Paper D

Cabinet
- 11th February 2019

Treasury Management Strategy Statement 2019-20

Cabinet Member: Cllr Mandy Chilcott – Cabinet Member, Resources
Division and Local Member: All
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	Seen by:	Name	Date
Report Sign off	County Solicitor	Honor Clarke	21-01-2019
	Monitoring Officer	Scott Wooldridge	21-01-2019
	Corporate Finance	Peter Lewis	17-01-2019
	Human Resources	Chris Squire	21-01-2019
	Senior Manager	Stephen Morton	14-01-2019
	Cabinet Member	Cllr Mandy Chilcott	21-01-2019
	Opposition Spokesperson	Cllr Liz Leyshon	21-01-2019
	Relevant Scrutiny Chairman	Cllr Anna Groskop	21-01-2019
Forward Plan Reference:	FP/17/11/01		
Summary:	The Council recognises that effective treasury management underpins the achievement of its business and service objectives and is essential for maintaining a sound financial reputation. It is therefore committed to driving value from all of its treasury management activities and to employing suitable performance measurement techniques, within the context of effective risk management. This report brings together the requirements of the Chartered Institute of Public Finance Accountants (CIPFA) Treasury Management in the Public Services Code of Practice Revised 2017 Edition (CIPFA TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities: Revised 2017 Edition (CIPFA Prudential Code). Whilst most of the requirements of the 2018 Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance are no longer relevant to Treasury Management Investments (it now overwhelmingly refers to non-treasury investments), it does adhere to MHCLG guidance to prioritise Security, Liquidity and Yield, in that order. The Council currently holds £324.55m of debt as part of its strategy for funding previous years' capital programmes. Of this,		

	£159.05m is Public Works Loan Board (PWLB) debt, £108m is Lender Option Borrower Option (LOBO) debt, and a further £57.5m of fixed rate bank loans. As at 31st December the average rate paid on all debt was 4.66%. Investment balances for 2018-19 to the 31st December have ranged between £185m to £251m, averaging £218m. These balances include approximately £60m of cash held on behalf of other entities, just over £53m as at 31st December being for the Local Enterprise Partnership (LEP). An average rate of 0.95% has been achieved, yielding an annual income in excess of £2m. Within this figure £10m is invested with the Churches, Charities, Local Authorities (CCLA) pooled Property Fund, currently yielding in excess of 4%. A new Investment Strategy paper covering non-treasury investments is to be presented separately at this meeting.
Recommendations:	The Cabinet is asked to endorse the following and recommend approval by Council on 20th February 2019: • To adopt the Treasury Borrowing Strategy (as shown in Section 2 of the report). • To approve the Treasury Investment Strategy (as shown in Section 3 of the report) and proposed Lending Counterparty Criteria (attached at Appendix B to the report). • To adopt the Prudential Treasury Indicators in section 4. The Cabinet is recommended: • To note the current Treasury Management Practices (TMPs) attached at Appendix D to the report. •
Reasons for recommendations	Under new CIPFA guidance the Treasury Management Strategy (TMS) can be delegated to a committee of the Council under certain conditions. However, it is seen as a key element of the overall Capital Strategy and as that must be presented to the Full Council, it is regarded as appropriate that the TMS should be part of that process.
Links to Priorities and Impact on Service Plans:	Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.
Consultations undertaken:	None

Financial Implications:	The budget for investment income in 2019-20 is £1.53m, based on an average investment portfolio of £160m at an interest rate of 0.95%. (These figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership). The budget for debt interest paid in 2019-20 is £16.12m, based on an average debt portfolio of £356.3m at an average interest rate of 4.52%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.
Legal Implications:	Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.
HR Implications:	None
Risk Implications:	The TMS is the Council's document that sets out strategy and proposed activities to conduct Treasury Management activity while mitigating risks. Appendix D, the Treasury Management Practices document gives detailed explanation of the policies and procedures specifically used in treasury risk management.
Other Implications (including due regard implications):	None
Scrutiny comments / recommendation (if any):	The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies.

1. Introduction and Background

Treasury management is the management of the Council's cash flows, borrowing and treasury investments, and the associated risks. The Council has significant debt and treasury investment portfolios and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Investments held for service purposes or for commercial profit, collectively referred to as non-treasury investments, are considered in a new report, the Investment Strategy.

Treasury risk management at the Council is conducted within the framework of the CIPFA Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Non-treasury investments are substantially covered by the 2018 Revised MCHLG guidance in the separate Investment Strategy.

Under Section 3 of the LGA 2003 (duty to determine affordable borrowing limit), a Local Council must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which Treasury and Investment Management, and Capital Financing are managed. The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits, the maturity structure of borrowing, and longer-term investments.

In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, Somerset County Council (SCC) adopts the Treasury Management Framework and Policy recommended by CIPFA. These can be found in Appendix A.

The current TMPs are attached for information as Appendix D to this report and set out the main categories of risk that may impact on the achievement of Treasury Management objectives. No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk

The schedules to the TMPs provide details of how those risks are actively managed.

External Context

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019-20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year-on-year, broadly in line with the Bank of England's (BoE) November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while wages, adjusted for inflation grew by 1.0%.

At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the BoE's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the BoE expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee (MPC) continues to reiterate that any further increases will be at a gradual pace and limited in extent.

The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts. The BoE released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

The Council's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The BoE's MPC has maintained expectations for slow and steady rate rises over the forecast horizon.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck, and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in mid-December). As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

An economic and interest rate forecast provided by Arlingclose is attached at Appendix C.

Internal Context
As at 31st December 2018 the external long-term debt portfolio of SCC stood at just over £324m as in the table below.

	Balance on 31-03-2018 £m	Debt Matured / Repaid £m	New Borrowing £m	Balance on 31-12-2018 £m	Increase/ Decrease in Borrowing £m
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00
PWLB	159.05	0.00	0.00	159.05	0.00
LOBOs	113.00	5.00	0.00	108.00	-5.00
Fixed Rate Loans	57.50	0.00	0.00	57.50	0.00
Total Borrowing	**329.55**	**5.00**	**0.00**	**324.55**	**-5.00**

The investment portfolio at the same time stood at just over £191m, although approximately £60m of this was held on behalf of other entities, just over £53m being for the Local Enterprise Partnership (LEP).

	Balance as at 31-03-2018 £m	Rate of Return at 31-3-2018 %	Balance as at 31-12-2018 £m	Rate of Return at 31-12-2018 %
Short-Term Balances (Variable)	16.89	0.49	30.49	0.75
Comfund (Fixed)	179.68	0.69	151.15	0.94
CCLA Property Fund	10.00	4.22	10.00	4.07
Total Lending	**206.57**	**0.84**	**191.64**	**1.07**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while useable reserves and working capital are the underlying resources available for investment.

Statutory guidance is that debt should remain below the CFR, except in the short-term. The Council expects to comply with this in the medium term.

In the table below, as shown in the Capital Strategy, the 'Assumed debt not yet taken' row indicates that £91m of new borrowing could be needed by the end of March 2020. Timings of actual capital expenditure linked to the capital plan are not totally predictable, but it is envisaged that significant levels of borrowing may be necessary during 2019-20.

External Debt and the Capital Financing Requirement in £ millions

	31.3.2018 actual	**31.3.2019 forecast**	**31.3.2020 budget**	**31.3.2021 budget**	**31.3.2022 budget**
Short term debt	8.360	10.000	10.000	10.000	10.000
Long term debt *	316.101	309.606	306.483	301.285	294.708
Assumed debt not yet taken	0.000	21.792	90.985	139.723	181.355
PFI & leases	44.118	42.948	41.972	40.970	39.872
Total external borrowing	**368.579**	**384.346**	**449.440**	**491.978**	**525.935**
Capital Financing Requirement	**366.114**	**385.443**	**450.733**	**493.447**	**527.551**

*Reduces for Minimum Revenue Provision (MRP) & debt repayment

SCC has a projected cash income of approximately £800m for 2019-20.

These factors represent significant cash flow, and debt and investment portfolio management for the Council's Officers. In the current financial and economic environment and taking into account potential influencing factors, it is imperative that the Council has strategies and policies in place to manage flows and balances effectively. The strategies and policies herein state the objectives of Treasury Management for the year and set out the framework to mitigate the risks to successfully achieve those objectives.

2. Borrowing Strategy

The Council currently holds £324.55m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in the table above shows that the Council may have a need to borrow up to £91m by the end of 2019-20.

Objectives: The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

The Council will adhere to MHCLG guidance, which states "Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed".

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow shorter-term loans instead, i.e. from Local Authorities for 1-3 years, or PWLB for 5-10 years.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2019-20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The use of Call Accounts and MMFs will continue for short-term liquidity; However, it may be appropriate and/or necessary to borrow short-term (1 week to 3 months) to cover cash flow fluctuations. Where this is deemed advantageous, short-term funds will be obtained from the money market using the services of a panel of money market brokers.

Sources of borrowing: Approved sources of borrowing are cited in the TMPs. Whilst all options will be considered, it is most likely that the primary source for borrowing will be the Public Works Loan Board (PWLB). It is envisaged that any new borrowing, should it be taken, will be in the short to medium-term periods (up to 25 years), as this is most compatible with the current maturity profile. Interest rates for these maturities are expected to remain lowest as the continued economic uncertainty necessitates lower interest rates for longer. Variable rate loans also currently mitigate the cost of carry. Shorter-dated Equal Instalment of Principal (EIP) loans are cheaper than loans paid on maturity and are repaid systematically in equal instalments over their life. Both will be actively considered, as will shorter dated loans (1-3 years) from other Local Authorities.

No new borrowing will be in the form of LOBOs. SCC will continue with the current policy not to accept any option to pay a higher rate of interest on its' LOBO loans and will exercise its own option to repay the loan should a lender exercise an option. SCC will also investigate opportunities to repay where a lender is looking to exit the LOBO by selling the loan. This would be undertaken in conjunction with our treasury advisors. SCC may utilise cash resources for repayment or may consider replacing any loan(s) by borrowing from the PWLB or other Local Authorities. Depending on prevailing rates and the amount to be repaid, new loans might be taken over a number of maturities. The 'Maturity Structure of Borrowing' indicators have been set to allow for this contingency strategy.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. Officers continually monitor repayment rates and calculate premiums to identify opportunities to repay or reschedule PWLB loans.

3. Investment Strategy

In 2018, the MHCLG issued revised Statutory Guidance on Local Government Investments (3rd Edition). It states "Investments made by local authorities can be classified into one of two main categories:

- Investments held for treasury management purposes; and
- Other investments.

"Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance".

The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long-term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

- Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
- There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and
- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

This strategy applies only to investments held for treasury purposes. Any non-treasury investments are dealt with in a separate Investment Strategy (separate agenda item). The Council's treasury investments can be divided into two areas. Money that is lent to help smooth anticipated monthly cash flow movements, and funds which have been identified as not being immediately required (core balances), which can be lent over a longer timeframe. Total balances for 2018-19 to the end of November have ranged between £185m to £251m, averaging £218m to the 31st December 2018. These balances include approximately £60m of cash held on behalf of other entities, just over £53m being for the Local Enterprise Partnership (LEP).

If a passive borrowing strategy is adopted, i.e. internal borrowing to fund capital expenditure, investment levels will decrease. If Arlingcloses' 'cost of carry' and breakeven analysis determines that the Council borrows additional sums at long-term fixed rates in 2019-20 with a view to keeping future interest costs low, investment balances could possibly be higher.

Objectives: The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: If the UK enters into a recession in 2019-20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Investment strategy will largely be driven by the implementation of the borrowing strategy.

- If a passive borrowing strategy is adopted, investment levels will decrease. In this scenario, investments will need to be kept short to meet proposed capital spend. As currently, the majority of funds would likely be invested via short-term deposits with highly rated banks, local authorities, and the use of the money market funds, providing security via diversification, and liquidity.
- If 'cost of carry' and breakeven analysis suggests that the Council should borrow additional sums at long-term fixed rates in 2019-20, balances would increase, potentially significantly. In this case it may be more appropriate to diversify a proportion of investments into more secure and/or higher yielding asset classes during 2019-20.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Implementation: The Section 151 Officer (Director of Finance) under delegated powers will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. He in turn delegates responsibility for implementing policy to Treasury Management Officers. This is done by using only the agreed investment instruments, and credit criteria below and in appendix B. As is current procedure, the use of a new instrument or counterparty would be proposed in conjunction with the Council's Treasury Advisors, Arlingclose and specifically authorised by the Section 151 Officer (Director of Finance).

Approved Investments: The list below shows currently approved instruments, with a brief description of current and potential investment instrument characteristics underneath.

- Business Reserve Accounts and term deposits.
- Deposits with other Local Authorities.
- AAA-rated Money Market Funds *
- The Debt Management Office (DMO)
- Variable Net Asset Value (VNAV) Money Market Funds.
- Gilts and Treasury Bills.
- Certificates of Deposit with Banks and Building Societies
- Commercial Paper
- Use of any public or private sector organisation that meets the creditworthiness criteria rather than just banks and building societies.
- Building Societies – Including unrated Societies with better creditworthiness than their credit rated peers.
- Corporate Bonds – Can offer access to high credit rated counterparties, such as utility, supermarket, and infrastructure companies.
- Covered Bonds and Reverse Repurchase Agreements (Repos) present an opportunity to invest short-term with banks on a secured basis and hence be exempt from bail-in
- Pooled Funds. These funds allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. Their values change with market prices, so will be considered for longer investment periods. It would be the Council's intention to be invested in Longer-dated Bond Funds or Equity Funds, and for Property Funds for 5 years plus.

* Following EU reform to the operation and management of Money Market Funds implemented during 2018-19, all non-government MMFs will have to convert from Constant Net Asset Value (CNAV) to LVNAV (Low Volatility Net Asset Value) or VNAV. Those used by SCC have convert to LVNAV. LVNAV funds have to operate within tighter requirements (e.g. tolerance of the fund's NAV deviating from £1 narrows from 99.5p to 99.8p; and higher liquidity requirements).

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Approved counterparties – Credit Rated: SCC maintains a restricted list of financial institutions to be used as counterparties, and in accordance with the credit criteria set out in appendix B. Any proposed additions to the list must be approved by the Section 151 Officer (Director of Finance).

Approved counterparties – Non-Credit Rated: As investment decisions are never made solely based on credit ratings, and some institutions may not have ratings at all, account will be taken of any relevant credit criteria in appendix B, and any other relevant factors including advice from our treasury advisors for the approval of individual institutions. Again, this will be specifically authorised by the Section 151 Officer (Director of Finance).

Credit rating: SCC has constructed and will maintain a counterparty list based on the criteria set out in Appendix B. The minimum credit quality is proposed to be set at A- or equivalent. The credit standing of institutions (and issues if used) will be monitored and updated on a regular basis.

SCC will continuously monitor counterparties creditworthiness. All three credit rating agencies' websites will be visited frequently, and all ratings of proposed counterparties will be subject to verification on the day of investment. (MHCLG guidance states that a credit rating agency is one of Standard & Poor's, Moody's Investor Services Ltd, and Fitch Ratings Ltd). All ratings of currently used counterparties will be reported to the monthly treasury management meeting, where proposals for any new counterparties will be discussed. New counterparties must be approved by the Section 151 Officer (Director of Finance) before they are used. Any changes to ratings that put the counterparty below the minimum acceptable credit quality whilst we have a deposit, or a marketable instrument will be brought to the attention of the Section 151 Officer (Director of Finance) immediately, and an appropriate response decided on a case-by-case basis. Sovereign credit ratings will be monitored and acted on as for financial institution ratings. Investment limits are set by reference to the lowest published long-term credit rating from the three rating agencies mentioned above. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including those outlined below.

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the factors above give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits: Investment limits are set out in appendix B. In setting criteria in appendix B, account is taken of both expected and possible balances, the availability and accessibility of the various instruments to be used, and their security, liquidity, and yield characteristics.

Liquidity management: The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

4. Prudential and Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

The Authorised Limit and Operational Boundary are Prudential Indicators and are authorised by Full Council as part of the Capital Strategy. They are included here for information only. The 'Maturity Structure of Borrowing'', 'Principal sums invested for periods longer than a year', and 'Credit Risk' Indicators are specific Treasury Management Indicators and are to be adopted as per the recommendations set out in this paper.

Authorised limit and Operational Boundary: The Council is required to set an authorised limit and an operational boundary for external debt. In order that the preceding borrowing strategy can be carried out, the following Prudential Indicators have been proposed to Council in the Capital Strategy but are shown again here to give the full picture. (These figures rounded to nearest million)

	2019-20 £m	**2020-21 £m**	**2021-22 £m**
Authorised limit			
Borrowing	487	536	579
Other Long-Term Liabilities	54	54	54
Total	541	590	633
Operational boundary			
Borrowing	457	506	549
Other Long-Term Liabilities	47	46	45
Total	504	552	594

Maturity Structure of Borrowing: The Council has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. The calculation is the amount of projected borrowing maturing in each period, expressed as a percentage of the total projected borrowing. CIPFA Code guidance for the 'maturity structure' indicator states that the maturity of LOBO loans should be treated as if their next option date is the maturity date. The 'maturity structure of borrowing' indicators have been set with regard to this, and having given due consideration to proposed new borrowing, current interest rate expectations, and the possibility of rescheduling or prematurely repaying loans outlined in the borrowing strategy. The three shorter-dated bands have each increased by 5%, otherwise the bands and limits remain as for 2018-19 and are: -

	Upper Limit	Lower Limit
Under 12 months	50%	15%
>12 months and within 24 months	25%	0%
>24 months and within 5 years	25%	0%
>5 years and within 10 years	20%	5%
>10 years and within 20 years	20%	5%
>20 years and within 30 years	20%	0%
>30 years and within 40 years	45%	15%
>40 years and within 50 years	15%	0%
>50 years	5%	0%

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

The prime policy objectives of local authority investment activities are the security and liquidity of funds, and authorities should avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider the return on their investments; however, this should not be at the expense of security and liquidity. It is therefore important that authorities adopt an appropriate approach to risk management with regards to their investment activities. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds. These principles should be borne in mind when investments are made, particularly for the medium to long term. It is proposed that SCC will have a rolling portfolio of cash deposits via the Comfund, including the possibility of some in excess of one year. Should the Council wish to diversify more into pooled funds, it would be the Council's intention to be invested in these for periods of 1-5 years plus. Therefore, a prudential indicator of £40m is deemed necessary for year 1, with anticipated reductions at this point, in years 2 and 3.

	2019-20	**2020-21**	**2021-22**
Prudential Limit for principal sums	**£m**	**£m**	**£m**
invested for periods longer than 1 year	40	40	40

The sums indicated in this indicator do not include any investment in non-Treasury Investments covered by a separate Investment Strategy.

Credit Risk Indicator: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk (in conjunction with Arlingclose) and will be calculated quarterly.

Credit risk indicator	**Target**
Portfolio average credit rating (score)	A (6.0)

CIPFA no longer recommends setting upper limits on fixed and variable rate exposures, so these are no longer calculated for this paper.

5. Other Matters

The CIPFA Code requires the Council to include the following in its treasury management strategy.

Derivative Instruments: The code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). However, the Council does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

External Service Providers: The code states that external service providers should be reviewed regularly and that services provided are clearly documented, and that the quality of that service is controlled and understood.

SCC recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". So as not to place undue reliance on treasury advisors and other external services, SCC has always sourced its own information, performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team to ensure that services provided can be challenged, and that undue reliance is not placed on them.

Member Training: All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management, and particularly non-treasury investments demand appropriate skills.

The new Investment Strategy demands a greater level of understanding and involvement by members, and that document sets out the specific requirements for that purpose; However, there should still be an appropriate level of skills and understanding applied to the Treasury Management Strategy.

All SCC Members receive introductory training, which includes an overview of the treasury management function.

SCC Officers would be able and willing to provide a more detailed level of training, if Councillors thought that there would be no conflict of interest.

Through contacts with the CIPFA Treasury Management Forum and its independent Treasury Advisors, SCC could also facilitate training via an independent third party. SCC Officers also have contacts within a number of money market brokers and fund managers who could provide training.

As and when needed, information sheets could be prepared and made available to help keep members abreast of current developments.

Markets in Financial Instruments Directive II (MiFID II): As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could “opt up” to professional client status, providing certain criteria was met. This included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the Council have at least a year’s relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Council has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

6. <u>Background papers</u>

Local Government Act 2003 – Guidance under section 15(1)(a) 3rd Edition, effective from 1 April 2018.

The CIPFA ‘Treasury Management in the Public Services’ Code of Practice Revised Edition 2017.

CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2017.

Note: For sight of individual background papers please contact the report author.

Appendix A

Treasury Management Policy Statement

Introduction and Background

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management: -

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. Full Council Members) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance as Section 151 Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Policies and Objectives of Treasury Management Activities

2.1 The Council defines its treasury management activities as: -

> *"The management of the organisation'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."*

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

SCC Lending Counterparty Criteria 2019-20 Appendix B

The following criteria will be used to manage counterparty risks to Somerset County Council Investments for new deposits / investments from the time that the new Treasury Management Strategy is passed by Full Council at its meeting in February 2019.

Please note that the limits in this appendix apply only to Treasury Management Investments, not to those detailed in the Separate Investment Strategy.

Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Deposits - Any Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.

Unrated Building Societies
Unrated Building Societies as identified by Treasury Advisors can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.

Marketable Instruments – Any bank, other organisation, or security whose credit ratings satisfy the criteria below: -

Rating of Counterparty or Security
<u>Deposits or instruments of less than 13 months duration (Refer to long-term ratings)</u>
Fitch A- or above
S&P A- or above
Moody's A3 or above

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £20m. This is approximately 8.0% of maximum balance, 9.2% of average balance for the year to 31st December 2018-19. The % may be significantly less if borrowing up to the CFR is taken early in the year.

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-, and Moody's Aa3, will be £25m. This is approximately 10.0% of maximum balance, 11.5% of average balance for the year to 31st December 2018-19. The % may be significantly less if borrowing up to the CFR is taken early in the year.

<u>Deposits or instruments of more than 13 months duration (Refer to long-term ratings)</u>
Fitch AA- or above
S&P AA- or above
Moody's Aa3 or above

The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £10m. This figure is to be included in the overall figure above.

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.
Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Operational Bank Accounts
As the Council's current bankers, Nat West are currently within the minimum criteria. If they should fall below criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements. This will generally be for smaller balances where it is not viable to send to other counterparties or in the event of unexpected receipts after the daily investment process is complete. Money will be placed in the instant access Nat West call account overnight.

Public Sector Bodies
Any UK Local Authority or Public Body will have a limit of £15m and a maximum maturity of 5 years.

The UK Government, including Gilts, T-Bills, and the Debt Management Office (DMADF) will be unlimited in amount and duration.

The table below gives a definition and approximate comparison of various ratings by the three main agencies: -

Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	F1+	Exceptionally strong	P-1	Superior	A-1+	Extremely strong
	F1	Highest quality			A-1	Strong
	F2	Good quality	P-2	Strong	A-2	Satisfactory
	F3	Fair quality	P-3	Acceptable	A-3	Adequate
	B	Speculative	NP	Questionable	B and below	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		(1,2, or 3)		(+) or (-)	
Long-Term	AAA	Highest quality	Aaa	Exceptional	AAA	Extremely strong
	AA	V High quality	Aa	Excellent	AA	Very strong
	A	High quality	A	Good	A	Strong
	BBB	Good quality	Baa	Adequate	BBB	Adequate capacity
	BB	Speculative	Ba	Questionable	BB and below	Significant speculative characteristics
	B	Highly Speculative	B	Poor		
	CCC	High default risk	Caa	Extremely poor		

Financial Groups
For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) investments can be split between entities, but an overall limit equal to the highest rated constituent counterparty within the group will be used.

Country Limits
Excluding the UK, there will be a limit of £30m. This is approximately 12.0% of maximum balance, 13.6% of average balance for the year to 31st December 2018-19. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Money Market Funds
With regulatory changes now effected, previously titled Constant Net Asset Value (CNAV) Money Market Funds have been converted into Low Volatility Net Asset Value (LVNAV) funds. Any LVNAV Fund used must be rated by at least two of the main three ratings agency, and must have the following, (or equivalent LVNAV) ratings.

Fitch AAAmmf Moody's Aaa-mf Standard & Poor's AAAm

Subject to the above, deposits can be made with the following limits: -
The lower of £15m or 0.5% of the total value for individual Funds.
No more than 50% of total deposits outstanding are to be held in LVNAV MMFs.

VNAV Pooled Funds
Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Many VNAV bond funds are not rated. Equity, multi-asset and property funds are also not credit rated. The decision to invest in a particular asset class or fund will be based on the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth.

No more than £30m of total deposits outstanding are to be held in VNAV Funds (excluding LVNAV MMFs).

Other Indicators
The Council will continue to use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

Arlingclose Economic Outlook & Interest Rate Forecast

Economic Outlook

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019-20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year on year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

Credit Outlook

The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast

Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity *(at the time of writing this commentary in mid-December).* As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

The table below highlights the forecast for key benchmark rates

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.13**
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.27**
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.40**
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.33**
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.18**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.99**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

Appendix D

SOMERSET COUNTY COUNCIL

TREASURY MANAGEMENT PRACTICES

Version 5: May 2016

Approved by Section 151 Officer

…………………………… Date…………………

Approved by Deputy Section 151 Officer

…………………………… Date…………………

Introduction

The overriding legislation governing Treasury Management in Local Authorities is the Local Government Act 2003. Statutory Instrument 3146, the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003, states that: -

> *"In carrying out its functions under Chapter 1 of Part 1, a local authority shall have regard to the code of practice contained in the document entitled "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" published by CIPFA, as amended or reissued from time to time".*

Furthermore, the Act states that: -

> *"In complying with their duties under section 3(1) and (2) (duty to determine affordable borrowing limit), a local authority and the Mayor of London shall have regard to the code of practice entitled the "Prudential Code for Capital Finance in Local Authorities" published by CIPFA, as amended or reissued from time to time".*

This code requires the setting of a number of Prudential Indicators, benchmarks within which, Treasury and Investment Management, and Capital Financing are managed. The first Prudential Indicator in respect of treasury management is that the Council has adopted the CIPFA TM Code.

The Office of the Deputy Prime Minister, (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003. Revised guidance is effective from 1st April 2010. The overriding aim of the guidance is to encourage authorities to invest prudently, without burdening them with detailed prescriptive regulation.

The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). The generation of investment income is distinct from these prudential objectives and is accordingly not a matter for the guidance. However, that does not mean that authorities are recommended to ignore such potential revenues. Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities. This widely recognised investment policy is sometimes more informally and memorably expressed as follows: -

__S__ecurity - __L__iquidity -__Y__ield ...in that order!

This serves to demonstrate the link from legislation through to regulation and the importance of the CIPFA Codes. The Council adopts the content and the spirit of the Prudential and TM codes.

In formulating the annual Treasury Management and Annual Investment Strategies, and the setting of Prudential Indicators, SCC adopts the Treasury Management Framework and Policy recommended by the CIPFA TM Code. These are outlined overleaf: -

Treasury Management Policy Statement

Introduction and Background

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management: -

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.

- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council Members) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance & Performance as Section 151 Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Policies and Objectives of Treasury Management Activities

2.1 The Council defines its treasury management activities as: -

> "The management of the organisation'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."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important, but are secondary considerations.

CIPFA recommends that an organisations treasury management practices include those of the following that are relevant to its treasury management powers and the scope of its' treasury management activities:

TMP1 Risk Management

TMP2 Performance measurement

TMP3 Decision-making and analysis

TMP4 Approved instruments, methods and techniques

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

TMP6 Reporting requirements and management information arrangements

TMP7 Budgeting, accounting and audit arrangements

TMP8 Cash and cash flow management

TMP9 Money laundering

TMP10 Training and qualifications

TMP11 Use of external service providers

TMP12 Corporate governance

Each of the twelve Treasury Management Practices is set out on the following pages, and fuller notes are provided in Schedules A to M, where it is felt that more detailed information would be helpful, or to explain how each of the Practices is managed.

Whilst it is envisaged that the Treasury Management Practices will not change unless CIPFA's guidance were to be amended, the notes in the Schedules will be subject to regular review and amended where necessary in line with new regulation, guidance, market developments, or any other factors which may from time to time affect the operations of the treasury management function. Any suggested amendments will be brought to a monthly treasury management meeting, and will be ratified by the Director of Finance & Performance (Section 151 Officer)

Kevin Nacey
Director of Finance & Performance (Section 151 Officer)

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SCHEDULES TO THE TREASURY MANAGEMENT PRACTICES

TMP1 RISK MANAGEMENT

General statement

The responsible officer, currently the Director of Finance & Performance (Section 151 Officer), will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation’s objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*.

In respect of each of the following risks, the arrangements, which seek to ensure compliance with these objectives, are set out in the appendix to this document.

[1] Credit and counterparty risk management

SCC regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

[2] Liquidity risk management

SCC will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

SCC will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

[3] Interest rate risk management

SCC will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements*.

It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

[4] Exchange rate risk management

It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

[5] Refinancing risk management

SCC will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.

[6] Legal and regulatory risk management

SCC will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 [1] C*redit and counterparty risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

SCC recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[7] Fraud, error and corruption, and contingency management

SCC will ensure that it has identified the circumstances, which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

[8] Market risk management

SCC will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 Performance measurement

SCC is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation’s stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the schedule to this document.

TMP3 Decision-making and analysis

SCC will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP4 Approved instruments, methods and techniques

SCC will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 *Risk management.*

Where SCC intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. SCC will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements.

SCC considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when SCC intends, as a result of lack of resources or other circumstances, to depart from these principles, the responsible officer will ensure that the reasons are properly reported in accordance with TMP6 *Reporting requirements and management information arrangements*, and the implications properly considered and evaluated.

The responsible officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The responsible officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The responsible officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the responsible officer in respect of treasury management are set out in the schedule to this document. The responsible officer will fulfill all such responsibilities in accordance with the organisation’s policy statement and TMPs and, if a CIPFA member, the *Standard of Professional Practice on Treasury Management.*

TMP6 Reporting requirements and management information arrangements

SCC will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum:
SCC (i.e. Full Council) will receive: -

- An annual report on the strategy and plan to be pursued in the coming year
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the SCC treasury management policy statement and TMPs.

The Senior Management Team will receive regular (monthly) monitoring reports on treasury management activities and risks.

The body responsible for scrutiny, such as audit or scrutiny committee, will have responsibility for the scrutiny of treasury management policies and practices.
Local authorities should report the treasury management indicators as detailed in their sector specific guidance notes.

The present arrangements and the form of these reports are detailed in the schedule to this document.

TMP7 Budgeting, accounting and audit arrangements

The responsible officer will prepare, and SCC will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk management*, TMP2 *Performance measurement,* and TMP4 *Approved instruments, methods and techniques.* The responsible officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 *Reporting requirements and management information arrangements.*

SCC will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP8 Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of SCC will be under the control of the responsible officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1 [2] *Liquidity risk management.*

The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP9 Money laundering

SCC is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this, are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 Training and qualifications

SCC recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements.

The responsible officer will ensure that Council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The present arrangements are detailed in the schedule to this document.

TMP11 Use of external service providers

SCC recognises that responsibility for treasury management decisions remains with the Council at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons, which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over-reliance on one or a small number of companies.

Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the responsible officer, and details of the current arrangements are set out in the schedule to this document.

TMP12 Corporate governance

SCC is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

SCC has adopted and has implemented the key principles of the Code. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

TMP1: RISK MANAGEMENT SCHEDULE A

1.1 Credit and counterparty risk management

Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources.

As a holder of public funds, the Council recognises its responsibility to the prudent management of public funds, and follows relevant Government guidance. The Office of the Deputy Prime Minister, (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003. This has been revised and revisions are effective from 1st April 2010. The overriding aim of the guidance is to encourage authorities to invest prudently, without burdening them with detailed prescriptive regulation.

The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). The generation of investment income is distinct from these prudential objectives and is accordingly not a matter for the guidance. However, that does not mean that authorities are recommended to ignore such potential revenues. Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities. This widely-recognised investment policy is sometimes more informally and memorably expressed as follows:

__S__ecurity - __L__iquidity -__Y__ield …in that order!

Consequently, SCC will seek to optimise returns commensurate with the management of the associated risks.

1.1.1 Criteria to be used for creating and managing an approved counterparty list and limits

The Director of Finance & Performance (Section 151 Officer) will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct criteria comprising time, type, sector and specific counterparty limits. Members will approve criteria at least annually, as part of the AIS/TMSS.

Credit ratings remain a key source of information, but it is important to recognise that they do have limitations. Credit ratings are only used as a starting point when considering credit risk.

Officers will use credit rating criteria in order to assist selection of creditworthy counterparties for placing investments with. Credit ratings will be used as sourced from all of the following credit rating agencies: -

Fitch Ratings
Moody's
Standard & Poor's

The Council will use ratings and information from all three ratings agencies where available (some institutions are only rated by one agency, some by two, some by all three), as part of its counterparty criteria.

SCC will remain vigilant to changes in ratings, with reference to information available on the website of the three rating agencies and other sources. All ratings for any proposed counterparty will be verified on the day, before any investment is made. The only exception to this will be when an additional deposit of less than £5m is made to an existing call, or money market fund account.

If a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. Changes to ratings of current and most often used counterparties are also highlighted at the monthly TM meeting. Any changes to ratings that put the counterparty below the rating criteria whilst they hold a deposit will be brought to the attention of the Director of Finance & Performance (Section 151 Officer) immediately, with an appropriate response decided on a case-by-case basis.

If any counterparty is placed on Rating Watch Negative, further deposits will be suspended until the reasons have been established. Further action will depend on the current rating and possible re-rating. This will be closely monitored with an appropriate response decided on a case-by-case basis.

Sovereign credit ratings will be monitored and acted on as for financial institution ratings.

Current counterparty criteria can be found in the AIS within the Treasury Management Strategy Statement (TMSS) that is agreed by Full Council each year.

1.1.2 Approved methodology for changing limits and adding/removing counterparties

All ratings of currently approved counterparties are reported at the monthly TM meeting. Proposals for any new counterparties will be discussed and agreed at this meeting. Email confirmation, or a letter to the counterparty will be obtained from the Director of Finance & Performance (Section 151 Officer), and the decision recorded in the minutes of the meeting. Limits are approved annually as part of the AIS and any revision to these would require Full Council approval.

1.1.3 List of approved counterparties and date of formal approval

In order to ensure that the approved counterparty list is at all times up to date, a separate schedule will be kept (Schedule N). As soon as a change is authorised by the Director of Finance & Performance (Section 151 Officer), this will be updated.

1.1.4 Country, sector, and group listings and limits

These form part of the AIS that is approved by Full Council each year.

1.1.5 Use of credit rating agencies' services

SCC is a registered user of all three stated rating agency websites. It does not subscribe to the detailed research element, but has free access to all ratings, and notification of ratings changes.

1.1.6 Use of other sources of information for risk assessment

To supplement information from ratings agencies, relevant information from various publications is continuously garnered and assessed to help build a bigger picture, to help identify generic and specific counterparty risk.

As had previously been the case with SCC, and is now a requirement of the revised CLG guidance, SCC will use a range of indicators to assess counterparties, not just credit ratings. Among other indicators to be taken into account will be:-

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Government Guarantees and Support, including ability to support.
- Share Price of listed institutions.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

Supplementary information is sourced daily by reference to the quality press, Internet sources, Bloomberg terminals, and emails from broking and investment houses. There is also regular ongoing contact with a panel of money market brokers, money market fund managers, and other investment industry specialists.

1.2 Liquidity risk management

Liquidity risk is the risk that cash will not be available when it is required. This can jeopardise the ability of SCC to carry out its functions or disrupt those functions being carried out in the most cost effective manner. The Director of Finance & Performance (Section 151 Officer) will therefore have sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. He will also seek to ensure that SCC cash flow forecasting gives as accurate a picture as possible of the movement and timing of income and expenditure and the resulting residual daily cash balances.

1.2.1 Amounts of approved minimum cash balances and short-term investments

The Treasury Management section shall seek to minimise the balance held in the Council's main bank accounts at the close of each working day. Borrowing, calling on Call A/c or Money Market Fund balances, or lending shall be arranged in order to achieve this aim.

1.2.2 The County Council has the following facilities available: -

- Standby facilities – SCC operates a number of call accounts, each with differing features in relation to minimum balances to be maintained, number of permitted withdrawals during certain periods, and rates paid. SCC will retain balances within these accounts only when it is more advantageous than placing them on short-term deposits.

- Bank overdraft arrangements - An overdraft at 1.75% over base rate has been agreed as part of the banking services contract. The overdraft is assessed on a group basis for the Council's accounts, and is agreed annually via a formal document signed by the Director of Finance & Performance (Section 151 Officer).

- Short-term borrowing facilities - The Council can access temporary loans through approved brokers on the London money market.

- Insurance/guarantee facilities - There are no specific insurance or guarantee facilities as the above arrangements are regarded as being adequate to cover all unforeseen occurrences.

1.2.3 Policy on borrowing in advance of need

The overriding objective for all approved borrowing is that it will be carried out in line with the CIPFA TM Code, i.e. that performance measurement should consider risk as well as return (borrowing rate). Priority will be given to risk management, and then the pursuit of minimising rate. There are many circumstances that may force borrowing at rates higher than the lowest achievable rate, but may be directly attributable to good risk management or differing risk tolerances. These may include:-

- Taking loans of a stated maturity regardless of rate to ensure the desired maturity profile and thereby reduce refinancing risk.
- Taking Lender's Options Borrower's Option (LOBO) loans with greater regard to the structure rather than the cheapest rate where optionality exposes the Authority to refinancing, liquidity, and interest rate risk.
- Taking LOBO loans that dovetail with existing LOBO optionality.
- It may not be policy to borrow in advance of need even though it may be generally accepted that rates will go higher in the near future.
- It may be prudent to wait until capital expenditure has been incurred before loans are taken, even though rates may increase in the interim.

Actual borrowing undertaken and the timing will depend on timing of income and capital expenditure, interest rate forecasts, and market conditions during any given year. This may include borrowing in advance if after suitable risk analysis (including evaluating the cost of carry), market conditions and interest rates are deemed advantageous at that time. The short-term investment of these monies, until they are needed, will follow the same rigorous policies and criteria as the rest of the Council's investment balances.

1.3 Interest rate risk management

1.3.1 Interest Rate Monitoring

Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in the income contained in the annual estimates. The Director of Finance & Performance (Section 151 Officer) will seek to minimise this risk by continuously monitoring interest rates, and particularly the economic indicators that influence their movement. As well as daily contact with a number of brokers, the opinions of expert analysts are sourced through various market publications.

The direction and timing of potential interest movements and their implications for SCC are discussed at the monthly TM meeting. A 'house view' is then taken, and recorded in the minutes.

1.3.2 Interest Rate Strategy

Appropriate strategy, limits and trigger points are set in light of interest rate expectations, and are incorporated into the Treasury Management and Annual Investment Strategy Statements (together with the Prudential Indicators, they form the body of the Treasury Management Strategy Statement or TMSS). Strategy, limits and trigger points will be monitored during the relevant year to identify whether modifications are required in light of actual movements in interest rates.

The annual Prudential Indicators via theTMSS will set out details of the following: -

- Approved interest rate exposure limits
- Upper limit for fixed interest rate exposure and
- Upper limit for variable interest rate exposure

1.3.3 Trigger points for borrowing/investments

Trigger points and other guidelines for taking advantage of changes to interest rate levels are discussed at the TM monthly meeting and decisions are recorded in the minutes.

Officers will review the Treasury Management Strategy Statement during the year to see whether any modifications are required in the light of actual movements in interest rates.

1.3.4 Policies concerning the use of instruments for interest rate management

- Forward dealing - Consideration will be given to dealing from forward periods dependant upon market conditions. When forward dealing is more than three months forward, the approval of the Director of Finance & Performance (Section 151 Officer) is required or in his absence, the Deputy Section 151 Officer (Strategic Manager-Finance Technical).

- Structured Investments - The Council may use Callable deposits, Snowballs, Escalators, Range Trades, or other such structured investments as it deems prudent, as part of its overall investment portfolio strategy. The limits for their use in any given year will be set out in the Annual Investment Strategy (AIS).

- LOBOs (borrowing under lender's option/borrower's option) - Use of LOBOs will be considered as part of the annual borrowing strategy. Specific approval of the Director of Finance & Performance (Section 151 Officer) is required (or in his absence, the Strategic Manager-Finance Technical).

An explanation of a LOBO loan, and the various structured investments mentioned can be found at schedule M.

1.3.5 Policy concerning the use of derivatives for interest rate risk management

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

1.4 Exchange rate risk management

Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council has a minimal exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currency for treasury management purposes. It will also seek to minimise what risk it does have by using the policies below.

1.4.1 Approved criteria for managing changes in exchange rate levels

As a result of the nature of the Council's business, the Council may have an exposure to exchange rate risk from time to time. This will mainly arise from the receipt of income or the incurring of expenditure in a currency other than sterling.

SCC maintains a Euro account with its current bankers. This allows income to be received without incurring exchange costs for each transaction. A number of one-off, and recurring monthly payments are also made from the account. A relatively small balance is maintained, for which interest is now received.

The Council will consider the use of a hedging strategy to control and add certainty to the sterling value of any transactions, if values are judged by the Director of Finance & Performance (Section 151 Officer) to be significant.

1.4.2 Policy concerning the use of derivatives for exchange rate risk management

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

1.5 Refinancing risk management

Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets.   These budgets have therefore been set at a level after considering as many factors and rate forecasts as possible and this risk has thus been reduced to a level that is perceived as acceptable.

1.5.1 Debt/other capital financing, maturity profiling, policies and practices

The Council will establish through its Prudential Indicators the amount of debt maturing in any year/period.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling to take place will include:

- The generation of cash savings at minimum risk
- To reduce the average interest rate
- To amend the maturity profile and /or the balance of volatility of the debt portfolio.

1.5.2 Projected Capital Investment Requirements

The Director of Finance & Performance (Section 151 Officer) will prepare a three-year plan for capital expenditure for the Council. This is approved by members. The capital plan will be used to prepare a three-year revenue budget for all forms of financing charges.

Under the new capital financing system, the definition of capital expenditure and long term liabilities used in the Code will follow recommended accounting practice.

1.5.3 Policy concerning limits on affordability and revenue consequences of Capital Financing

In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on Council tax. It will also take into account affordability in the longer term beyond this three-year period.

The Council will use the definitions provided in the Prudential Code for borrowing (83), capital expenditure (84), debt (86), financing costs (87), investments (88), net borrowing (89), net revenue stream (90), other long term liabilities (91).

1.6 Legal and regulatory risk management

Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss.

1.6.1 References to relevant Statutes and Regulations

The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The major relevant documents currently are:

- Local Government Act 2003
- CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2011
- CIPFA Treasury Management in the Public Services Codes of Practice and Cross-Sectoral Guidance Notes: Revised Edition 2011
- S.I. 2003 No.2938 Local Government Act 2003 (Commencement No.1 and Transitional Provisions and Savings) Order 2003 13.11.03
- S.I. 2003 No.3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and associated commentary 10.12.03
- S.I. 2004 No.533 Local Authorities (Capital Finance) (Consequential, Transitional and Savings Provisions) Order 2004 8.3.04
- S.I. 2004 No.534 Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2004 8.3.04
- Guidance on Investments ODPM November 2009, effective from 1/04/2010
- Requirement to set a balanced budget - Local Government Finance Act 1992 section 32 for billing authorities and section 43 for major precepting authorities.
- Local Government Finance Act 1988 section 114 – duty on the responsible officer to issue a report if the Council is likely to get into a financially unviable position.
- CIPFA Standard of Professional Practice on Treasury Management 1995
- LAAP Bulletin 55 CIPFA's Guidance on Local Authority Reserves and Balances
- The Non Investment Products Code (NIPS) - (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.
- Financial Conduct Authority's Code of Market Conduct (MAR1)
- PWLB annual circular on Lending Policy
- The Council's Standing Orders relating to Contracts
- The Council's Financial Regulations
- The Council's Scheme of Delegated Functions

1.6.2 Procedures for evidencing the Council's powers/authority to counterparties

The Council's powers to borrow and invest are contained in legislation as follows:

Investing: Local Government Act 2003, section 12
Borrowing: Local Government Act 2003, section 1

SCC will bring this to the attention of interested counterparties as necessary.
Evidence of the SCC scheme of delegation, and the individual officers authorised to deal on behalf of the Council is sent to new counterparties.

1.6.3 Required information from counterparties concerning their powers / authorities

Lending will only be made to counterparties who fulfill the prevailing counterparty criteria.

When lending directly to a new counterparty, a list of permitted contacts is requested, along with Standard Settlement Instructions (SSIs) and bank details on headed paper.

When lending via a broker we rely on the broker to provide bank details and payment instructions.

1.6.4 Statement on the Council's political risks and management of same

The Director of Finance & Performance (Section 151 Officer) shall take appropriate action with the Council, the Chief Executive, and the Leader of the Council to respond to and manage appropriately political risks such as change of majority group, leadership in the Council, change of Government etc.

1.6.5 Responsibility for ensuring legality of Treasury Management function

The Monitoring Officer is the Strategic Manager - Governance and Risk. The duty of this officer is to ensure that the treasury management activities of the Council are lawful.

The Chief Financial Officer (Section 151 Officer) is the Director of Finance & Performance; the duty of this officer is to ensure that the financial affairs of the Council are conducted in a prudent manner and to make a report to the Council if he has concerns as to the financial prudence of its actions or its expected financial position.

1.7 Fraud, error and corruption, and contingency risk management

Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements that identify and prevent losses through such occurrences.

1.7.1 Fraud, Corruption, and Anti-Money Laundering Policies and Practices

The Council has a fraud and corruption, and an anti-money laundering policy in place. All members of the Investments team are familiar with the policies, which are posted on the SCC Internet site.

The Council is committed to the use of procedures and practices that will reduce the risk of the above, and will therefore: -

- Seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal procedures that minimise such risks.
- Fully document all its treasury management activities so that there can be no possible confusion as to what proper procedures are.
- Staff will not be allowed to take up treasury management activities until they have had proper training in procedures and are then subject to an adequate and appropriate level of supervision.
- Records will be maintained of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out.

1.7.2 Details of systems and procedures to be followed, including internet services

Authority

1) The Scheme of Delegation to Officers sets out the delegation of duties to officers.
2) All loans and investments are negotiated by the Principal Investment Officer, or in his absence, the Funds and Investments Manager, the Senior Investment Officer or Deputy Senior Investment Officer (the dealer).
3) Cash movements and justification for Loan(s) are verified by one of a panel of checkers, with resulting CHAPS, BACS, International payments and Inter-Account Transfers being authorised by a designated senior finance officer, via Nat West proprietary on-line systems, using passwords and CHIP & PIN technology.

Procedures
A fully documented procedures guide is kept for reference. This provides a very brief and simplified outline of the key stages for daily Treasury Management.

1) Overall daily balances are determined from downloaded bank information. ENPA and SWRB balances are separately identified and transfers to or from the main SCC bank account are affected to bring balances back to zero.
2) Payments or receipts of loans or loan interest are identified via the Treasury Management database.
3) Other payments / receipts are identified from the cash flow element of the TM database and other sources.
4) Excess cash will be invested according to security of investment, liquidity needs and prevailing market rates. Shortfalls will be covered by money in call accounts or short-term borrowing.

Investment and borrowing transactions
1) A detailed register of all loans and investments is maintained in the TM database. This is updated immediately after loans have been agreed. Accuracy of this is verified by the daily checking process.
2) Written confirmation is received and checked against the dealer's records for the transaction. Any discrepancies are immediately reported to the dealer for resolution. This acts as a second verification for accuracy of the database.
3) A broker note showing details of the loan arranged confirms all transactions placed through brokers. Any discrepancies are immediately reported to the broker, for resolution.

Regularity and security
1) Lending is only made to institutions that fulfill the relevant counterparty criteria.
2) The TM database prompts the dealer that money borrowed or lent is due to be repaid.
3) All loans raised and repayments made go directly to and from the bank account of approved counterparties.
4) Counterparty limits are set for every institution that the Council invests with.
5) Brokers have a list of SCC counterparty criteria and named officials authorised to agree deals.
6) Counterparties with whom SCC deals directly have a list of officials authorised to agree deals.
7) There is a separation of duties in the section between dealers and the checking and authorisation of all deals.
8) No member of the treasury management team is an authorised signatory for payments made from any SCC account.

9) Payments are verified by one of a panel of checkers. Payments entered onto the Nat West proprietary system can only be authorised by nominated senior officers.
10) The Nat West Bankline system can only be accessed by password, and authorisation can only be achieved by using CHIP & PIN technology.

Checks

1) One of a panel of checkers verifies that all daily cash movements are accurate, complete, and duly authorised.
2) Entries to the loans database are checked for accuracy and completeness. Reports are presented showing loans outstanding and current balances with counterparties, highlighting the loans made that day, and their effect on balances held with counterparties.
3) Where investments are made, current ratings of counterparties are attached to loan documentation, giving the checker and ultimately the authoriser, opportunity to verify the counterparty creditworthiness.
4) Entries onto the Nat West system are checked for accuracy and completeness, giving an opportunity for challenge of details.
5) Bank reports are monitored and retained, showing the progressive status of payments. Any variances are immediately investigated and resolved.
6) A reconciliation of payments and receipts is carried out daily from the bank statement to the TM database, and periodically to the financial ledger.
7) Interest, both paid and received is periodically reconciled to bank statements and the financial ledger.

Calculations

1) The calculation of repayment of principal and interest notified by the lender or borrower is checked for accuracy against the amount calculated by the TM database.

Use of Internet Services

1) The Internet is used for a variety of functions performed during the course of treasury management. The application and the security of SCC instructions and data are paramount. To this effect, all proposed new systems are discussed and risk-assessed in conjunction with the Internal Audit team at SCC, prior to their use.

1.7.3 Emergency and Contingency Planning arrangements

Disaster Recovery Arrangements

All computer files are backed up on the dedicated Investments team server. All systems input are filed separately until a back up of data is taken each night. Having a dedicated server enables files to be accessed from remote sites.

In the event of massive systems failure, SCC has arrangements to go to various partner sites. Treasury Management canl be coordinated from the offices of Nat West, which offer access to systems, information, and personnel, or from home via VPN.

Pension Fund operations can also be coordinated from the offices of TDBC, or Taunton Library. The use of services via the Internet will facilitate these arrangements.

Should travelling to County Hall or other identified sites not be possible, best efforts would be made using home computers and web-based applications, along with mobile communications.

Easy access to hard copies of essential documents and contact details is maintained, to facilitate in an emergency.

1.7.4 Insurance cover details

The Council has 'Fidelity' insurance cover. This covers the loss of cash by fraud or dishonesty of employees.

The Council also has a 'Professional Indemnity' insurance policy, which covers loss to third parties from the actions and advice of its Officers, which are negligent and without due care. This cover is limited to £20m for any one event with an excess of £10,000 for any one event.

The Council also has a 'Business Interruption' cover as part of its property insurance.

1.8 Market value of investments risk management

Market risk is the risk of fluctuations in the principal value of the Council’s investments.

1.8.1 Details of approved procedures and limits for controlling exposure to investments whose capital value may fluctuate (Gilts, CDS, etc.)

Gilts, Commercial Paper, CD’s and Money Market Funds (MMFs) are among the products that SCC may use, that pose market risk.

For MMFs a maximum percentage is set in the counterparty criteria, as part of the annual AIS. For other tradable instruments, it is always the intention to hold to maturity. It is recognised that it may be prudent to sell and crystalise a loss, and in such circumstances approval would be obtained from the Director of Finance & Performance (Section 151 Officer)

TMP 2 PERFORMANCE MEASUREMENT SCHEDULE B

2.1.1 Evaluation and review of Treasury Management decisions

The Director of Finance & Performance (Section 151 Officer) has a number of approaches to evaluating treasury management decisions: -

- Monthly reviews carried out by the treasury management team
- Annual meetings with, and quarterly reports by Treasury Management advisors
- Annual and mid-year review as reported to Council
- Comparative reviews via CIPFA Benchmarking Club

2.1.2 Periodic reviews during the financial year

The Director of Finance & Performance (Section 151 Officer) and Strategic Manager – Finance Technical hold a treasury management review meeting with senior members of the investments team on a monthly basis, to review actual activity against the Treasury Management Strategy Statement and cash flow forecasts. This will include: -

- Evaluation of borrowing activity during the period under review
- Total debt including average rate and maturity profile
- Total investments including average rate and maturity profile
- Changes to the above from the previous review and against the TMSS
- Counterparty exposure
- Exposures relative to Prudential Indicators
- Future interest rates and strategy are discussed

2.1.3 Mid-year review

A Mid-year Review is submitted to Full Council, which reviews all activities involving the treasury management operation for the first six months of the year. This report contains the following: -

- Total debt and investments at the beginning of the year and at mid-year
- Borrowing activity for the 6-month period compared to strategy
- Investment activity for the 6-month period compared to strategy
- Explanations for variance between original strategies and activities
- Debt rescheduling undertaken in the period
- Actual borrowing and investment rates available through the period
- Comparison of return on investments to the investment benchmark
- Compliance with Prudential Indicators
- Other

2.1.4 Annual Review after the end of the financial year

An Annual Treasury Outturn Report is submitted to Full Council each year after the close of the financial year, which reviews all activities involving the treasury management operation. This report contains the following: -

- Total debt and investments at the beginning and close of the financial year and average interest rates

- Borrowing activity for the year compared to strategy
- Investment activity for the year compared to strategy
- Explanations for variance between original strategies and activities
- Debt rescheduling done in the year
- Actual borrowing and investment rates available through the year
- Comparison of return on investments to the investment benchmark
- Compliance with Prudential Indicators
- Other

2.1.5 Comparative reviews

When data becomes available, comparative reviews are undertaken to see how the performance of the authority on debt and investments compares to other authorities with similar size portfolios (but allowing for the fact that Prudential Indicators are locally set). Data used canl be sourced from: -

- CIPFA Treasury Management statistics published each year for the last complete financial year
- CIPFA Benchmarking Club –Quarterly reports
- Treasury Advisors

When comparing outcomes, it is most important to find out why any variance from other Local Authorities is occurring, and to understand the relative risks of the portfolios. In drawing any conclusions the Council will consider that the risk characteristics of other treasury management operations may differ from those of the Council's. Factors to consider are: -

- Use of different counterparties, by type and name
- Differing views on, and suitability of duration, at a portfolio and counterparty level
- Levels of cash to be invested
- Different advice of Treasury Advisors
- Availability and suitability of various instruments

2.2 Benchmarks and calculation methodology with regard to risk and return

2.2.1 Debt management

The overriding objective for approved borrowing is that it will be carried out in line with the CIPFA TM Code, i.e. that performance measurement should consider risk as well as return (borrowing rate). Priority will be given to risk management, and then the pursuit of minimising rate. There are many circumstances that may force borrowing at rates higher than the lowest achievable rate, but may be directly attributable to good risk management or differing risk tolerances. These may include:-

- Taking loans of a stated maturity regardless of rate to ensure the desired maturity profile and thereby reduce refinancing risk.
- Taking Lender's Options Borrower's Option (LOBO) loans with greater regard to the structure rather than the cheapest rate where optionality exposes the Authority to refinancing, liquidity, and interest rate risk.
- Taking LOBO loans that dovetail with existing LOBO optionality.
- It may not be policy to borrow in advance of need even though it may be generally accepted that rates will go higher in the near future.

- It may be prudent to wait until capital expenditure has been incurred before loans are taken, even though rates may increase in the interim.

There are simple performance benchmarking measures available, i.e. debt rate achieved in relation to average PWLB rates for the year, for any given maturity and type of loan. However, it is suggested that each loan be looked at individually to develop an appreciation of the factors influencing performance, with a view to improving the future processes of treasury decision-making.

CIPFA produces detailed reports of our performance compared with other authorities. Whilst these headline figures can be a useful guide in assessing performance, they should not be seen in isolation. It is important to also assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management. There are many factors that affect treasury performance that are not apparent from the CIPFA reports.

It will be highlighted that each authority will have different needs during any given year. For example, a large capital requirement in a year when borrowing rates are high can have an enormous adverse affect on the overall portfolio performance for years to come. Conversely, a high rate loan that drops out of a small portfolio can make performance look extremely impressive in a year when no activity was undertaken.

The CIPFA reports look at one year in isolation. LOBOs can be taken and reported with a reduced rate initially, but with a big increase after an initial period that is not apparent in the reporting period.

The above caveats aside, these reports can offer insight into specific areas of debt and can be used to challenge and inform prevailing strategy and tactics.

2.2.2 Investment

The overriding aim of SCC is in line with CLG guidance, i.e. to invest prudently. The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). It goes on… "Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities".

Ordinarily the Council would aim to achieve a performance benchmark such as 0.5% above 7-day Libid over a rolling 3-year period. However it would be prudent for the Council to suspend return-driven performance targets until such time that financial markets return to more normal operations..

The performance of investment returns is measured against the Local Authority universe, and a selected peer-group of nineteen similar Councils via the CIPFA Benchmarking Club.

Similar to the debt portfolio, these headline figures can be a useful guide in assessing performance, but should not be seen in isolation. It is important to take a wider view in relation to timeframes and overall risk management.

There may be different priorities to satisfy revenue or capital requirements. If revenue interest is the priority in a low interest rate environment, the need for extra yield may influence investment decisions.

Overall policy and risk appetite will differ, as will the techniques and tools used to achieve objectives, and as part of risk management.

2.3 Policy concerning best value in Treasury Management

2.3.1 Banking services

The Council's current banking arrangements are for a five-year contract starting in April 2015. Pricing is to be reviewed every three years, to ensure that tariffs, and volume of transactions used for tariffs continue to be value for money and appropriate respectively.

2.3.2 Money-broking services

In addition to direct dealing with counterparts, use is made of money broking services in order to make deposits or to borrow, and will establish charges for all services prior to using them.

An approved list of brokers will be established which takes account of both prices (if borrowing is required) and quality of services.

2.3.3 Consultants'/advisers' services

Arlingclose Ltd, have been treasury advisors to SCC since 2009. They provide ongoing independent analysis and advice on market and investment conditions, and the suitability of counterparties among other services. The full schedule of services they provide can be found at 11.1.3.

SCC recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". SCC has always performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team. This ensures that services provided by advisors can be challenged, and that undue reliance is not placed on them.

2.3.4 Policy on External Managers (Other than relating to Pension Fund)

The Council's policy at present is to not use External Managers. This position is reviewed on a regular basis.

The delegation of investment management, if appointed, to external managers will entail the following: -

- Formal contractual documentation;
- Agreement on terms for early termination of the contract;
- Setting of investment instruments, constraints/parameters/conditions
- Setting of investment counterparty limits;
- Setting a performance measurement benchmark and a performance target;
- Frequency of performance reporting;

- Frequency of meetings with investment managers;

The activities of any appointed external manager will be regularly reviewed by the Director of Finance & Performance (Section 151 Officer) and reported appropriately.

TMP 3 DECISION-MAKING AND ANALYSIS SCHEDULE C

3.1 Funding, borrowing, lending, and new instruments / techniques

3.1.1 Records to be kept

The Treasury section has a dedicated database system (Logotech), in which all investment and loan transactions are recorded. The following records will be retained: -

- Daily cash balance forecasts
- Rates available on the day, from two brokers (to support investment decision)
- Copy of dealing sheet highlighting rates quoted from direct counterparties, and that sufficient headroom is available for proposed investment
- Confirmation of counterparty ratings
- Deal ticket for all money market transactions
- List of outstanding investments and counterparty limits
- Brokers' confirmations for investment and temporary borrowing transactions
- Confirmations from borrowing / lending institutions
- Other documentation as required to support the decision, i.e. PWLB rates if LOBO taken, Libor rates for range trades.

3.1.2 Processes to be pursued

- Ongoing review of economic factors, and analysis of their impact re opportunities and threats to the debt and investment portfolios
- Cash flow forecasting and analysis
- Debt and investment maturity analysis
- Review of opportunities for debt restructuring
- Review of borrowing requirement to finance capital expenditure
- Performance information (e.g. monitoring of actual against budget for debt charges and interest earned).

3.1.3 Issues to be addressed

3.1.3.1 In respect of every treasury management decision made the Council will: -

- Above all be clear about the nature and extent of the risks to which the Council may become exposed
- Be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained
- Be content that the documentation is adequate both to deliver the Council's objectives and protect the Council's interests, and to deliver good housekeeping
- Ensure that third parties are judged satisfactory in the context of the Council's creditworthiness policies, and that limits have not been exceeded
- Be content that the terms of any transactions have been fully checked against the market, and have been found to be competitive

3.1.3.2 In respect of borrowing and other funding decisions, the Council will: -

- Evaluate economic and market factors to form a view on future interest rates so as to determine the manner and timing of decisions to borrow
- Consider the sources of borrowing, alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- Consider the merits and demerits of alternative forms of funding, including funding from revenue, leasing and private partnerships to minimise costs and risks
- Consider the ongoing revenue liabilities created, and the implications for the Council's future plans and budgets
- Seek to reduce the overall level of financing costs / smooth maturity profiles through debt restructuring

3.1.3.3 In respect of investment decisions, the Council will: -

- Consider the optimum period, in the light of cash flow availability and prevailing market conditions
- Consider the alternative investment products and techniques available, especially the implications of using any which may expose the Council to changes in the value of its capital
- Determine appropriate credit policy limits and criteria to minimise the Council's exposure to credit and other investment risks

SCHEDULE D

TMP 4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

4.1 Approved activities of the Treasury Management operation

- Borrowing
- Lending
- Debt repayment and rescheduling
- Consideration, approval and use of new financial instruments and treasury management techniques
- Managing the underlying risk associated with the Council's capital financing and surplus funds activities
- Managing cash flow
- Banking activities
- Leasing

4.2 Approved instruments for investments

As investment instruments are constantly being developed and evolved by financial institutions, staff will keep abreast of developments and report to the monthly TM meeting, those that it feels may be considered for use by SCC. The Director of Finance & Performance (Section 151 Officer) has the delegated authority to approve the use of any such investments, subject to what has been approved by members in the AIS/TMSS, and prudential limits.

Those currently used, or that are proposed to be used in the next year, will be detailed in the AIS, as part of the TMSS approved by Full Council each year.

4.3 Approved techniques

- Forward dealing
- The use of Snowballs, Range Trades, Escalators, Callable deposits, or any other structured investment approved by the Director of Finance & Performance (Section 151 Officer)
- LOBOs - lenders' option, borrowers' option borrowing instrument

4.4 Approved methods and sources of raising capital finance

Finance will only be raised in accordance with the Local Government Act 2003 and within this limit the Council has a number of approved methods and sources of raising capital finance. These are: -

On Balance Sheet	Fixed	Variable
PWLB (Loans issued by HM Treasury)	●	●
Market Loans (including LOBOs)	●	●
Market (temporary)	●	●
Local Authorities	●	●
Local Bonds	●	
Overdraft		●
Internal (capital receipts & revenue balances)	●	●

Other Methods of Financing

Government and EC Capital Grants
Lottery monies
PFI/PPP
Operating leases

Borrowing will only be done in Sterling. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The Director of Finance & Performance (Section 151 Officer) has authority to take the most appropriate form of borrowing from the approved sources.

4.5 Investment limits

The AIS sets out the limits and the guidelines for use of each type of investment instrument.

4.6 Borrowing limits

See the TMSS and Prudential Indicators for agreed annual limits.

4.7 Use of Derivatives

The revised CIPFA TM code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks.

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

In developing a risk management framework governing the use of derivatives, SCC Officers would need to: -

- Ensure full understanding of the product(s)
- Demonstrate the derivative transaction has reduced overall exposure to treasury risks
- Consider whether officers have the skills and experience to identify, evaluate and control the risks involved.

TMP 5 ORGANISATION, CLARITY AND SEGREGATION SCHEDULE E

OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

5.1 Limits to responsibilities / discretion at Council / Executive levels

- ✓ Full Council will approve the Prudential Indicators and revise them as and when necessary
- ✓ Full Council will receive and review reports on treasury management policies, strategies, and activities.
- ✓ The Director of Finance & Performance (Section 151 Officer) will be responsible for amendments to the Council's adopted clauses, treasury management policy statement and treasury management practices.
- ✓ The Director of Finance & Performance (Section 151 Officer) will approve the segregation of responsibilities
- ✓ The Director of Finance & Performance (Section 151 Officer) or Strategic Manager – Finance Technical will receive and review internal and external audit reports and put recommendations to the Audit Committee
- ✓ Approving the selection of external service providers and agreeing terms of appointment will be decided by the Director of Finance & Performance (Section 151 Officer)

5.1.1 Principles and practices concerning segregation of duties

Separate officers must undertake the following duties: -

Dealing	Negotiation and approval of deal – Dealer
	Receipt and checking of brokers confirmation note against loans diary – Finance Assistant
	Reconciliation of cash control account – Corporate Accounting Team (CATS)
	Bank reconciliation – CATS (2)
Checking	Verification of accuracy of information and legitimacy of payments - Panel of approved senior officers
Payment of Deal	Entry onto system - Dealer
	Approval and payment – Approved authorisers
Accounting Entry	Production of transfer note – Dealer
	Processing of accounting entry – Cashiers / CATS

5.1.2 Treasury Management organisation chart

Director of Finance & Performance
(Section 151 Officer)
↓
Strategic Manager - Finance Technical (Deputy Section 151 Officer)
↓
Investments Manager
↓
Principal / Senior Investment Officer
↓
Finance Assistant

5.2 Statement of duties / responsibilities of each treasury post

5.2.1 The Director of Finance & Performance (Section 151 Officer)

The Director of Finance & Performance (Section 151 Officer) will: -

- Submit budgets and budget variations in accordance with Financial Regulations and guidance.

- In setting the prudential indicators, the Director of Finance & Performance (Section 151 Officer) will be responsible for ensuring that all matters are taken into account and reported to the Cabinet so as to ensure the Council's financial plans are affordable, prudent and sustainable in the long term.

- Establish a measurement and reporting process that highlights significant variations from expectations.

- Make reports to the Cabinet under S114 of the Local Government Finance Act 1988 if the Director of Finance & Performance (Section 151 Officer) considers the Council is likely to get into a financially unviable situation.

- Recommend treasury management policy, strategy, and practices for approval, reviewing the same on a regular basis, and monitoring compliance.

- Submit treasury management reports as required to the full Council.

- Review the performance of the treasury management function and promote best value reviews.

- Ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.

- Ensure the adequacy of internal audit, and liaise with external audit.

- Recommend on appointment of external service providers in accordance with Council standing orders.

2) The Director of Finance & Performance (Section 151 Officer) has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.

3) The Director of Finance & Performance (Section 151 Officer) may delegate his power to borrow and invest to members of his staff. The Treasury Management Team must conduct all dealing transactions, or staff authorised by the Director of Finance & Performance (Section 151 Officer) to act as temporary cover for leave/sickness.

4) The Director of Finance & Performance (Section 151 Officer) will ensure that Treasury Management Policy is adhered to, and if not will bring the matter to the attention of elected members as soon as possible.

5) Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the Director of Finance & Performance (Section 151 Officer) to be satisfied, by reference to the County Solicitor and external advisors as appropriate, that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations.

6) It is also the responsibility of the Director of Finance & Performance (Section 151 Officer) to ensure that the Council complies with the requirements of The Non Investment Products Code (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.

The Director of Finance & Performance (Section 151 Officer) may delegate some or all of the above duties that do not fall under the responsibility of the Section 151 Officer, to the Deputy Section 151 Officer, currently the Strategic Manager – Finance Technical.

5.2.2 The Investments Team will be responsible for: -

1) Execution of transactions and conduct of other day-to-day activities in accordance with the Treasury Management Practices.

2) Adherence to agreed policies and limits.

3) Managing the overall treasury management function.

4) Ensuring appropriate segregation of duties.

5) Monitoring performance on a day-to-day basis.

6) Submitting management information reports to the Director of Finance & Performance (Section 151 Officer).

7) Maintaining relationships with third parties and external service providers and reviewing their performance.

5.2.3 The Monitoring Officer – The Strategic Manager – Governance & Risk

The responsibilities of this post will be: -

1) Ensuring compliance by the Director of Finance & Performance (Section 151 Officer) with the treasury management policy statement and treasury management practices, and that they comply with the law.

2) Being satisfied that any proposal to vary treasury policy or practice complies with law or any code of practice.

3) Giving advice to the Director of Finance & Performance (Section 151 Officer) when advice is sought.

5.2.4 Internal Audit

The responsibilities of Internal Audit will be: -

1) Reviewing compliance with approved policy and treasury management practices.

2) Reviewing division of duties and operational practice.

3) Assessing value for money from treasury activities.

4) Undertaking probity audit of treasury function.

In all cases, audits will be conducted using a risk-based approach, identifying, assessing, and recommending mitigation actions relating to treasury management risks.

5.3 Absence cover arrangements

In the absence of the Principal Investment Officer, the responsibility for day-to-day operations of the Treasury Management function rests with the Investments Manager, or the Senior Investment Officer and Deputy.

5.4 Dealing limits

To ensure flexibility and maximum continuity, there are no dealing limits for individual posts

5.5 List of approved brokers

A list of approved brokers is maintained within the Treasury Management Team and a record of all transactions recorded against them. See TMP 11.1.2.

5.6 Policy on brokers' services

It is the Council's policy to allocate business between brokers on an equitable basis whenever possible. However, for similar levels of counterparty risk and liquidity, the broker with the most advantageous rate will be used.

5.7 Policy on taping of conversations

It is the Council’s policy not to tape conversations with counterparties or brokers.

5.8 Direct dealing practices

The Treasury Management team deal direct with counterparties in addition to the use of money brokers. A copy of the counterparty Standard Settlement Instructions (SSIs) is required before funds are placed.

5.9 Settlement transmission procedures

All settlements are dealt through the Clearing Houses Automated Payments System (CHAPS) via the SCC bankers’ proprietary system. After checking for accuracy and authenticity of counterparty bank details by the checker, one of a pool of authorised signatories sends the payment raised by the Dealer.

5.10 Documentation requirements

For each deal undertaken a record is entered into the TM database, giving details of dealer, amount, period, counterparty, interest rate, dealing date, payment date(s), and broker. A print of each deal is attached to the pack of papers along with a revised balances outstanding report and a revised counterparty limits report. Prints of the proposed counterparty rating(s) are also attached. These documents are verified before payments are sent.

Any breach of counterparty limit is referred to the Director of Finance & Performance (Section 151 Officer) or other senior officer, who has the discretion to authorise the breach, dependent on circumstances.

5.11 Arrangements concerning the management of counterparty funds

SCC has a contract to provide treasury management services to the Police and Crime Commissioner for Avon and Somerset. It manages these funds on a segregated basis under contractual arrangements.

SCC manages funds on behalf of Exmoor National Park Authority, and the South West Regional Board. This money is managed on an aggregated funds basis under terms agreed in a Service Level Agreement.

SCC manages funds of other public or not-for-profit organisations via the Comfund. Specified terms and conditions are agreed and signed by participating bodies.

SCHEDULE F

TMP 6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGMENTS

6.1 Annual Treasury Management Strategy Statement

The TMSS sets out the specific expected treasury activities for the forthcoming financial year. This strategy will be submitted to Full Council for approval before the commencement of each financial year. It will also be made available to the Audit Committee.

The formulation of the annual TMSS involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter-term variable interest rates. For instance, the Council may decide to postpone borrowing if fixed interest rates are expected to fall, or borrow early if fixed interest rates are expected to rise.

The TMSS is concerned with the following elements: -

- Current Treasury portfolio position
- Borrowing requirement
- Borrowing strategy
- Debt rescheduling
- Investment strategy
- Prudential Indicators
- Any extraordinary treasury issue

The TMSS will take into account expected moves in interest rates against alternatives (using all available information such as published interest rate forecasts where applicable), and consider sensitivities in different scenarios.

6.2 Prudential Indicators

The Council approves before the beginning of each financial year a number of treasury limits which are set through Prudential Indicators.

The Director of Finance & Performance (Section 151 Officer) is responsible for incorporating these limits into the annual TMSS, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the Director of Finance & Performance (Section 151 Officer) shall submit the changes for approval to the Council.

6.3 Mid-year review of activity

A mid-year report will be presented to Full Council at the earliest practicable meeting after the end of the first half of the financial year. This report will include the following: -

- ✓ Movement in the debt and investment portfolios during the first six months
- ✓ Significant transactions executed
- ✓ Measurements of performance
- ✓ Monitoring of compliance with approved policy, prudential limits, practices and statutory / regulatory requirements, and reporting of any deviations
- ✓ Risk management

6.4 Annual report on Treasury Management activity

An annual report will be presented to Full Council at the earliest practicable meeting after the end of the financial year. This report will include the following: -

- ✓ A comprehensive picture for the financial year of all treasury policies, strategies, activities and results
- ✓ Movement in the debt and investment portfolios during the year
- ✓ Significant transactions executed
- ✓ Measurements of performance
- ✓ Monitoring of compliance with approved policy, prudential limits, practices and statutory / regulatory requirements, and reporting of any deviations
- ✓ Risk management

6.5 Management information reports

Management information reports will be prepared at regular intervals by the Treasury Management Team and will be presented to the Director of Finance & Performance (Section 151 Officer) at monthly meetings. The reports are used to inform discussion on current, future, and potential risks, past performance and future tactics and operations. They focus on the risks to the achievement of TM objectives, and the tools, techniques, and tactics to mitigate risks.

Management reports will contain the following information: -

1) Movements in interest and money market rates and the yield curve
2) Movements in SCC cash, cash balances, and types of deposit made
3) Performance of investments
4) Comfund performance and details of investments made
5) Current debt portfolios, including analysis of market loans
6) Movements in PWLB and market rates and opportunities / threats arising
7) Current and changes (actual and potential) to ratings of current and potential counterparties
8) Analysis of risk metrics for investment portfolios
9) Compliance with Prudential limits and other stated policies, strategies, codes of practice, and practices
10) Any other treasury management business

SCHEDULE G

TMP 7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

7.1 Statutory / Regulatory requirements

The accounts are drawn up in accordance with the Code of Practice on Local Authority Accounting in Great Britain that is recognised by statute as representing proper accounting practices. The Council has also adopted in full the principles set out in CIPFA's 'Treasury Management in the Public Services - Code of Practice' (the 'CIPFA Code'), together with those of its specific recommendations that are relevant to the Council's treasury management activities.

7.2 Accounting Practices Standards

Due regard is given to the CIPFA Code of Practice on Local Authority Accounting Practices.

7.3 Sample budgets / accounts / Prudential Indicators

The Director of Finance & Performance (Section 151 Officer) will prepare a three-year medium term financial plan with Prudential Indicators for treasury management, which will incorporate the budget for the forthcoming year and provisional estimates for the following two years. This will bring together all the costs involved in running the function, together with associated income. The Director of Finance & Performance (Section 151 Officer) will exercise effective controls over this budget and monitoring of performance against Prudential Indicators, and will report upon and recommend any changes required in accordance with TMP6.

7.4 List of information requirements of external auditors

- Reconciliation of loans outstanding in the financial ledger to Treasury Management records
- Maturity analysis of loans outstanding
- Certificates for new long term loans taken out in the year
- Reconciliation of loan interest, discounts received and premiums paid to financial ledger by loan type
- Calculation of loans fund interest and debt management expenses
- Details of interest rates applied to internal investments
- Calculation of interest on working balances
- Interest accrual calculation
- Principal and interest charges reports from the Treasury Management system
- Analysis of any deferred charges
- Calculation of loans fund creditors and debtors
- Mid-year and Annual Treasury Outturn Reports
- Treasury Management Strategy Statement and Prudential Indicators
- Information of charges to the Income & Expenditure account in respect of MRP analysed into its constituent parts
- Details of any amounts held on behalf of external bodies and movements in those funds during the year.

TMP 8 CASH AND CASH FLOW MANAGEMENT SCHEDULE H

8.1 Arrangements for preparing cash flow statements

Cash flow projections are prepared regularly. The annual and monthly cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received of new or revised amounts to be paid or received as and when they are known.

Cash flow is recorded on the TM database with as great an accuracy as is possible, to assist in analysis and better future predictions.

All efforts are made to contact various departments prior to the financial year in order to ascertain timings and amounts of grants and other income to be received, or payments to be made.

Cash flow forecasts are updated daily as information flows from payroll, creditors etc pass through the TM team for payment.

8.2 Bank statements procedures

The Corporate Accounting Team receives daily bank statements and a daily download of data from the bank. All amounts on the statement are checked to source data from Treasury Management documents as well as Payroll and Creditor information. The Corporate Accounting Team (CATS) allocates expenditure to codes daily, which helps to identify differences. Cashiers perform the same process for income. CATS also undertake formal bank reconciliation on a monthly basis.

8.3 Payment scheduling and agreed terms of trade with creditors

SCC policy is to pay creditors at the latest possible date within the terms of the creditor. The creditor system is able to apply different terms for each creditor. The Exchequer Team performs this function. The Exchequer team is also responsible for the arrangements for monitoring debtor and creditor levels.

There may be occasions where advantageous terms can be gained by paying in advance of contractual terms. The decision to enter into revised terms will remain with the senior officers responsible for the budget.

8.4 Procedures for banking of funds

All money received by an officer on behalf of the Council will without unreasonable delay be passed to the bankers to deposit in the Council's banking accounts. .

TMP 9 MONEY LAUNDERING SCHEDULE I

9.1 Procedures for establishing identity / authenticity of lenders

The Council does not accept loans from individuals.

All loans are obtained from the PWLB, other local authorities or from authorised institutions under the Financial Services and Markets Act 2000. This register can be accessed through the Financial Conduct Authority (FCA) website at www.fca.org.uk

When repaying loans, the procedures in 9.2 will be followed to check the bank details of the recipient.

9.2 Methodology for identifying deposit takers

In the course of its Treasury activities, the Council will only lend money to or invest with those counterparties that fulfill the counterparty criteria approved by Full Council, as part of the Annual Investment Strategy. Where these are deposits, they will only be placed with a Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits, is a Building Society incorporated in the UK, or is a passported EEA institution.. A 'List of Banks' is published by the Prudentioal Regulation Authority (PRA) and can be accessed through the Bank of England website http://www.bankofengland.co.uk/pra/Pages/authorisations/banksbuildingsocietieslist.aspx . The exceptions to this are other Local Authorities and the DMO.

Where a counterparty is contracted via a broker, the broker confirms bank details. Where SCC has previously used the counterparty, details are checked against those currently held. Any changes are confirmed by the broker and by the counterparty on headed paper. When a broker introduces a new counterparty, SSIs on headed paper are requested.

When dealing with counterparties direct, a copy of SSIs is requested, as well as a list of contacts that are authorised to transact and / or provide information.

All payment transactions are carried out via CHAPS, for making deposits or repaying loans.

9.3 Proceeds of Crime Act 2002 (POCA)

Please find below an explanation of the current responsibilities of local authorities: -

> *The Proceeds of Crime Act 2002 imposes an obligation on any person or other body that undertakes a regulated activity as defined by the Act to report any incident that leads them to suspect that an individual or other body is making transactions with the proceeds of any criminal activity. This is an extension of the obligations previously imposed principally on financial services organisations and employees under money laundering legislation. The money laundering legislation, as reinforced by the FSA guidance, made it clear that an organisation had to nominate a money laundering reporting officer, MLRO, through whom suspicious transactions had to be reported and it was incumbent on the MLRO to decide if these transactions had to be reported to the National Criminal Investigation Service (NCIS), being the police body charged with dealing with these matters.*

The question therefore arises as to whether organisations now caught under the provisions of the Proceeds of Crime Act (POCA) have to also nominate a MLRO. There is nothing that states that an MLRO has to be nominated and indeed, a number of organisations that are caught by POCA would not have a direct regulator to notify. However, it is equally clear that such organisations must have a process in place whereby employees can alert management of activities that may fall under POCA and that process must make it clear to whom an internal report has to be made. Therefore, whether called an MLRO or not, under their internal processes organisations need to appoint a senior officer (F.D., Treasurer, Head of Legal) to whom suspicions must be reported and who is responsible for deciding whether to pass the report to NCIS.
NCIS
PO BOX 8000
LONDON SE11 5EN

www.ncis.co.uk

The Director of Finance & Performance (Section 151 Officer) is conversant with the requirements of the Proceeds of Crime Act 2002 and will train the following staff in being diligent to be alert for suspicious transactions: -

- Treasury management
- Cashiers section
- Other as appropriate

The Council has appointed the Strategic Manager – Finance Controls & Standards to be the responsible officer to whom any suspicions that transactions involving the Council may include a party who is involved in criminal activity. Suspicious transactions will be investigated as far as the Council is in a position to do so or it is appropriate for the Council to do so, and if doubts remain, these transactions will then be reported to the National Criminal Investigation Service.

9.4 Other relevant Legislation

Money Laundering Regulations 2007 - SCC has written Anti Money Laundering, and Anti Fraud and Corruption Policies, which are available on the intranet. The Investments Team is aware of these policies.

Terrorism Act 2000 – Local Authorities are subject to full provisions

Bribery Act 2010 – Local Authorities should be mindful of its requirements

TMP 10 STAFF TRAINING AND QUALIFICATIONS SCHEDULE J

10.1 Details of approved training courses

SCC does not currently subscribe to membership of the CIPFA Treasury Management Network, but attends seminars on an ad hoc basis. to keep abreast of relevant industry and market developments, and to share best practice with practitioners from other Local Authorities and Public Services.

There is no list of approved training courses maintained, but sources of training and contents of courses and seminars are received frequently from a host of external suppliers. In line with the Council Line Management & Annual Review (LMAR), courses deemed suitable will be suggested and approved accordingly. These may be provided by CIPFA, ratings agencies, or money brokers etc.

10.2 Starting Qualifications

There is a stated minimum level of qualification needed, as part of each job description for the various posts within the Investments team.

The Council recognises the importance that all treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council operates a (LMAR) system, which identifies the training requirements of individual members of staff engaged in treasury related activities.

Additionally, training may also be provided on the job and it will be the responsibility of the Director of Finance & Performance (Section 151 Officer) to ensure that all staff under his authority receives any necessary training.

10.3 Statement of Professional Practice (SOPP)

As a member of CIPFA the Director of Finance & Performance (Section 151 Officer) is required to be committed to professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.

Other staff involved in treasury management activities who are members of CIPFA must also comply with the SOPP.

10.4 Details of qualifications & experience of treasury staff - As at May 2016

Investments Manager

- Has experience working within the financial and investment services industry in both the public and private sectors since 1996, and has been heading up the SCC Investments team since March 2003.
- Is a Chartered Financial Analyst and an Associate of the Society of Investment Professionals.
- Holds a BSc (Hons) degree in Accounting and Financial Analysis.

Principal Investment Officer

- Has worked in the SCC investments team since 1998, with the exception of 2 years in the SCC internal audit team.

- Holds a BA (Hons) degree in Business Administration
- Is AAT qualified
- Holds the Investments Administration Qualification from the Securities Institute.

Senior Investment Officer

- Has worked in the SCC investments team for 11 years, and a further 7 years in various accounting functions of SCC
- Is AAT qualified
- Holds the Investment Management Certificate.

10.5 Records of training received by treasury staff

Formal records of training received by treasury staff are kept by the individuals involved. All course material is kept for as long as it is deemed relevant.

10.6 Records of training received by those charged with governance

All new Councillors receive an overview of the treasury management function as part of their induction.

Training opportunities for members are highlighted each year in the TMSS. Invitations to attend CIPFA events relevant to Treasury Management are offered.

Records of any training received are to be kept by those charged with governance.

TMP 11 USE OF EXTERNAL SERVICE PROVIDERS SCHEDULE K

11.1 Details of contracts with service providers, including bankers, brokers, consultants, and advisers

11.1.1 Banking services

- Name of supplier of service is currently Nat West Bank
- The branch address is: 49 North Street, Taunton, TA1 1NB
- Contract commenced 1 April 2015 and runs for five years. Cost of service is variable depending on schedule of tariffs and volumes
- Payments due quarterly

A full tender conducted under EU procurement rules will be undertaken at the end of the current contract.

11.1.2 Money-broking services

In addition to direct dealing, the Council will use money brokers for temporary borrowing and investment and long-term borrowing. It will seek to give an even spread of business amongst the approved brokers where rates offered are the same, but the best rate achieved will be the primary factor.

The Principal Investment Officer, on an ongoing basis, evaluates the service levels of brokers and in the event that rates are equal, the broker that has been offering the best service will be given the transaction. Contact with an approved list of 5 brokers (below) is maintained. Appropriate recommendations to change the approved brokers list will be made to the Director of Finance & Performance (Section 151 Officer) at monthly TM meetings.

Current broker contacts: -

- Tullett Prebon
- Tradition UK Ltd
- Sterling International Brokers (Part of BGC Brokers)
- Intercapital (Europe) Ltd
- RP Martin

11.1.3 Consultants' / advisors' services

Treasury Advisor Services

Arlingclose were selected as Treasury Advisora to SCC In February 2009, and have retained the position after a full competitive tender in 2012. Under the schedule of services to be provided, they will: -

1. Provide assistance in compliance with the CIPFA Code of Practice on Treasury Management in respect of policy and strategy statements, Treasury Management Practice maintenance and the reports made to Committee, Cabinet, Scrutiny and Council.

2. Assist in the calculation and setting of the Council's Prudential Indicators.

3. Provide advice in monitoring the Council's internal treasury procedures.

4. Provide economic and interest rate forecasts.

5. Advise the Council on Investment Strategy and its execution.

6. Advise the Council on credit worthiness policy and reconciliation of Council's list of investment counterparties.

7. Hold an annual strategy and review meeting with the Council to set and review treasury strategy and monitor progress in response to changing economic, political and legislative events and circumstances

8. Provide advice and guidance within an agreed strategy on long-term borrowing as well as debt restructuring opportunities including the evaluation of the financial impact of activity on the General Fund in accordance with the Council's adopted treasury strategy, Prudential Indicators and relevant accounting standards.

9. Provide periodic reviews of progress and reassessment of the Council's financial objectives in light of prevailing interest rate forecasts, economic developments and any legislative changes that impact on management of the portfolio.

10. Assist in the monitoring of the Council's debt and investment portfolio performance.

11. Provide training opportunities to officers.

11.1.4 Leasing Consultancy Services

The Council currently uses Chrystal Consulting for leasing consultancy services. They are not paid a set fee, but earn their fees as a percentage of the savings that they make as a result of negotiating a better deal than that first offered by the lessor.

11.1.5 External Fund Managers

None used at present for Treasury Management purposes.

11.1.6 Credit rating agency

The Council does not subscribe to a credit rating service, but has free access to much ratings information through registration with all three major ratings agencies, Fitch, Moody's, and Standard & Poor's.

TMP 12 CORPORATE GOVERNANCE SCHEDULE L

12.1.1 List of documents to be made available for public inspection

The Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

It has adopted the CIPFA Code of Practice on Treasury management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

The following documents are available for public inspection: -

- Treasury Management Policy Statement
- Treasury Management Strategy Statement
- Annual Investment Strategy
- Annual Treasury Outturn Report
- Mid-year Outturn Report

- Annual Statement of Accounts
- Annual budget
- 3-Year Capital Plan

- Minutes of Full Council meetings

12.1.2 List of external funds managed on behalf of others and the basis for attribution of interest and costs

SCC has a contract to provide treasury management services to the Police and Crime Commissioner for Avon and Somerset. It manages these funds on a segregated basis under contractual arrangements.

SCC manages funds on behalf of Exmoor National Park Authority, and the South West Regional Board. These monies are managed on an aggregated funds basis in the name of SCC, under terms agreed in a Service Level Agreement with those bodies.

SCC manages funds of other public or not-for-profit organisations via the Comfund. Specified terms and conditions are agreed and signed by participating bodies.

EXPLANATION OF KEY INVESTMENT TERMS SCHEDULE M

LIBOR – London Interbank Offered Rate

LIBOR stands for London InterBank Offered Rate. LIBOR is an indicative average interest rate at which a selection of banks (the panel banks) are prepared to lend one another unsecured funds on the London money market
LIBOR is calculated for five currencies, across seven maturities. The official LIBOR interest rates are announced once a day at around 11:45 a.m. London time by ICE Benchmark Administration (IBA). They are trimmed averages of inter-bank deposit rates offered by designated contributor banks, for maturities ranging from overnight to one year..

There are between eight and sixteen contributor banks on each currency panel and the reported interest is the mean of the middle values (the interquartile mean). The rates are a benchmark rather than a tradable rate; the actual rate at which banks will lend to one another continues to vary throughout the day.

LOBO

A LOBO is a loan taken out against the issue of a Bond by the borrower, in this case Somerset County Council.

It gives the Lender (L) the Option (O) to vary the rate of the loan after a set initial period. If this option is exercised, the Borrower (B) has the Option (O) to agree to the new rate, or repay the loan without penalty.

Stepped LOBOs are simply a variation, which introduce an additional period into the agreement, and in doing so allow greater flexibility into the structure of the loan.

The providers of these funds are major banks who came into the Local Authority market around 1997. At this time the Public Works Loan Board restricted its lending to periods of 25 years, whereas previously it had loaned in periods of up to 60 years. The commercial market woke up to the fact that local authorities had large demands for long term funding, and also that Councils are very highly rated in terms of their creditworthiness.

Somerset started to use this new product in 1997, and now has a total of approximately £170m of such borrowings out of a total portfolio of £338.75m. The lenders are Barclays, FMS Wertmanagement, Dexia, KA Finanz, Landesbank Hessen-Thuringen, and Hypothekenbank.

In arranging new loans account is taken of the existing loans portfolio and the financing needs of the County Council in accordance with our usual risk-averse policies. We take particular note of when the lenders options fall due and plan our maturity profile on the assumption that we will repay the loan in full at the first option date so that we will not find ourselves in a compromised position of having to re-finance large sums in any given year. Our general policy on reacting to a lender exercising an option to raise the rate, is to repay and re-finance if necessary. This may be in the form of another market loan, PWLB loan, or temporary borrowing.

An added aspect with stepped loans is the ‘back end’ of the deal. An initial period at a lower rate is a bonus, and very useful to have to help the Revenue Budget. However, the prime consideration is ‘would we be happy to stay with the back end rate if it ran on to maturity? Typically we structure our loans such that the ‘back end’ is the same our lower than the longest available PWLB loan rate at the time that the loan is taken out and do this in preference to getting the cheapest rate before the step.

1) Callable Deposit

This is a very simple deposit that pays a rate higher than you would currently receive for the same period, but as the name suggests the borrower has the right to terminate the trade at pre-arranged dates in the future.

For example, a 3-year non-call 3-months deposit currently pays a rate of 5.5%.

In this example the borrower will pay you 5.5% for the first 3 months, and in 3 months time will decide whether to pay you the same rate for the next 3 months, or terminate the trade, and so on until maturity.

The borrower will pay 5.50% from today until 3 months time Guaranteed!
In 3 months time the borrower may pay you 5.5% for the next 3-month period. If this happens, in a further 3 months time the borrower may pay you 5.50% for the following 3 months, this process will continue until the maturity date of the deposit.

If the borrower does not wish to pay you 5.5% for the next period, the borrower then has the right to terminate the trade. This means that the borrower will either give you your money back with the accrued interest to that date, or both parties agree another callable trade, again at an enhanced rate in comparison to prevailing rates.

All aspects of the trade are negotiable, for example the term of the trade, the non-call period, the call periods etc, but each change will either have a positive or negative effect on the rate payable.

The bottom line on this deposit is that you get an enhanced rate compared to current market rates, the borrower can hold the lender to the full term, but can also cancel on the pre-agreed dates if they wish to. If they cancel the trade they may look to roll this into a new deposit, again at an enhanced rate compared to the market, but it is possible that the lender gets their money back early having achieved a better than market return in the period of the deposit.

The key risk to a callable deposit is that if rates fall, there is reinvestment risk, the risk that the borrower repays the deposit, and the lender is left to reinvest at the reduced prevailing rate. This is mitigated slightly, in that it is possible to enter a new callable deal at rates above prevailing rates, but by taking a callable loan, the lender has foregone the opportunity to lend longer for fixed periods.

A necessary consideration is the length of the loan. Similar to fixed-term deposits, if rates increase significantly during the period of the loan, the rate can be a drag on the rest of the portfolio.

2) Callable Range Accrual (Range Trade)

A Callable Range Accrual is so called because it is callable or cancellable by the bank after the initial period, as above. However, where it differs, is that interest accrues only as long as Libor (London Interbank Offer Rate, or another independently derived and published benchmark rate) stays within a pre-agreed range. The lender can choose the range, the non-call period, the Libor they wish to use, the call periods and the potential return they wish to receive.

A 3 years non-call 3 months will currently pay a rate of 11.00% as long as 3 month Libor stays within a range of 0% and 5.50%.
For any day that the Libor sets outside the chosen range, the lender will receive 0% for each day. If Libor then subsequently resets back within the range the lender will accrue again at the enhanced rate (in this case 11.00%)

It is possible to set the minimum guaranteed, so rather than receive 0% if Libor is outside the range, a minimum of 3% or 4% is payable. In this case, the rate paid if within Libor is reduced, in this case, to roughly 8.5%.

The bank has the right to cancel this trade after the first 3 months, and every 3 months thereafter.

With a range trade, the lender is backing his judgement on interest rate movements and in exchange for that can achieve a significantly enhanced return. This is done as part of portfolio management. The risk of rates going above Libor on a small part of the portfolio (and therefore none, or little payment on a range accrual) will be offset by the fact that the rest of the portfolio will be returning more than expected.

The key risk to a callable range accrual is obviously that the contractual Libor rate goes outside the specified range. It is possible to mitigate this risk by analysing the historical behaviour of any specified Libor relative to base rate. By taking a view on expected base rate (which is done on all deposits), a lender can minimise exposure, and choose a range to match his risk appetite.

As with all callable loans, there is reinvestment risk as stated above.

3) Snowball

A Snowball deposit takes a 'bearish' view on rates, i.e. that rates are going to fall faster (or rise slower) than the market expects. If this view proves correct, the interest coupon will increase or '*snowball*'. The snowball can be a useful tool for protecting a portfolio against falling cash yields.

The coupon for the first period is set at a fixed level on the trade date. Subsequent coupons then increase (or decrease) depending on how rates have actually moved over time, in comparison to a 'strike' level, which is also determined on the trade date.

The lender can choose the initial coupon, strike levels, and as for the Callable Range Accrual; the non-call period, the rate you wish to use and the call periods (snowballs may be issued as either callable or non-callable). Note that the coupon amount is determined at each payment date, rather than accruing on a daily basis.

To illustrate how this works, consider the following (hypothetical) example: Libor is currently at 6% and the market expects rates to remain there *but* you believe rates will fall to 5.50%.

You invest in the following snowball deposit paying you an initial Coupon of 7% for 3 months. Subsequent coupons are calculated as follows every quarter:

Previous Coupon + 6.25% - Libor (where 6.25% is your chosen strike level)

So let’s consider what happens for the next coupon if Libor does fall to 5.50%. It would be: 7% + 6.25% - 5.50% = 7.75%

On the other hand, if Libor instead rises to 6.50% the coupon would be:
7% + 6.25% - 6.50% = 6.75%

So the coupon rises if Libor falls below your strike level or falls if Libor rises above the strike. To complete the picture and to move on to the third coupon, the calculation, taking the first of the above alternatives, would be:
7.75% + 6.25% - Libor

If Libor fixes below 6.25%, the coupon continues to rise, or snowball.

The key risk to a snowball is that the specified Libor rate goes against the interest view of the lender. If this scenario continues through many call periods, the rate may snowball in reverse, or melt away. There would be an opportunity to reschedule the loan, but this would probably be at a punitive rate if rates were expected to go with the borrowers. As with range trade accruals, the risk of rates going above Libor on a small part of the portfolio (and therefore reduced payment on a snowball), will be offset by the fact that the rest of the portfolio will be returning more than expected.

As with all callable loans, there is reinvestment risk as stated above.

1.13 List of currently approved counterparties and date of formal approval

(Updated 25-05-2016)

Bank or Building Society	**Date Approved**	**Bank or Building Society**	**Date Approved**
Bank of Scotland Plc	01/01/2007	Bank of Nova Scotia	20-04-2016
Barclays Bank Plc	01/01/2007	National Australia Bank	20-04-2016
HSBC Bank Plc	01/01/2007		
Lloyds Bank Plc	01/01/2007		
National Westminster Bank	01/01/2007		
Nationwide Building Society	01/01/2007		
Royal Bank of Scotland Plc	01/01/2007		
Santander UK	01/01/2007		
Australia & New Zealand Bank	17-07-2012		
Standard Chartered (Suspended)	13-09-2012	**Sterling CNAV Money Market Funds**	
Svenska Handelsbanken AB	13-09-2012	Goldman Sachs	26-06-2009
Nordea Bank AB	13-09-2012	Invesco Aim	29-06-2009
Close Brothers Limited	02-05-2013	RBS Global Treasury	07-07-2009
Deutsche Bank AG (Suspended)	22-08-2013	Prime Rate	31-07-2009
Rabobank	22-08-2013	JP Morgan	09-10-2009
Development Bank of Singapore	29-07-2104	Insight	09-11-2009
United Overseas Bank	29-07-2104	Ignis (Standard Life)	18-11-2009
Goldman Sachs Investment Bank	29-07-2104	Blackrock	01-07-2011
Oversea-Chinese Banking Corp	20-04-2015	Deutsche	01-07-2011
Pohjola Bank	15-06-2015	LGIM	23-02-2012
Commonwealth Bank of Australia	06-08-2015		
Toronto Dominion	04-11-2015	**Other**	
Landesbank Hessen-Thuringen Girozentrale (Helaba)	04-11-2015	DMO	05/02/2009
Bank of Montreal	29-01-2016	Other Local Authorities	01/01/2007

Certified by the Director of Finance & Performance (Section 151 Officer)

…………………………………………………… Date …………………………

And the Deputy Section 151 Officer

…………………………………………………… Date ………………………...