay financial commitments, but may be vulnerable

Individual rating
This assesses how a bank would be viewed if it were entirely independent and could not rely on external support.

A – very strong bank – outstanding profitability and balance sheet integrity
B – strong bank – no major concerns regarding the bank
C – adequate bank – may have one or two troublesome characteristics
D – weak
E - serious problems
F – defaulted

Support rating
Judgement of a potential supporter's (either sovereign state of parent) propensity to support the bank and it's ability to support it.

1 – extremely high probability of external support
2 – extremely high probability of external support
3 – moderate probability
4 – limited probability
5 – cannot rely on support

Rating watch
This suggests that there is likely to be a rating change of any of the above four ratings.

Investments with UK and International Banks (including the Nationwide Building Society) are limited by the Head of Corporate Finance and Information Systems to a maximum principal sum of £25m with any of the institutions listed above. A group limit of £25m will also be applied to institutions that are part of a group.

Investment with the Government's Debt Management Account Deposit Facility (DMADF), local authorities or any AAA MR1 + rated or equivalent Money Market Fund (with a maximum 60 day weighted average maturity) will be limited to a maximum principal sum of £25m. However, the Head of Corporate Finance and Information Systems can decide day to day maximum sums lower than this; an operational limit of £15m is currently in place.

ANNEX B5

SEFTON COUNCIL
STANDARD LENDING LIST – main list

UK and International Banks (including Nationwide Building Society	RATING	Negative rating watch?	Individual rating	Support rating	CDS
United Kingdom AAA					
Santander UK)	F1+ / AA-	Yes	B	1	Monitoring
Bank of New York Mellon	F1+ / AA-			1	N/A
Barclays	F1+ / AA-	Yes	B	1	In range
Clydesdale Bank	F1+ / AA-	Yes	C	1	N/A
HSBC	F1+ / AA	Yes	B	1	In range
Lloyds TSB/HBOS - nationalised	F1+ / AA-		C	1	N/A
RBS Group – nationalised	F1+ / AA-		C/D	1	N/A
Nationwide	F1+ / AA-	Yes	B	1	In range
Canada AAA					
Bank of Montreal	F1+ / AA-	Yes	B	1	N/A
Bank of Nova Scotia	F1+ / AA-		B	1	N/A
Canadian Imperial Bank of Commerce	F1+ / AA-	Yes	B	1	N/A
Royal Bank of Canada	F1+ / AA	Yes	A/B	1	N/A
Toronto Dominion Bank	F1+ / AA-	Yes	B	1	N/A
Finland AAA					
Nordea Bank	F1+ / AA-		B	1	N/A
France AAA					
BNP Paribas	F1+ / AA	Yes	B	1	In range

UK and International Banks (including Nationwide Building Society	**RATING**	**Negative rating watch?**	**Individual rating**	**Support rating**	**CDS**
CNCE Calyon Corporate & Investment	F1+ / AA-	Yes	C	1	In range
Credit Industriel et Commercial	F1+ / AA-		B/C	1	N/A
Credit Agricole	F1+/ AA-	Yes		1	In range
Germany AAA					
Deutsche Bank	F1+ / AA-	Yes	B/C	1	In range
Landwirtschaftliche retenbamk	F1+/AAA		W/D	1	N/A
Netherlands AAA					
Bank Nederlandse Gemeenten	F1+ / AAA		A	1	N/A
Coop Centrale Raiffeisen – Boerenleenbank BA	F1+ / AA+	Yes	A/B	1	In range
Singapore AAA					
DBS	F1+ / AA-		B	1	In range
Overseas Chinese Banking Corporation	F1+ / AA-		B	1	In range
United Overseas Bank	F1+ / AA-		B	1	In range

UK and International Banks (including Nationwide Building Society	RATING	Negative rating watch?	Individual rating	Support rating	CDS
Sweden AAA					
Nordea Bank	F1+ / AA-	Yes	B	1	N/A
Svenska Handelsbanken	F1+ / AA-	Yes	B	1	In range
Switzerland AAA					
Credit Suisse	F1+ / AA-	Yes	B	1	In range
USA AAA					
Bank of New York Mellon	F1+ / AA-	Yes	A/B	2	N/A
Deutsche Bank Trust Company Americas	F1+ / AA-	Yes	N/R	1	N/A
HSBC Bank USA	F1+ / AA	Yes	B/C	1	N/A
JP Morgan Chase Bank	F1+ / AA-	Yes	B	1	In range
Northern Trust Company	F1+/ AA-	Yes	B	1	N/A
Wells Fargo	F1+ / AA-	Yes	B	1	In range

ANNEX C

SEFTON COUNCIL

MONEY LAUNDERING

POLICY

2011/12

CORPORATE FINANCE AND INFORMATION SERVICES

1. Introduction

1.1. This document sets out the Council's policy in relation to money laundering. The aim of the policy is to outline the approach the Council will adopt complying with its legal and professional obligations in relation to money laundering. The policy applies to all employees of the Council and aims to maintain the high standards of conduct that currently exist within the Council by preventing criminal activity through money laundering.

2. What is Money Laundering?

2.1. Money laundering is defined within Part 7 of the Proceeds of Crime Action (POCA) 2002 and Section 18 of the Terrorism Act 2000.

2.2. Money laundering is defined as:

a) Concealing, disguising, converting, transferring criminal property or removing it from the UK (s327 of the POCA 2002); or
b) Entering into or becoming concerned in an arrangement which you know or suspect facilitates the acquisition, retention, use or control or criminal property by or on behalf of another person (s328 of the POCA 2002); or
a) Acquiring, using or possessing criminal property (s329 of the POCA 2002); or
b) Becoming concerned in an arrangement facilitating concealment, removal from the jurisdiction, transfer to nominees or any other retention or control of terrorist property (s18 of the Terrorism Act 2000).

2.3. The above are the primary money laundering offences and thus prohibited acts under the legislation.

2.4. Potentially, any member of staff could be caught by the money laundering provisions if they suspect money laundering and either become involved with it and/or do nothing about it. This policy outlines the approach to be taken in raising any concerns about money laundering.

2.5. It is recognised that the risk to the Council of contravening the legislation is low. However, it is extremely important that all employees are familiar with the legal responsibilities, as serious criminal penalties can be imposed for breaches of the legislation.

3. Obligations on the Council

3.1. The Council is required to undertake the following:

a) Appoint a Money Laundering Reporting officer ("MLRO") to receive disclosures from employees concerning suspicions of money laundering activity;
b) Implement disclosure procedures to enable the reporting of suspicions of money laundering by all staff;

c) Provide training to those staff considered to be most likely to encounter money laundering.

4. The Money Laundering Reporting Officer

4.1. The officer nominated to receive disclosures about money laundering activity within the Council (w.e.f. 1 April 2011) will be Margaret Rawding, Head of Corporate Finance and Information Services, who can be contacted as follows:

Address: 4th Floor, Magdalen House, Trinity Road, Bootle, L20 3NJ
Telephone No: 0151 934 4096.

4.2. The officer nominated to act as deputy in the absence of the MLRO is Mike Martin, Strategic Finance Manager, who can be contacted as follows:

Address: 4th Floor, Magdalen House, Trinity Road, Bootle, L20 3NJ
Telephone No: 0151 934 3506.

5. Disclosure Procedure

5.1. Following approval of the policy, guidelines will be separately produced by the MLRO and made available to all staff detailing the action that should be taken in the event of suspicions of money laundering. They will include a value limit for cash transactions above which staff must report the transaction to the MLRO. The value of this transaction limit has been set at £10,000.

5.2. The Guidelines will be drafted in a manner that ensures the Council and its staff act in a manner which complies with the relevant money laundering legislation. The guidelines will detail:

a) How staff should report their suspicions to the MLRO;
b) Action to be taken by staff once the report has been made to the MLRO;
c) Evaluation action to be taken by the MLRO on receipt of a report;
d) Action to be taken by the MLRO following evaluation of the report.

6. Training and Awareness

6.1. The success of the Council's actions in seeking to prevent money laundering will depend largely on the communication of the policy and guidelines to staff, particularly those staff more involved in the handling of cash transactions which could be significant and exceed the transaction limit noted at Para 5.1. In respect of current staff, communication of the money laundering policy and guidelines will be carried out as part of the normal cascading of information by senior management within the Council and by publishing the documents on the intranet.

6.2. Communication of the policy and guidelines will also be achieved as part of induction training of relevant new employees of the Council.

7. **Summary**

7.1. The Council is determined to ensure that it has robust procedures in order to prevent money laundering as a result of criminal activity. This Policy has been written in order to ensure that the Council establishes procedures that will ensure that it meets its legal and professional requirements in relation to money laundering but in a way that reflects the low risk to the Council of contravening the legislation.