

By: Cabinet Member for Finance  
Director of Finance

To: Cabinet - 14 June 2010

Subject: **TREASURY MANAGEMENT**

Classification: Unrestricted

Summary: To seek decisions on treasury management issues and update on developments in Iceland.

**FOR DECISION**

### **INTRODUCTION**

1. Treasury Management is reported on a quarterly basis to the Governance and Audit Committee. In addition, regular reports are now being made to Cabinet to help increase the level of communication on these issues.
2. This process is much enriched by the Treasury Advisory Group (TAG), an all party sub-group of Cabinet, which is responsible for advising the Cabinet and Director of Finance on treasury management.
3. Following the recommendation of TAG this report makes a proposal for a change on the duration of deposits. In addition, it reports borrowing recently undertaken and also updates on the Icelandic recovery process.

### **DURATION OF DEPOSITS**

4. This issue was considered by the Treasury Advisory Group on 26 March and they agreed the approach which is set out.
5. We want to maintain a dynamic approach to investments and even since October 2009 when Cabinet agreed the move away from all deposits being in the Debt Management Office (DMO) there have been a number of significant changes:
  - (1) In December 2009 the Financial Services Authority (FSA) introduced a new liquidity framework for financial institutions which will be implemented through 2010. Whilst the change is good for investors a likely effect is the removal of call accounts or their terms becoming less attractive. We need to be ready to respond to these changes.

- (2) Most forecasts envisage short term rates staying at their current very low rates for longer than expected with downside risks from the economy deteriorating further. This suggests we should consider the maximum duration of deposits being extended to 12 months. However, given the need to cover KCC's liquidity requirements we would need to be cautious about committing money longer term. There are currently a small number of relatively attractive options for up to 12 months deposits. TAG agreed the extension to 12 months subject to Cabinet.
6. We would need to be highly selective on the choice of institutions for longer term deposits.
7. The £40m counterparty limits were set inclusive of Superannuation Fund Cash and when the average cash balance exceeded £400m. Given that overall cash balances are now lower and Superannuation Fund Cash is now segregated its appropriate to consider whether the £40m level should be maintained. Again as long as the Credit Guarantee Scheme is in place we are not running additional risk and it does mean that we minimize funds with the DMO. On balance it is reasonable to maintain the level but if the Director of Finance has any concerns the level can be reduced and members notified. TAG endorsed this approach.
8. The governance arrangements allow for the Director of Finance to immediately withdraw money from a counterparty. On 30 April following a downgrade in Spain's sovereign rating £40m on call with Santander was recalled. The position remains under review.
9. Current deposits are shown in Appendix 1.

## **LONG TERM BORROWING**

10. The Council has not undertaken any new long term borrowing since February 2009. In 2008-09 of the budgeted requirement of £49.2m we borrowed £40m. We have not borrowed any of the 2009-10 requirement of £106.2m and the budgeted requirement for 2010-11 is £74.4m.
11. Prior to October 2008 the Council's approach to long term borrowing was to seek to take advantage of short term movements in rates and borrow at advantageous points in the rate cycle. A year's borrowing would be taken in 3-5 steps to reduce the risk of being caught out by unexpected volatility in interest rates.
12. Local authorities are not allowed to borrow solely to have funds to invest and KCC have never done this. However because there was a large ongoing borrowing requirement we were able to borrow at advantageous times.

13. A key factor in the period up to October 2008 was that short term rates on deposits were higher than the long term borrowing rates. We were therefore able to borrow long term funds and in the short term earn more than we were paying in interest.
14. The relationship between short and long term interest rates has been transformed by the dramatic reduction in base rates. So typically now we are receiving 1% on call account deposits but the 50 year PWLB rate has been between 4.49% and 4.82%.
15. Given this position we have taken a deliberate decision, reflected in the Treasury Strategy, of running down the level of cash balances. This decision also reflects reducing risk in a volatile market. Nevertheless, this strategy has a natural duration period and cashflow projections would suggest the need to borrow within the next 12 months.
16. In the last week of May long term gilt rates moved down and this was reflected in long term PWLB rates. On 25 May the Director of Finance in-consultation with the Cabinet Member for Finance for Finance, the Leader and TAG borrowed £50m, £25m at 4.27% (22-22.5 years) and £25m at 4.29% (38.5 – 39 years). These are highly advantageous long term rates and rates have since gone up. We also undertook a forward deal to re-finance £50m of maturing loans in August 2011, at a rate of 3.83%.

### **ICELANDIC RECOVERY PROCESS**

17. It is well documented that at the time of the global banking failure, Kent County Council (KCC) had a total of some £50m deposited in Icelandic banks. Some £33m related to core KCC cashflow, £1m held on behalf of Kent Fire and the rest belonging to the Kent Pension Fund. (It should be noted that the Pension Fund was unusually holding high cash deposits at this time to avoid the serious deterioration in equity values that would otherwise have occurred).
18. The following paragraphs set out in some detail the position of each bank where monies are deposited. While it is noted that we have now reached the expected stage where “preferential creditor” status is being tested in Icelandic courts, the legal advice continues to be that this status will be upheld. This means that some 93% of the deposited monies will be returned. This view is expected to be supported by the imminent LAAP (Local Authority Accounting Practice) Bulletin and the issue has been discussed fully with KCC’s external auditor as part of the 2009-10 accounts closure process.

19. Heritable

- (1) The Heritable recovery process is proceeding as the administrator initially set out. Ernst and Young have increased their base case recovery to 79-85% and to date we have received the following payments:

July 2009	16.13p in £
December 2009	12.66p in £
March 2010	6.19p in £

This gives a total return of £6.4m to date out of a total exposure of £18m and we anticipate quarterly returns through 2010 and 2011.

- (2) A trust law issue which relates to the last deposit with Heritable is being pursued through the courts with KCC and the Financial Services Compensation Scheme.

20. Glitnir and Landsbanki

- (1) The total exposure to Glitnir is £15m and Landsbanki £17m - of this £32m one-third relates to the Superannuation Fund Committee and £1m to Fire.
- (2) From the earliest visits to Iceland it has been clear that there would be litigation to confirm the preferred status of depositors. Other creditors, major banks and bondholders, were bound to challenge and have little to lose in doing so. The CIPFA guidance for closing the accounts is a 100% recovery from Glitnir and 95% from Landsbanki if preferred status holds.
- (3) The recovery work is coordinated by a steering committee including KCC. Bevan Brittan were commissioned at an early stage to provide the core legal input – they have also involved UK Queens Council and Icelandic legal advisers. The costs of the legal work is charged pro-rata to the value of deposits across all local authorities with deposits in Landsbanki and Glitnir.
- (4) In Appendix 2 based on a template provided by Bevan Britten the legal process is set out.
- (5) Bevan Brittan and Logos will be providing advice on merits once the written submissions have been filed. Either way it is in the Council's interests to participate in the litigation for the following reasons:

- (a) If the Council does not do so it will need to withdraw its objection and accept the decisions of the winding up board. On Landsbanki this would mean foregoing the claim for interest and costs. It would also leave the winding up board to argue the Councils' claims are deposits entitled to enjoy priority without the benefit of the full factual background. This will increase the risk of the general unsecured creditors succeeding in their arguments that the Council's claims are not deposits entitled to enjoy priority.
  - (b) On Glitnir it would mean accepting the winding up board's decision that claims are general unsecured claims and foregoing the claim for interest and costs. This would reduce potential recoveries by approximately 70%.
- (6) In Appendix 3 the Form of Authority required by Bevan Brittan is attached. This was signed by the Director of Finance under delegated powers to meet the deadlines of participating in the litigation. This approach is endorsed by the Director of Law & Governance.

## 21. Action Against Bank Management

On 10 May the Glitnir Resolution Committee informed the Informal Creditors Committee that it was commencing legal proceedings against some individuals who had held senior positions in the Glitnir bank prior to its collapse. A figure of \$2bn was referred to which would make a significant difference to the return from the bank for non-preferred creditors if the funds could be recovered. The position will be closely monitored.

## **RECOMMENDATION**

22. Members are asked to:

- (1) Accept TAG's recommendation to extend the maximum duration of deposits from 6 to 12 months.
- (2) Note the borrowing undertaken.
- (3) Note the litigation in Iceland on the Glitnir and Landsbanki claims.

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