Extract from the Minutes of the Cabinet Scrutiny Committee on 22 October 2008

93. KCC's Treasury Management Policies

(Item. F3)

The Chairman welcomed Mr N J D Chard, Cabinet Member for Finance, Ms L McMullan, Director of Finance and Mr N Vickers, Head of Financial Management, to the meeting.

Mr Smyth began the debate by asking how decisions on investments were made within KCC. Specifically, he wanted to know more about the role of the Treasury Policy Group (TPG) in terms of deciding where to invest money. Ms McMullan stated that the overall framework for the management of local authority investments is contained within guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The overall strategy for investments is determined by the full Council each year and contained within the Medium Term Plan. Once the treasury strategy is approved, the Council uses a counter party list, which is based on the ratings provided to the authority on the various banks and other financial institutions. The Treasury Policy Group (TPG) meets on a quarterly basis to discuss the counter party list and decide where the Council should be investing its money and on what terms. Ms McMullan confirmed that officers had delegated authority to make investments, particularly as some investment decisions needed to be made quickly.

In response to a further question from Mr Smyth, Mr Chard stated that there was a clear structure to investments based on the ratings of the relevant institutions. He stressed that KCC does not get direct access to the information held by the 3 ratings agency; only the interpretation of this information by the Council's advisers, Butlers.

Mr Northey asked what the Council does when things go wrong. Specifically, he asked what the latest information was about the future of the Icelandic banks and what the likelihood was of KCC receiving a full refund of its invested money and over what timescale. Secondly, he asked what plans KCC had for the future to safeguard other investments if something else unexpected happened. Mr Chard stated that KCC had been very open and transparent about its investments from a very early stage, unlike some of the other 122 local authority investors in Iceland and that certainty was given about KCC's liquidity and continued ability to pay for its services, salaries, pensions and contractors. He also stated that the Governor of the Bank of England had been quoted in "The Times" to say that the an "extraordinary and unimaginable series of events" had led to the current situation and that "not since the 1st World War has our banking system been so close to collapse." He added that all new investments were being made with the Debt Management Office, which whilst completely safe, attracted a much lower rate of interest, which will have an impact on the County Council in terms of it being able to limit council tax increases.

Ms McMullan confirmed that KCC had some £18.35m invested in the Heritable Bank and she referred to the joint release by the LGA and the Administrator, which stated that the assets and liabilities of the Heritable Bank were about the same and that the next step was to set up a Working Party to begin the process of ensuring that investments were returned to local authorities as soon as possible. She stated that the LGA was leading on this work, supported by a small number of key local authorities including KCC and that good news was expected fairly swiftly. The remainder of KCC's Icelandic investments were with Glitner and Landsbanki, but that there was no further information at the moment about the timescale or process for the return of these investments.

Ms McMullan confirmed that a full review of KCC's remaining investments had been undertaken; this was particularly important given the fact that maturity dates for some investments would necessitate a decision on re-investment and as other money became available for investment. She stated that the use of the Debt Management Office was the only appropriate option at this stage, but that she did not consider that this was a sustainable position. She added that the cross-party Economic Management Group would have a key role to play in helping to decide on the future investment strategy and that a meeting request had gone out for 3 November.

Mr Northey asked for further information about how long KCC was likely to hold its investments with the Debt Management Office and whether anyone knew what the situation was with regard to the 2 Iceland banks. Mr Chard stated that he would prefer to leave the discussion on how long KCC was likely to use the Debt Management Office until after the meeting of the Economic Management Group on 3 November. Mr Chard added that the situation with regard to the 2 Icelandic banks was a difficult one, but when the Bank of Credit and Commerce International collapsed in 1991, some 90% of all investments were eventually returned to depositors.

Mr Christie asked when the TPG met prior to 9 October. Ms McMullan stated that the group last met at the end of July 2008, but that information was often shared electronically amongst the group members, particularly if urgent decisions had to be made. Mr Christie then referred to the article in the "Local Government Chronicle", which stated that local authorities had been warned some 7 months ago about the potential risks of investing in Iceland. He also asked whether Mr Chard wanted to clarify the comment attributed to him that the government had asked KCC to make these investments. Finally, Mr Christie asked Mr Chard to provide further information about why KCC actually needed to invest the money in the first place, if there was no effect on services, salaries or pensions.

Mr Chard responded by saying that about one third of local authorities (123 out of 388) had investments or deposits with Icelandic banks totalling approximately £1bn. The figure of 123 was made up of approximately half of County Councils, one third of London Boroughs and one quarter of District Councils but did not include charities, universities, Transport for London and the Audit Commission. With regard to the comments attributed to him, Mr Chard stated that he had checked the tape of the interview he had done with Meridian and gave an assurance that at no time had he ever said or implied that the Government had asked KCC to deposit money with Icelandic banks. He stated that he had said that the Government expected local authorities to spread their risks and adhere to the CIPFA guidelines on investments, which KCC had done, with assistance from its advisers and the information from the ratings agencies.

With regard to the £50m invested, Mr Chard stated that this was working capital and reserves, which the Council was perfectly entitled to put on deposit, within the guidelines, in order to earn interest and help offset unnecessary increases in the levels of Council Tax. He added that KCC had received some £56m the previous day from its precept and £13m today in the form of Dedicated Schools Grant money, which did not need to be paid out either today or tomorrow, nor was it needed for immediate cash flow and so would be invested.

Mrs Dean expressed her disappointment that Butlers were not present but asked for further information about what their role actually was. Mr Simmonds interjected to say that such a discussion at this stage, prior to the consideration of the PWC report, was premature and could prejudice further discussions. He asked for legal advice about the nature of the line of questioning Mrs Dean was seeking to pursue. Mrs Dean stated that she was not seeking to examine the quality of the advice from Butlers, only their role. In doing so, she stated that she had searched a number of relevant websites recently, where Butlers had described their services as providing information not advice. She added that having clarity on the role of Butlers in KCC's investment decisions was crucial, given the fact that the Government had stated that they could not guarantee the deposits of local authorities because they were informed investors and received professional advice from companies like Butlers. Mr Wild advised the Committee that Mrs Dean's questions were appropriate at this stage, if all she was seeking to do was to clarify the role of companies such as Butlers. He added that it was appropriate for this Committee to look at the general picture first, not the specifics, in advance of the various investigations being undertaken elsewhere.

Ms McMullan read extracts from KCC's contract with Butlers, which stated that in terms of investment policy "advice would be given with regards to the implications of investing funds internally. In conjunction with our interest rate forecast, we will provide advice on the period of investment". On credit ratings, the contract stated that "where funds are invested externally, advice would incorporate an initial assessment and constant review of the credit rating and counter-party list selected by the Council. Monthly summaries of credit ratings will be supplied. Advice will also be provided immediately of any changes to these ratings".

Mrs Dean then asked what PWC had been asked to do in terms of their investigation and report: were PWC expressing an opinion on the Council's Treasury Management policies or giving an opinion as to whether KCC had abided by the rules on investments? Ms McMullan stated the PWC had been asked to look at this matter in two stages; firstly, whether KCC had followed existing processes and, secondly, how could those processes be improved for the future. She added that the PWC report had been commissioned as soon as possible after the Icelandic situation came to light.

Mrs Dean stated that she had received information that approximately half of the KCC money invested in Iceland did not mature until between February and August next year and she asked when Butlers first advised KCC that there was a potential problem with the Icelandic banks and what action was taken. Ms McMullan stated that the advice came through from Butlers on 30 September and at that stage, KCC was unable to get its money out. Mrs Dean stated that the credit ratings of banks and other financial institutions was information that was readily available, but what was more important was how the ratings were interpreted and what action was taken having considered those interpretations. She asked, therefore, when KCC was advised as to the reasons for the ratings on the Icelandic banks and why they had changed. Ms McMullan stated that the last meeting KCC held with Butlers was 29 September and she re-read one of the extracts from KCC's contract with Butlers with regard to their role in providing advice (referred to above).

Mr Harrison asked what KCC would do with the £50m if it was to be returned tomorrow. He also asked for further information on the membership of the Economic Management Group Mr Chard stated that the only option for investment at the present time was the Debt Management Office, because it was safe but he reiterated his previous comment that the interest earned on that money would be very low, which would affect the Council's finances adversely. He added that the membership of the Economic Management Group would include the Members of the cross-party IMG on budgetary issues, the Chairman of the Superannuation Fund Committee (Mr Scholes), the Chief Executive, Ms McMullan and himself. With regard to the proposed meeting on 3 November, the notification stated that, if those Members could not attend personally, substitutes would be accepted.

Mr Chell referred to recent Government legislation that had affected access to potential lower interest rates on borrowing, which meant that KCC would no longer be able to transfer or reschedule loans to preferential lower interest rates. He stated that this matter had been raised at the Audit Committee recently. He asked what this legislation would cost the tax payers of Kent. Mr Chard that the question from Mr Chell was outside the remit of the Icelandic situation and that he would provide a written answer in due course.

Mr Hotson asked what the political make up was of the 122 other local authorities that had Icelandic investments and also asked Mr Chard to comment on the benefits to Council taxpayers in Kent over, say, the last 10 years of the Council's approach to investments. Mr Chard stated that the make up of the 122 local authorities was right across the political spectrum and that, whilst the relevant details could be made available to Members, he stressed that he did not view the matter as a party political one.

Mr Truelove asked Mr Chard to confirm which Members of KCC were accountable in deciding that the money should be invested in Iceland. Mr Chard stated that all Members of the Council had a responsibility for the treasury management policies of the Council, but that beyond that, he was unwilling to comment further until the PWC report had been published.

Mr Scholes stated that, as Chairman of the Superannuation Fund Committee, he could reassure pensioners that the amount of money being paid into the pension fund exceeded the amount that had to be paid out, because of a decision in May 2007 to store cash rather than invest. He added that this had resulted in the accumulation of £16m in cash, which was now held in Iceland. He added that, by not investing £150m, the fund had made an additional £60m.

Mr Simmonds asked whether consideration would now be given in the future to country exposure and also what the net difference was between the Debt Management Office rates of interest and what could be achieved in the market and the effect of this on the Council Tax payer. Ms McMullan stated that country exposure would be one of the issues examined going forward. She also stated that, if all maturing and new money was invested in the Debt Management Office, the difference in interest rates would be between 60% and 70% less than the market. If KCC sustained that position moving forward, the estimated effect on KCC's finances would be in the region of £6m per year, which equated to just over 1% on the Council Tax.

Referring to the Local Government Chronicle, the Chairman stated that the rating of Landsbanki had been reassessed from “A” to “BBB” on 30 September. He asked what information had been available on the ratings for the other 2 Icelandic banks where KCC had investments. Ms McMullan stated that the PWC report would include a full chronology of events, including the dates on which ratings information was made available to KCC and the dates that investments in Iceland were made.

Mrs Dean referred to the suggestion from the Leader to the government of a new way of investing, which would involve local authorities placing all of their investments with British banks. She asked what discussions had taken place about that suggestion before it was made formally to the Government. Mrs Dean also asked for an explanation as to why the Superannuation Fund Committee had decided some time ago to retain cash rather than invest, when other parts of the Council had decided to retain investments. In response, Mr Vickers stated that it was the policy of the Superannuation Fund Committee not to hold cash but to be fully invested, either in equities, property or Government bonds. He added that the long standing policy was different to other parts of KCC because of the different nature of the liabilities. The decision in mid-2007 to hold cash was due to the expectations and predictions of other forms of investment, notably property. He reiterated that the decision to hold cash had resulted in additional income over that period of £60m.

With regard to the Leader’s suggestion that local authority investments should be held in British banks, Mr Chard stated that he was not aware what discussions the Leader might or might not have had with other Members. He added that he as aware of the idea and that it merited further debate.

Mr Christie asked what information the TPG had available about the extent of the Icelandic liabilities when deciding to invest in Icelandic banks, adding that one report had suggested the liabilities were 9 times the size of that country’s GDP. Mr Chard stated that KCC’s investment decisions were made in accordance with the treasury management policies and with the assistance of the Council’s advisors.

The Chairman asked for confirmation of where the PWC report will go formally, once it is produced. Specifically, the Chairman asked whether the PWC report would be made public. Mr Chard stated that he would be very happy for the report to be made public, subject to the advice from the Council’s Monitoring Officer on aspects of commercial confidentiality and any possible future litigation. Mr Scholes confirmed that he had already asked for the PWC report to be reported to the Superannuation Fund Committee.

Mrs Dean asked whether the Treasury Management Strategy was a public document and whether it would be discussed at the Economic Management Group, as she considered it to be a confusing document. Mr Chard stated that it would be discussed by the group and would also feature in the PWC report.

RESOLVED: That (1) Our Committee notes the ongoing preparation of the report by PWC into KCC’s Treasury Management policies and asks that this report is made available for scrutiny by our Committee as soon as it is available;

(2) We ask that a copy of the contract between KCC and Butlers be provided to Members of the Committee on a confidential basis;

(3) We welcome the addition of Members of the Budget IMG to the membership of the Economic Management Group, set up and chaired by the Leader of the Council; and

(4) We expect Butlers to attend a meeting of our Committee at an appropriate stage in the future, following the completion of the PWC report.