CIPFA The Chartered Institute of Public Finance & Accountancy

Consultation on Proposed Changes to the Treasury Management Code and Cross Sectoral Guidance Notes

Closes 30th September 2017

INTRODUCTION

The first version of the *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, CIPFA, 2011* (TM Code) was published in 2001 with a recommended start date of 1 April 2002. The TM Code provides a framework for effective treasury management in public sector organisations.

The TM Code defines treasury management as follows:

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.

Whilst the TM Code covers all public services, it is primarily designed for the use of local authorities (including police and crime commissioners and fire authorities), providers of social housing, higher and further education institutions and the National Health Service. Local authorities in England, Scotland and Wales are required to "have regard" to the TM Code.

The TM Code was last updated in 2011. Since then the landscape for public service delivery has changed significantly following the sustained period of reduced public spending and the developing localism agenda. There are significant treasury management portfolios within the public services; for example, as at 31 March 2016 UK local authorities had outstanding borrowing of £88bn and investments of £32bn.

It was therefore considered an appropriate time for the TM Code to be reviewed and for views to be sought from stakeholders of areas where it can be strengthened or amended. An initial consultation was therefore launched on 22 February 2017 and closed on 21 April 2017 with responses specifically welcomed from local authorities, providers of social housing, higher and further education institutions and the National Health Service. Three questions were posed covering the TM Code's adoption by public service organisations, the relevance of the principles and any areas not fully covered by the principles.

FEEDBACK FROM CONSULTATION AND PROPOSED CHANGES

The first consultation question sought to establish the extent to which the TM Code was adopted outside of local authorities. Unfortunately, despite raising the profile of the consultation, there were limited responses from public sector organisations outside of local authorities. The three housing authorities and one university who responded had all adopted the TM Code. Of the 45 public service organisations who answered this question, all had adopted the TM Code.

Organisations were also asked to identify any practical implementation issues.

Treasury Management Indicators

Several respondents highlighted practical issues with the same three indicators; principal invested for longer than 364 days, interest rate exposures and maturity structure of borrowing. It is therefore proposed to make the following changes either in the Code itself or sector related guidance:

- Change the principal invested for longer than 364 days indicator to principal invested over 365 days in line with financial reporting definitions,
- Remove the interest rate exposure indictor and require TM Strategy to state how interest rate exposure is managed and monitored, and
- Extend the maturity structure of borrowing indicator to cover variable as well as fixed rate debt.

Q1: Do you agree with the proposed indicator changes?

Non Treasury Investments

A number of respondents queried the applicability of the TM Code to non-treasury management investments such as those made for regeneration or service objectives or those made under the "commercialisation" agenda. It was noted that such investments may not meet the security, liquidity and yield criteria required for purely "treasury management" investments. This area also links to the consultation on the Prudential Code for local authorities.

It is intended to clarify that the Code does cover all investments held primarily for financial returns, which may include some service investments. The annex to this document contains an extract of the substantive changes proposed to the code and in respect of non-treasury investments, attention is drawn to the introduction, policy statement and the new TMP 13 along with a requirement to maintain a schedule of non-treasury management investments alongside the treasury management strategy.

Q2: Do you agree with the clarification that the Code should cover all investments held primarily for financial returns and the proposed amendments to the Code set out in the annex?

Reporting

A number of respondents cited the reporting requirements of the TM Code as problematic. Issues raised included

- The suggestion that there would be benefits of permitting reporting to cabinet / executive rather than restricting to full council
- Timing of reporting problematic due to restrictions of full council committee cycles
- The difficulties of getting the correct balance between the level of detail, complexity and length of report
- The number of indicators and complex terminology do not aid understanding

It is therefore proposed to allow some reporting of detailed indicators and monitoring information to a committee or sub-committee whilst making clear that responsibility remains with the board/full council. The key changes are set out in the annex under clauses to be formally adopted (clause 2) and the cross sectoral guidance notes under organisation, clarity and segregation of responsibilities, and dealing arrangements.

Q3: Do you agree with the proposal to allow some delegation of reporting to a committee/sub-committee in order to promote more active engagement and with the subsequent changes proposed to the Code?

The second consultation question sought views as to the ongoing relevance of the TM Code's principles given the changing environment in which the TM Code operates. Of the 44 respondents to this question, all considered that the principles are still relevant. Some minor suggestions were made which will be incorporated into the Code where they aid understanding.

The third consultation question sought views as to whether respondents considered that there were any areas which were not covered by the principles. Of the 45 responses to this question, 24 indicated that there were areas which were not fully covered by the principles.

A number of areas relating to risk management were highlighted by respondents as requiring review, including execution and fiduciary risks, inflation risk, market risk and the general profile of risk. The risk section has been reviewed with some minor changes made to update the relevant sections where this aids understanding and it is intended that the changed reporting proposals will help to place an emphasis on the risks being managed and to allow these to put into the overall context of the organisation.

Some suggestions were made by respondents which related to principles, including linking to the Prudential Code, understandability, transparency and simplicity. The proposals for a Capital Strategy within the Prudential Code should improve the ability of organisations to make these links in their reporting and revised reporting requirements should aid understandability, transparency and simplicity.

A number of general suggestions were made by respondents as to areas which are not fully covered by the current principles, including borrowing coverage, MiFID II, Cost of Carry indicator, Liquidity measure, TM Policy being part of TMSS, Diversification Policy and Housing Association Guidance. These areas will all be picked up in future updates of sector specific guidance and references have been updated as necessary.

Q4 Are there any other comments you wish to make, including on the proposed substantive changes set out in the Annex?

Responses and Next Steps

CIPFA welcomes responses to all or part of the consultation, which should be made via email to matthew.allen@cipfa.org **.** The closing date for responses is 30th September 2017. Whilst respondents are encouraged as far as possible to meet this deadline to allow full consideration of responses, an extension may be requested via email.

It is intended to publish the revised code towards the end of the year for 2018/19 implementation.

ANNEX

Treasury Management Code

SECTION 1
Introduction

Within these organisations, CIPFA recognises that there is a wide range of interpretations of what activities comprise treasury management. For the purposes of this Code and accompanying guidance notes, CIPFA has adopted the following as its definition of treasury management activities:

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.

……..

'Investments' in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code.

The essentially more commercial nature of some public service organisations has the potential to create~~s~~ pressures and perhaps conflicts in their treasury management activities~~ which do not impact so heavily on those organisations that are largely service orientated.~~ These differences are explained more fully in the sector-specific guidance notes, however the key principle of control of risk and optimising returns consistent with the organisations risk appetite should be applied across all investment activities, including more commercially based investments.

SECTION 5
Clauses to be formally adopted

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1. This organisation 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.

    The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. This organisation (ie full board/council) 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. <u>Approval for monitoring the detailed Treasury Management policies is delegated to [note 1] but the organisation confirms that responsibility remains with [full board/council].</u>
3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to [note 1], and for the execution and administration of treasury management decisions to [note 2], 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.
4. This organisation nominates [note 3] to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Note 1: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as cabinet or executive.

Note 2: title of responsible officer (for the purposes of this Code, the term 'responsible officer' has been used, although it is recognised that, in practice, many different terms exist). For example in higher education, the vice-chancellor/principal or equivalent is the 'designated officer' who will ensure that the governing body complies with all terms and conditions of funding provided by the funding body, However it is usual for day-to-day financial management to be delegated to a director of finance who will take professional responsibility for such areas of an institution's work and this is the officer who is referred to here.

Note 3: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as audit committee or relevant scrutiny committee.

SECTION 6

The treasury management policy statement

CIPFA recommends that an organisation's treasury management policy statement adopts the following forms of words to define the policies and objectives of its treasury management activities:

1. This organisation 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. This organisation 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.
3. This organisation 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 comprehensive performance measurement techniques, within the context of effective risk management.

The policy statement should include the organisation's high level policies for borrowing and investments and include policies where the organisation has commercial investments held for financial return.

SECTION 7

Treasury management practices

TMP1 RISK MANAGEMENT

General statement

This organisation regards a key objective of its treasury management and other investment activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover~~ing~~ all external investment, including investment properties.

The responsible 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 schedule to this document.

TMP13 INVESTMENT MANAGEMENT PRACTICES FOR NON-TREASURY INVESTMENTS

This organisation recognises that investments taken for non-treasury management purposes require careful investment management. Such investments include loans supporting service outcomes, investments in subsidiaries, or investment property portfolios.

The organisation’s annual treasury management strategy, Investment Strategy and similar documents will cover all the organisation’s investments, and will set out, where relevant, specific policies and arrangements for non-treasury investments.

This schedule will include a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and contingent liabilities and the authority's risk exposure. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

Cross-Sectoral Guidance Notes

1.1 RISK MANAGEMENT

The Code acknowledges the substantial variations that exist between different parts of the public services in the nature of and extent to which they employ treasury management activities and techniques in pursuit of their business and service objectives. These variations are primarily a function of the respective statutory and regulatory regimes under which organisations operate, the powers they possess in respect of treasury management, and the services and businesses they pursue.

The Code states, however, that in CIPFA's view, the common and overriding aim of such organisations should be the effective identification, monitoring and control of risk. The Code recommends strongly that organisations' treasury management policies and practices reflect this belief, and this message is further reinforced in this section of the guidance notes.

In any investments the organisation makes, whether in relation to commercial activity or cash management, the organisation should understand the powers under which the investment is made, the extent to which the capital invested is placed at risk and the impact of any potential losses on the financial sustainability of the organisation. This should be reviewed on a regular basis to take account of changes in market and other conditions.

Some public service organisations may use derivatives for the management of risk; where this is the case public service organisations should satisfy themselves that they understand fully how underlying risks are affected and any additional risks that may result.

Managing treasury management risks

Uncertainty over market conditions at times of renegotiating or replacing borrowings or other market financings is an inevitable consequence of the need for most public service organisations to raise long-term funding. This uncertainty can be reduced, however, if an organisation ensures it has reliable records of its maturities and allows itself time to plan well in advance of its need to negotiate. The effective management and, in particular, the avoidance of a bunching in its maturities can reduce the prospect of having to negotiate at a time that is unfavourable to the organisation. Where an organisation provides financial guarantees to third parties, these should be included in these records and regularly reassessed as to the probability they will be called upon.

1.5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

Where an organisation produces a capital strategy, approved by full board/council, approval of detailed processes may be delegated to a committee or sub-committee of the board/council provided that the capital strategy includes as a minimum

- An overview of the governance process for treasury management including any delegations from full board/council to cabinet/committees etc. (note responsibility remains with full board/council)
- A projection of external debt and internal borrowing levels over the long term.
- Limits on overall borrowing for the following year.
- The organisation's risk appetite in terms of treasury management and the key risks it faces in terms of servicing its current and future debt requirement, and how these are managed, along with commentary on the sensitivity of projections.
- A summary of the knowledge and skills available to the organisation and confirmation that these are commensurate with the organisation's risk appetite.

CIPFA believes that delegation of approval of the detail of the treasury management strategy and ongoing monitoring should be permitted where this facilitates more active discussion of the strategy and performance by those with the most appropriate skills and knowledge. Responsibility at all times, however, remains with full board/council who should have access to the full treasury management strategy, annual report and in year monitoring and the ability to seek clarification/ask questions.

The allocation of responsibilities for tasks in (ii) to (iv) above may be influenced by other, wider issues in the way an organisation structures its treasury management function; however, overall responsibility for treasury management ~~cannot be devolved~~ at all times remains with the full board/council. Each organisation needs to decide on the arrangements most suited to its particular circumstances for the purpose of achieving these aims, although certain organisations in the public services have particular statutory or regulatory responsibilities placed on their officers and board/committee members.

1.8 CASH AND CASH FLOW MANAGEMENT

CIPFA recommends that every public service organisation should, as a minimum, prepare cash and cash flow management forecasts and actuals so as to be able to determine:

whether minimum acceptable levels of cash balances plus short-term investments might be (or have been) breached

the adequacy (or otherwise) of standby/overdraft facilities or other contingency arrangements

the optimum arrangements to be made for investing and managing surplus cash.

Where capital expenditure and investment is financed initially through internal cash reserves, allowing the requirement for borrowing to be deferred to future years, the impact on future liquidity should be considered.

1.13 INVESTMENT MANAGEMENT PRACTICES FOR NON-TREASURY INVESTMENTS

It is recognised that organisations may make investments for policy reasons outside of normal treasury management activity. This may include:

- 'Service investments' held clearly and explicitly in the course of the provision, and for the purposes, of operational services.
- 'commercial investments' which are taken for mainly financial reasons. These may include investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures such as IT providers or building services providers; or investments explicitly taken with the aim of making a financial surplus for the organisation. Commercial investments also include non-financial assets which are held primarily for financial benefit, such as investment properties.

'Treasury management investments' in contrast are those investments which arise from the organisation's cashflows and debt management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business.

Commercial investments for financial benefit rather than for service outcomes, are sometimes entered into outside of normal treasury management activity. These need more careful financial risk assessment. CIPFA recommends that the priority for security and liquidity over yield should generally be a stated policy for commercial investments, as well as for treasury management investments.

It is critical that due diligence processes and procedures reflect the additional risk an organisation is taking on. Due diligence procedures should ensure effective scrutiny of proposed investments, identification of risk to both capital and returns, any external underwriting of those risks, and the potential impact on the financial sustainability of the organisation if those risks come to pass. Where necessary independent and expert advice should be sought to ensure due diligence is suitably robust.

It is expected that many of the principles and arrangements in TMPs 1 to 12 will apply to non-treasury investments as they do to treasury investments. However, some aspects including governance and management are likely to be significantly different. A schedule under TMP13 should set out the organisation's investment management practices for non-treasury investments. This should be complied with by all officers or agencies responsible for such investments.

A register of investments and financial guarantees should be maintained as part of the treasury management strategy and regularly reviewed as part of performance reporting arrangements, including periodic reassessment of the probability of financial guarantees being called upon. This register should be reconciled to the financial instruments disclosures within the statement of accounts.

SECTION 2
Suggested schedules to accompany an organisation's statement of its treasury management practices

NON TREASURY MANAGEMENT INVESTMENTS

Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios

Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments

Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision-making in relation to non-treasury investments, and arrangements to ensure that appropriate professional due diligence is carried out to support decision making

Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken

Training and qualifications (TMP10 and schedules), including how the relevant knowledge skills in relation to non-treasury investments will be arranged