7. TREASURY MANAGEMENT POLICY COUNTERPARTY LIST

REPORT OF:	Head of Finance, ICT and HR
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Wards Affected:	All
Key Decision	Yes

Purpose of Report

1. To consider the addition and/or deletion of counterparties to the Treasury Management Policy Counterparty Lists.

Summary

2. This report considers the permitted counterparty list for the Council and whilst maintaining the current list, qualifies the investments that can be made with two parties on that list. It is recommended that this be reviewed on an annual basis with a view to removing the qualification as soon as is reasonably practical.

Recommendations

3. It is recommended to Council that :

a) Santander (UK) PLC remain as a permitted counterparty for the present but that no investments be made with that bank for the present time.

b) the Co-Operative Bank remain as a permitted counterparty but that no new investments be made with that bank at the present time;

c) both of these restrictions to be reviewed at the next annual review of the permitted list.

Background

4. Members will recall that at the Council meeting of March 2013 a report was received setting out the Council's Treasury Management Strategy for the forthcoming year. Included within that report was a section on the status of Santander UK PLC, the UK arm of the Spanish bank of Santander, and the merits of that bank remaining as a permitted counterparty was discussed. This in itself followed on from a discussion at an Audit Committee in September 2012 where concern had been expressed by a Member about the financial standing of Santander UK given the nature of the financial issues in Spain.

5. This report re-examines the background to Santander's financial situation and recommends a pragmatic way forward for the medium term.

Discussion

<u>The Counterparty List</u>

6. This Council has always taken a pragmatic approach to defining and re-defining its counterparty lists. Whilst we have never relied solely on the opinion of credit rating

agencies or treasury management consultants, we have tended to take their views into account when drawing up our lists. Presently, our counterparty list includes amongst other bodies ; all local government bodies, some nationalised industries, the major UK clearing banks, whollly UK based banks such as Santander or Clydesdale Bank as well as money market funds and the Government itself, by way of the Debt Management Organisation (DMO). This has given us a good spread of risk as well as a better rate of return than if we had simply placed our monies with the Government.

Members may recall that at some recent dates, the rate of return on lending to the Government has been low, sometimes as low as 0.3%. We have therefore tended to balance risk and reward and use building societies which in the main are not credit rated by the agencies, but restrict lending to those building societies with assets of over £1billion. Our rationale for this is that whilst building societies are prodominantly lenders to the housing market, that market would have to fall by some 40% in order for the financial institutions to have difficulties with meeting their commitments. On the basis that this is very unlikely to happen, if not impossible, the placing of funds with those institutions does look to be of insignficant risk.

<u>The Market</u>

7. We should also take into account that Mid Sussex is not a major player in the financial money markets. Most of our deposits are of no more than one, possibly two million pounds and are placed for mostly 1-2 years and, more often, much shorter periods. It therefore could be considered that whilst these sums are of significance to us, they are relatively minor to the financial institutions to which we are investing. It therefore could be considered that the financial situtation would have to be dire indeed if these institutions were not able to repay our investment at maturity. Again, officers do not consider that this is a significant risk.

<u>Money Market Funds</u>

8. Members will be aware that the Council frequently places money with money market funds (MMF). These are in effect structured like a unit trust in that the underlying investment is spread across many different institutions and therefore dilutes the risk, whilst preserving an investment return. However, when placing our deposit with a money market fund we have no sense of where the fund itself is placing the monies. In effect this means that we are or could be indirectly investing with lesser rated institutions, or un-rated intitutions but we do have the sureity that the money market fund itself is very highly rated, often AAA rated. Thus, the notion that we can avoid investing in particular financial institutions is moot.

<u>Santander (UK) PLC</u>

9. The current situation with Santandar is unchanged. The Euro Zone is still facing some instability and low growth forecasts. However, the view of the market and our treasury management advisors is unchanged; their latest commentary emphasises “Santander UK’s “high” systemic importance to the UK which primarily reflects the bank’s very strong market position in the UK residential mortgages and savings market. In Standard & Poor’s view, its financial prospects are primarily linked to the UK environment in which it operates rather than the fortunes of the wider group. Standard & Poor’s note that Santander UK has no structural reliance on group funding and is self-supporting from a liquidity standpoint. Furthermore, Standard & Poor’s believe that Santander’s UK status as a regulated entity supervised intensively by the UK Financial Services Authority would likely limit it from providing

support to the parent that would impair its own financial strength. Standard & Poor's also understand that Santander UK would be unlikely to be legally drawn into the parent's bankruptcy proceedings should this occur."

10. From this it can be seen that the specialists' view of the bank is that it is of no specific risk of default or failure. It remains every much as good a credit risk as other UK banks. It therefore makes sense to retain this bank on the Council's permitted counterparty list. However, it would be prudent whilst the Euro Zone is still settling down after its recent turbulance, to restrict our lending to Santander UK and, for the meantime, not place any funds with this bank. This situation can be reviewed annually by this Committee.

The Co-Operative Bank PLC

11. The position of the Co-Operative Bank is slightly different. As Members will know the Co-Operative Bank is the Council's banker, and many millions of pounds pass through its accounts on a weekly basis. Our treasury management advisors' advice is that the Co-Operative Bank remains a viable bank for day-to-day banking but that we should restrict deposits with our bank and not place funds with them. This somewhat contradictory position is difficult to decode since whilst this Council does have £4 million on deposit with the bank for periods up to one year, on any one particular day we may have well over £4 million passing through our account.

12. The concern about the Co-Operative Bank stems mainly from its need to increase its liquidity, ie. to keep more in its reserves as a proportion of its total lending. As a mutual of course, its cannot go to the market to sell shares to increase its capital but instead it must rely on investors placing funds. That being so, the greatest risk is that it cannot raise sufficient funds to cover its liabilities, or its increased capitalisation requirements, but it is felt unlikely that it will not be able to return the Council's, or any other counterparties, investments.

13. However, officers consider that this leaves Mid Sussex in a similar position to that which it is in with Santander UK. Given the issues that the Co-Operative Bank faces it may be prudent to restrict any new lending to the bank whilst waiting for our current investments to mature at the appropriate time. We would also keep banking with the Co-Operative and we would review this on an annual basis also.

Other Changes

14 There are no other changes proposed to the Counterparty List. Officers have been considering a product that appeared to offer greater returns than the average market value, but these appeared to offer more risk inasmuch as the capital sum was not guaranteed. On that basis, this was not felt to be a product that could be endorsed for adoption by Mid Sussex.

Policy Context

15. The Counterparty List is an intrinsic part of the Treasury Management Policy and should be reviewed on an annual basis.

Other Options Considered

16. These are detailed within the report.

Financial Implications

17. This report has no financial implications.

Risk Management Implications

18. This report has no risk management implications beyond those set out within.

Equality and customer service implications

19. None

Other Material Implications

20. None.

Background Papers

None