Gateshead Council

AUDIT AND STANDARDS COMMITTEE
25 July 2016

Title of report: **Amendment to the Treasury Policy Statement and Treasury Strategy 2016/17 to 2018/19**

Report of: **Darren Collins – Strategic Director, Corporate Resources**

Purpose of the Report

1. This report asks the Audit and Standards Committee to review the proposed amendment to the Treasury Policy Statement and Treasury Strategy for 2016/17 to 2018/19 prior to consideration by Cabinet in September 2016.

Background

2. To provide a framework for the Strategic Director, Corporate Resources to exercise his delegated powers, the Council agrees a three year Treasury Management Policy and Treasury Strategy which is reviewed at the start of each financial year.

3. The current Strategy was approved by Cabinet on the 15th March 2016 and the Strategy states that any in year changes have to be reported and agreed by Cabinet on an exception basis. This report is to consider an in year change.

4 Following on from the recent vote to leave the EU, Capita, the Council's Treasury Advisers produced a note providing an update on recent action taken by credit ratings agencies on the UK sovereign rating. This was to ensure that Local Authorities who have sovereign criteria in their strategy review their policy and remove the UK from this criteria.

5 The current strategy requires that all countries in which the Council invests monies have a minimum country sovereign rating of AA+ and this includes the UK. However the relevance of this sovereign rating for the UK has been weakened due to the evolution of financial market regulations that has seen the link between sovereigns and their respective banks materially weakened.

6 The result of the breakage of the link has meant that there is little or no "sovereign uplift" to any major bank ratings in the UK and beyond.

7 The Council's Treasury Advisers, Capita have advised that the UK sovereign rating is currently not a constraining factor for any UK bank ratings and while there are negative implications for the UK, its economy and financial institutions as a result of Brexit, financial markets and the operators therein are materially stronger, in terms of capital and liquidity than they were ahead of the financial crisis.

8 The Governor of the Bank of England has stated "…the capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the Country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets."

9 The impact of Brexit may filter through to the individual bank ratings that the credit rating agencies supply. These ratings are regularly reviewed to ensure compliance with the current strategy. We will continue to review the UK banks in line with the current strategy and advice from our Treasury advisers.

10 Failure to adopt this amendment could mean that the Council is in a position where no deposits can be made with UK Banks.

Proposals

11 The Committee is asked to review the amendment to the Treasury Policy and Treasury Strategy in Appendix 1 reflecting the removal of the UK from the requirement to have AA+ sovereign rating.

Recommendation

12 The Committee is asked to review the recommendations on the Treasury Policy and the Treasury Strategy and submit any comments to Cabinet.

Change required:

- Section 6. Investment Strategy 2016/17 to 2018/19 to change to reflect the exclusion of the UK from the requirement to have a sovereign rating of AA+ as shown in appendix 1.

For the following reason:

- To ensure that the Council fully complies with the requirements of good practice as recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in its Code of Practice on Treasury Management and Prudential Code for Capital and the Department for Communities and Local Government (CLG), Guidance on Local Government Investments.

6.12 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA+ to all banks outside the UK. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background, will still have an influence on the ratings of a financial institution.

6.13 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

Creditworthiness Policy

6.14 The Council uses the creditworthiness service provided by Capita Asset Services to assess the creditworthiness of counterparties. The service provided by Capita Asset Services uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following information as overlays which are combined in a weighted scoring system:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap spreads, financial agreements that compensate the buyer in the event of a default, which give an early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries outside the UK.