Appendix 3

Explaining the revised CIPFA TREASURY MANAGEMENT AND PRUDENTIAL CODES 2017 and other treasury changes

1. CIPFA Codes

In December 2017, the Certified Institute of Public Finance Accountants (CIPFA) issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management.

one of the more significant revisions is in appendix 5.8. ‘The treasury management role of the chief financial officer’. The specific roles of this officer have been extended to include a series of new roles in respect of the capital strategy and also a specific role in respect of investment in non-financial assets.

CIPFA’s revised codes have now drawn a clearer separation between treasury and non-treasury investments and revised the role of the treasury management team. Treasury management teams are now recognised as being unlikely to have specialist skills in such areas as property investment, therefore periodic reporting by the treasury management teams to members are expected to focus solely on treasury (financial) investments and this TMSS does not therefore include any level of detail on non-treasury investments.

1.1. Implementation in 2018/19?

CIPFA has issued a statement that accepts that the issue of revised codes at such a late stage in the current 2018-19 budget cycle will make it very difficult for most authorities to fully implement both codes. Accordingly, full implementation is not expected until 2019-20 across all authorities. However, our treasury management advisors have advised that local authorities may wish to consider writing some form of high level summary report on non-treasury investments to deal with significant purchases, their objectives, how they have been appraised, how they have been financed, and what powers were used to undertake these purchases.

1.2. Capital strategy.

The codes require all local authorities to produce detailed Capital Strategies, though CIPFA accepts that authorities may not be able to implement this in the 2018-19 budget cycle. The Capital Strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability. The development of a Capital Strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

The Capital Strategy should be tailored to the authority’s individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The Capital Strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.

Officers have incorporated this Capital Strategy requirement within the usual Capital Programme and Resources report which is being submitted to Members alongside the Revenue Budget and the Treasury Management Strategy Statement (TMSS) and the Treasury Management Practices (TMPs) in February 2018.

1.3. Investments for longer than 365 days.

In its consultation, CIPFA indicated support for a change in the requirement to report on investments for longer than 364 days to longer than 365 days. The revised Codes do not include any mention of this change. However, it is likely that the DCLG will include this in its impending revised investment guidance to replace the 364 day stipulation in its previous investment guidance. Accordingly, this change has already been incorporated into the TMSS.

2. OUTSTANDING CONSULTATIONS

2.1. Investment guidance

The DCLG consultation on investment guidance closed on 22 December 2017 and so officers are currently waiting for the revised guidance to be issued. This will focus particularly on non-financial asset investments, which have been excluded from the TMSS. However, it is expected that the 364 day limit specified in the previous investment guidance will be changed to 365 days. This change is already included in the TMSS for February 2018/19.

2.2. MRP guidance

The DCLG consultation on MRP guidance also closed on 22 December 2017 and so officers are currently waiting for the revised guidance to be issued. This will focus particularly on expenditure on purchasing non-financial asset investments. As non-financial assets have been excluded from our TMSS template report, any changes in this area of MRP guidance are unlikely to result in any changes to the TMSS for 2018/19.

3. THE SEARCH FOR HIGHER RETURNS - a summary from our treasury management advisors

3.1. Background

We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy - reflected in a 0.5% Bank Rate. As a consequence, authorities are not getting a material return from deposits. Against this backdrop it is, nevertheless, easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures. In this respect, we are seeing an increase in investment “opportunities” being offered to clients or being discussed in the wider press. What then, should officers and members consider when these are offered?

3.2. Do not look at the return, look at the product.

We suggest that you “look under the bonnet” when considering pooled investment vehicles, although this applies to any investment opportunity. It is not enough that other councils are investing in a scheme or an investment opportunity: you are tasked, through market rules, to understand the “product” and appreciate the risks before investing. A quote from the Financial Conduct Authority puts the environment in context.

The main risks in the industry for the coming year are firms designing products that:

- *aren’t in the long-term interest of consumers*
- *don’t respond to their needs*
- *encompass a lack of transparency on what’s being sold*
- *lead to a poor understanding by consumers of risk*
- *shift toward more complex structured products that lack oversight.*

3.3. Alternative investment instruments

The particular asset classes we have spoken on at our seminars include the following:

- Ultra short dated bond funds
- Corporate Bonds - direct, passive and active external management
- Property Funds
- Equity Funds
- Multi Asset Funds

There are varying degrees of risks associated with such asset classes and these need comprehensive appreciation. It is not just credit risk that needs to be understood, but liquidity and interest rate / market risk as well, although these can often be intertwined. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk. By carefully considering and understanding the nature of these risks, an informed decision can be taken.

3.4. Property funds.

A number of our clients are actively considering, or have already commenced investing in property funds. Where not already undertaken, this may require an addition to your list of non-specified investments in your Annual Investment Strategy (AIS). The following words could be used to add this investment to your AIS.

Councils may also wish to specify an appropriate monetary limit based upon an assessment of your reserves and balances going forward. Each authority will also need to evaluate whether investing in a particular property fund will qualify as being capital expenditure or not. If it does qualify as being capital expenditure, then the following wording will need to include an additional reference to the capital nature of this transaction.

The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

3.5. Building societies

At the time of writing only five building societies have the necessary ratings to render them suitable for consideration by clients who follow our suggested credit assessment methodology. This is a limited number, as the great majority of building societies do not have credit ratings, while a few do have ratings but they are not high enough to qualify to get into one of our suggested colour bands. If clients wish to use building societies as part of their own strategy, then they may need to consider what additional metrics they will use to determine suitability and, importantly, how these will be monitored.

3.6. Challenger banks

The vast majority of local authorities do not include challenger banks in their counterparty lists. At present, they do not have credit ratings and so would fall outside of most investment strategy criteria. However, we expect that some of these entities may get ratings in coming years, so we will continue to keep this area under review.

3.7. MMFs

Please see our newsflash of 6 July 2017 explaining the reform of MMFs. As from 21 July 2018, there will be three structural options for existing MMFs – CNAV, LVNAV, and VNAV. Please amend your tables for approved investments to specify which types of MMFs are approved for use for investing in line with these categories.

3.8. Municipal Bond Agency

Clients may wish to mention this new development and to flag up that they may want to use this as a new source of borrowing.

3.9. Impact of MIFID II reforms from 3 January 2018

Markets in Financial Instruments Directive, or MIFID II, is designed to offer greater protection for investors and inject more transparency into all asset classes: from equities to fixed income, exchange traded funds and foreign exchange. It will apply to all financial services across the EU.

MIFID II separates fund managers into two categories, professional and retail. One of the most high-profile aspects of the legislation involves how professional asset managers pay for the research they use to make investment decisions in order to tackle a conflict of interest at the heart of financial trading. Until now, professional asset managers received research, including written reports and phone calls with analysts, for free, although the cost of this service was built into trading fees, which are usually paid by their retail clients. For the first time, fund managers will have to budget separately for research and trading costs, a move known as unbundling, and this means that some types on investment will only be available to those professional fund managers.

Under MIFID II, all local authorities are now classified as retail counterparties and have to consider whether to opt up to professional status and for which types of investments. However, for authorities like Rossendale, with under £10m in total investments, this option to opt up to professional status is not available. As retail investors, smaller authorities will need to consider whether they need to change their approach to investing, as some existing investment options may no longer be available to them. For Rossendale Borough Council, this will make no difference to the current investment strategy or policy.