A reminder on Risk before you go

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CIPFA Scottish Treasury Management Forum Conference

Content

Panel's work on risk

- Derivatives Publication
- Toolkit Publication
- Risk Study

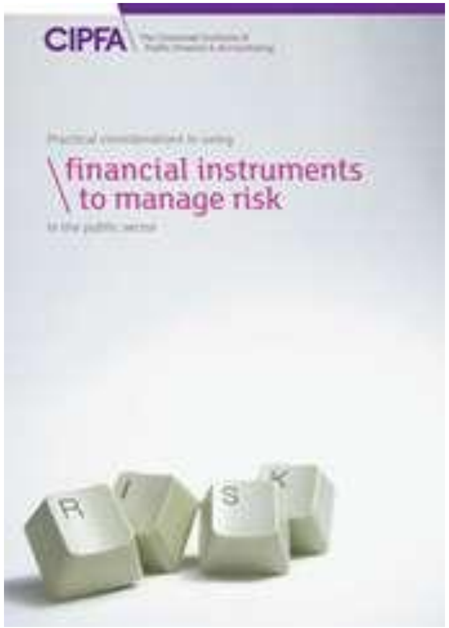
Cipfa / Panel Update

- Smaller Bodies Guidance
- Local Authority debt
- Challenger Banks
- Training
- CIPFA Scotland

What are derivatives?

- Financial instruments whose values and cash flows are derived from other variables
- Using a derivative to manage risk is called **hedging**
- Using a derivative to increase risk in the hope of increasing returns is **speculation**

Practical considerations in using financial instruments to manage risk



Aim of the guidance:

- To provide an introduction to the practical issues that a public sector organisation may face when considering using specific financial instruments to manage risk.
- To raise awareness of specific issues that will require further consideration
- It is not intended to be a definitive guidance document.

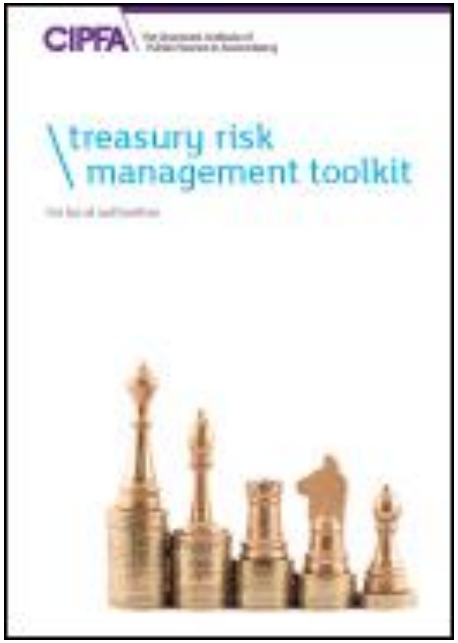
Key Considerations (1)

- Legal Position
- Approach to Risk
  - Identify the risk
  - Check it complies with your policy and strategy
  - Understand and model the scenarios
  - Check effectiveness, both in risk mitigation (cash flow) and accounting terms (bottom line impact)
  - Check any limits and constraints on derivative use
- Regular Monitoring & reporting

Key Considerations (2)

- Be clear about proposed use of specific Instruments
- Only use tools for the prudent management of financial affairs
- Take appropriate advice
- Ensure you have the necessary capability and capacity to provide adequate challenge

CIPFA TREASURY MANAGEMENT RISK TOOLKIT



Purpose of the Toolkit:

To provide a toolkit of techniques and reports that local authorities can use to identify, benchmark and manage their treasury risks.

Risk Management Methodology

1. Establish the organisation’s risk appetite

2. Establish quantified risk benchmarks which represent the agreed risk appetite, against which to measure the level of risk in the portfolio

3. Take treasury decisions and manage the portfolio, relative to the agreed risk benchmarks

4. Review outcomes and performance relative to the risk benchmarks.

2013 Risk Study

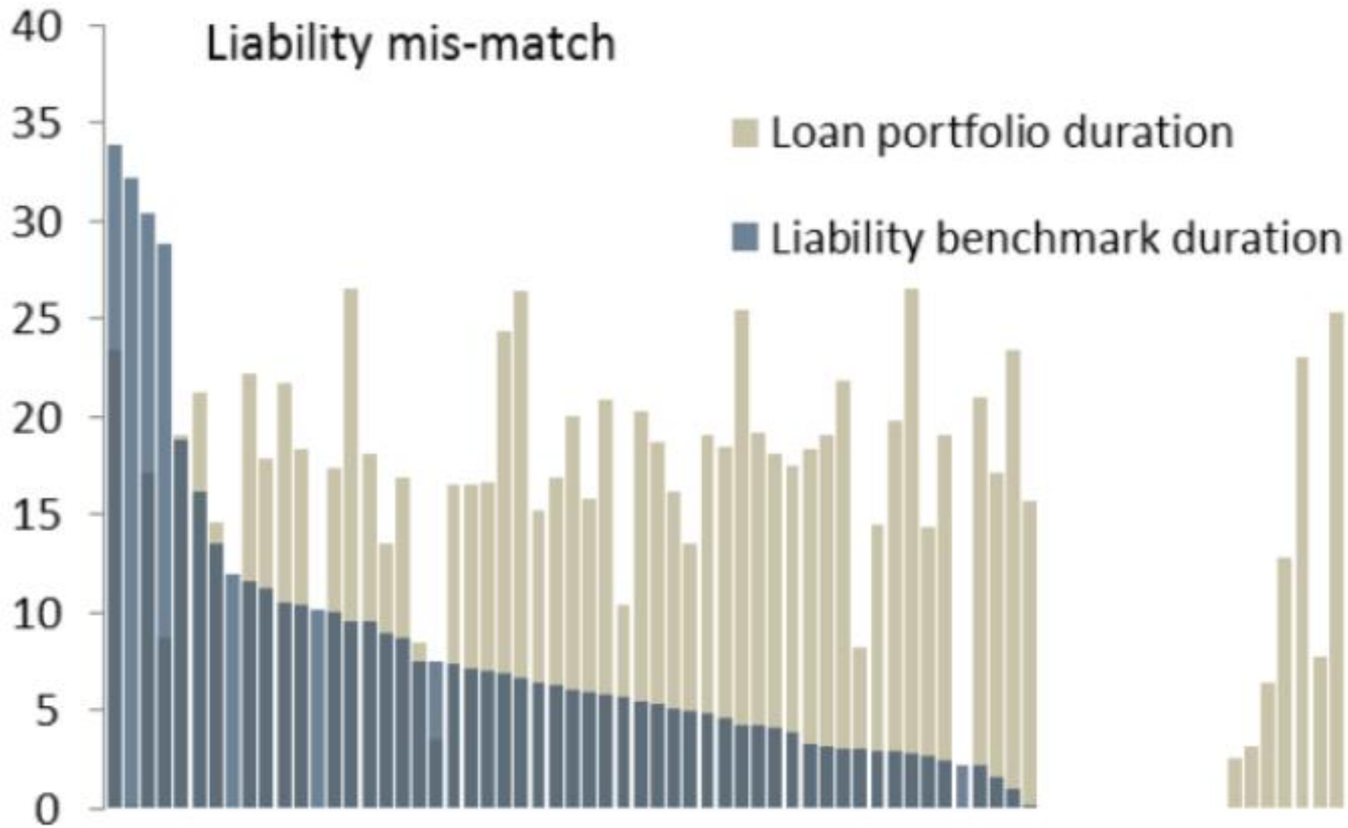
- Based on the concepts in the Risk Toolkit
- Objective analysis
- Not benchmarking, but includes peer analysis
- High levels of participation
- Free

Debt

- Very little variable rate debt
- Long dated portfolio
- Mismatch between liability benchmark and portfolio duration
- Cash balances likely to build up

Consider the duration of new borrowing carefully

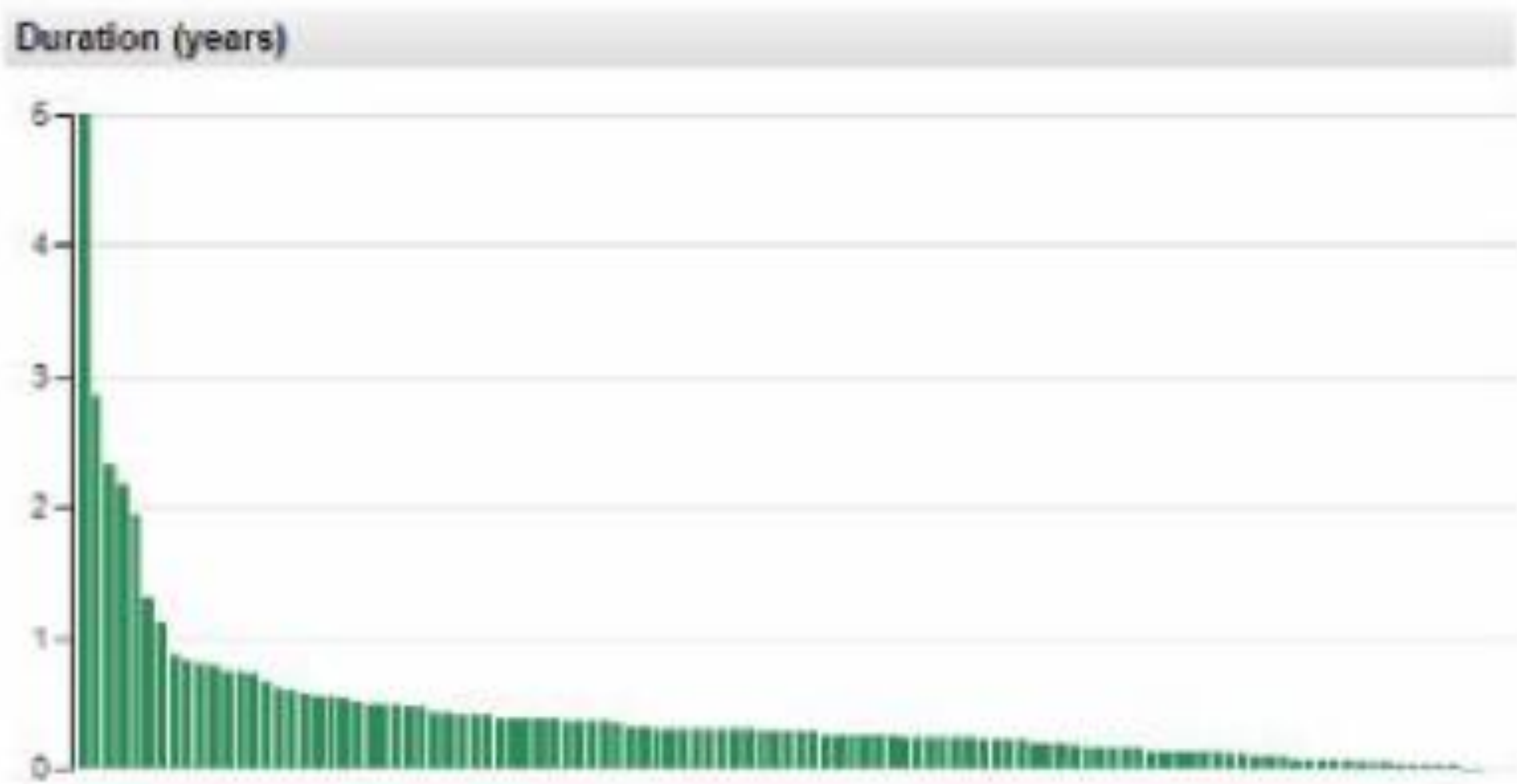
Debt


Liability mis-match
Loan portfolio duration
Liability benchmark duration
40
35
30
25
20
15
10
5
0

Investments

- Typically low credit risk
- Short duration investments
- High interest rate risk

Investments



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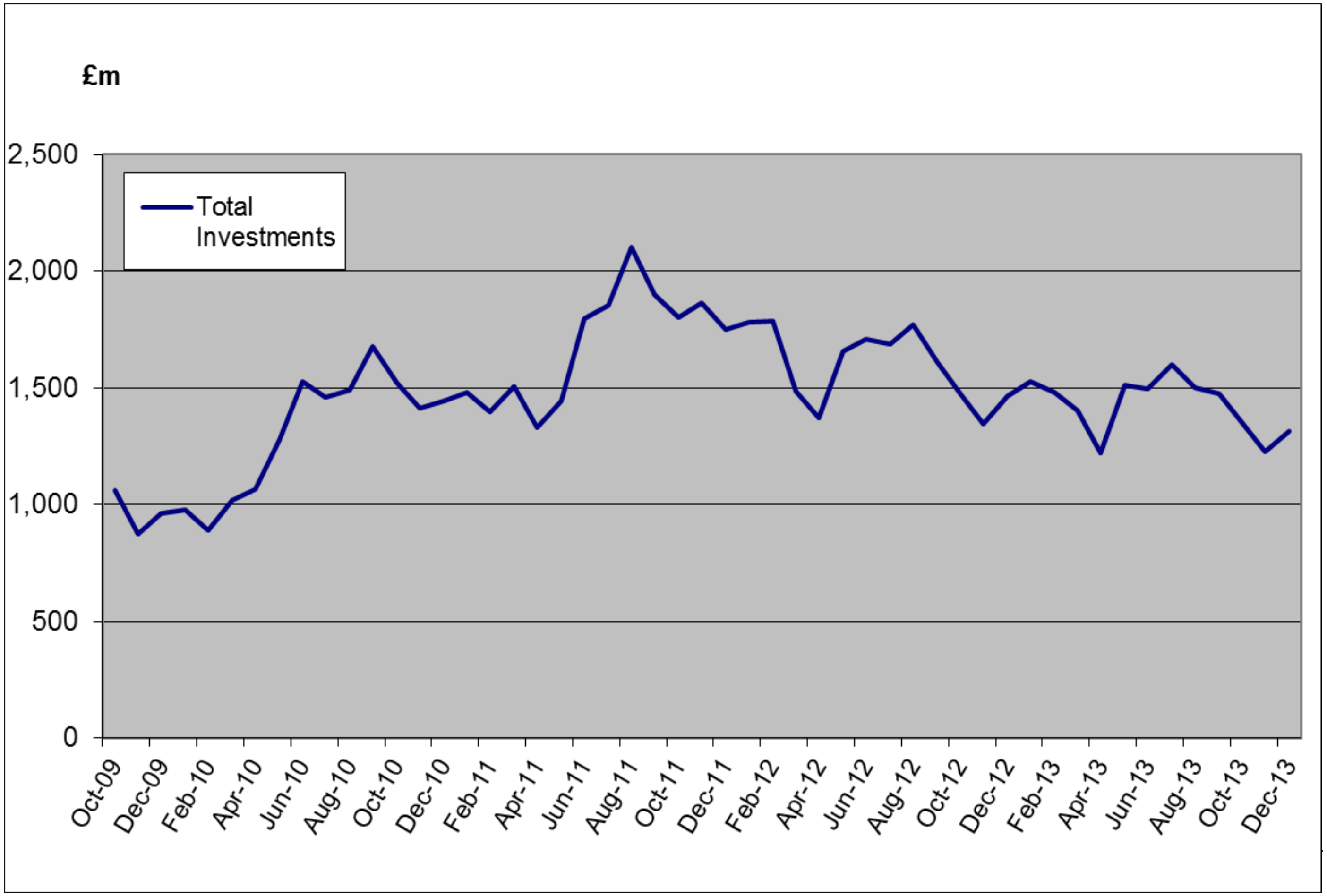
Summary of Scottish local authority Investment balances



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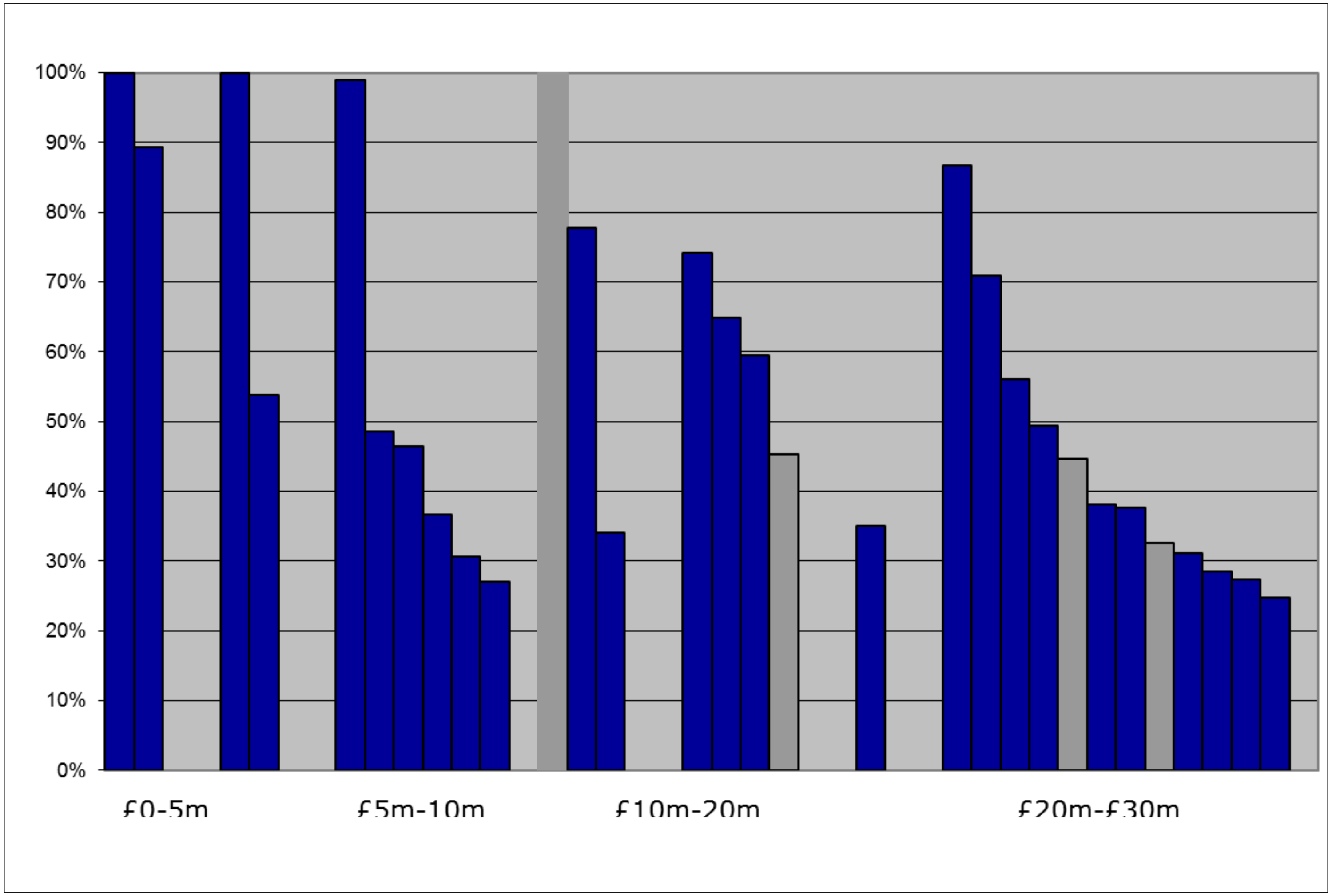
Percentage of Scottish Deposits with a Single Counterparty



Treasury Management Code Guidance for Smaller Bodies

- Fully updated publication for “smaller” LA’s, RSL’s and colleges / universities

- Definition of “smaller” for Scotland = less than 100,000 population

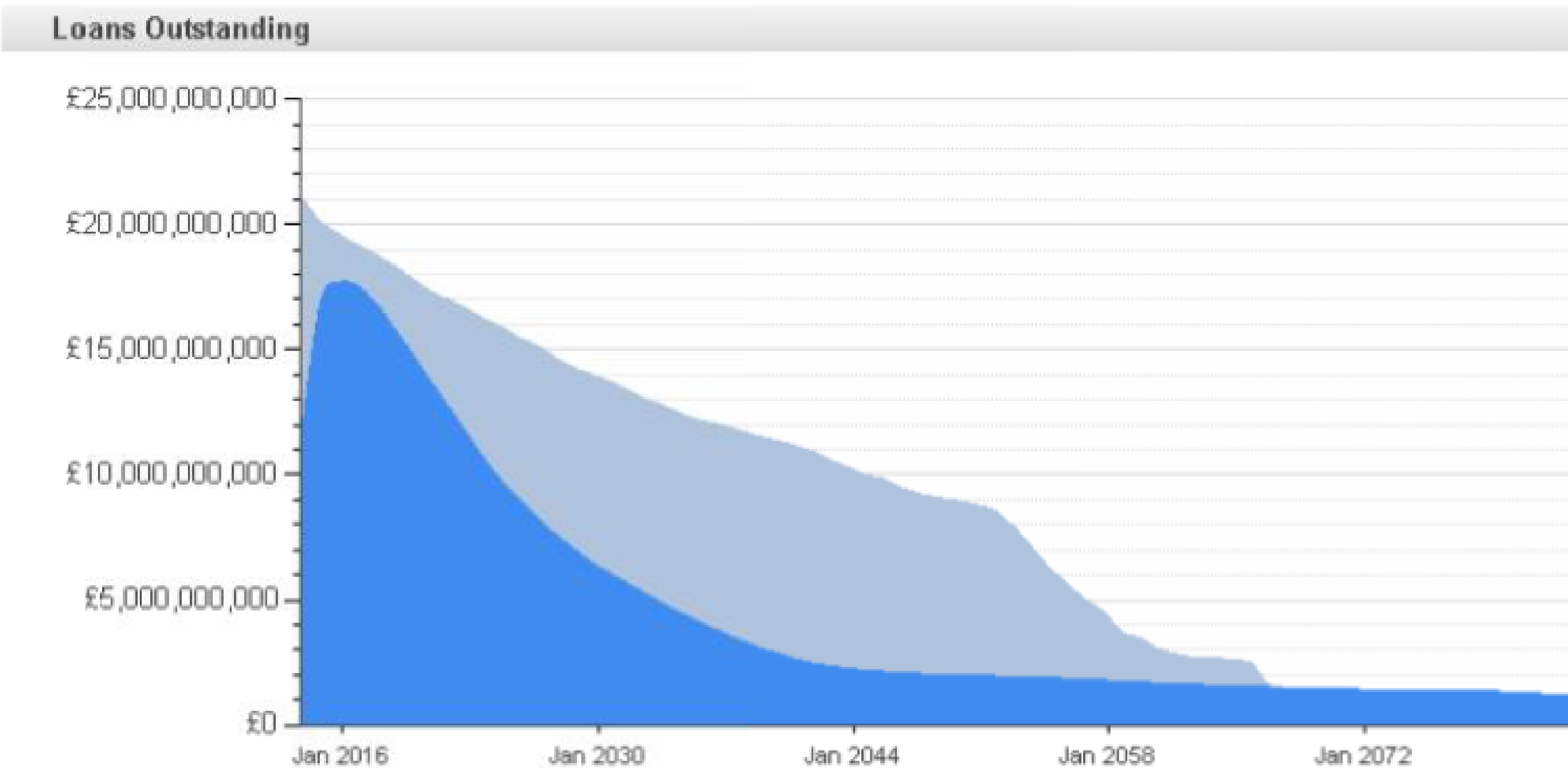
Local Authority debt

- Mainly long dated
- Mainly fixed rate

Recent changes

- Legislative changes – eg. self financing in England
- Reduced supported borrowing (in England)
- PWLB policy changes
- Interest rate environment,
  - reduced rates has increased the cost of repayment
  - Normal shaped yield curve
  - Higher cost of carry

Risk Study consolidated Liability benchmark in blue & existing loans in grey



Panel Correspondence

- Between panel chair and Chief Secretary to the Treasury
- Transfer debt between LA's?
- Not an option, but HMT interested in alternative suggestions
- Panel met with HMT officials in February 2014
- **Paper with possible options to HMT**

Challenger / New Banks

Parliamentary Commission on Banking Standards report – recommendation for DLCG:-

The Commission recommends that the Department for Communities and Local Government (DCLG) review its guidance on deposits held by financial institutions originating from central or local government (339).

DCLG response:

"…… DCLG has regular dialogue with the Chartered Institute of Public Finance and Accountancy (CIPFA) on Local Authority treasury management practice, and will look to facilitate a dialogue between the two sectors on this issue."

November meeting

- Panel members
- HM Treasury
- Department for Communities & Local Government
- Department for Business, Innovation & Skills
- New/ Challenger Banks
  - Metro Bank
  - Virgin Money
  - Aldermore
  - Silicon Valley Bank
  - Tesco Bank
- Arlingclose
- Capita Asset Services

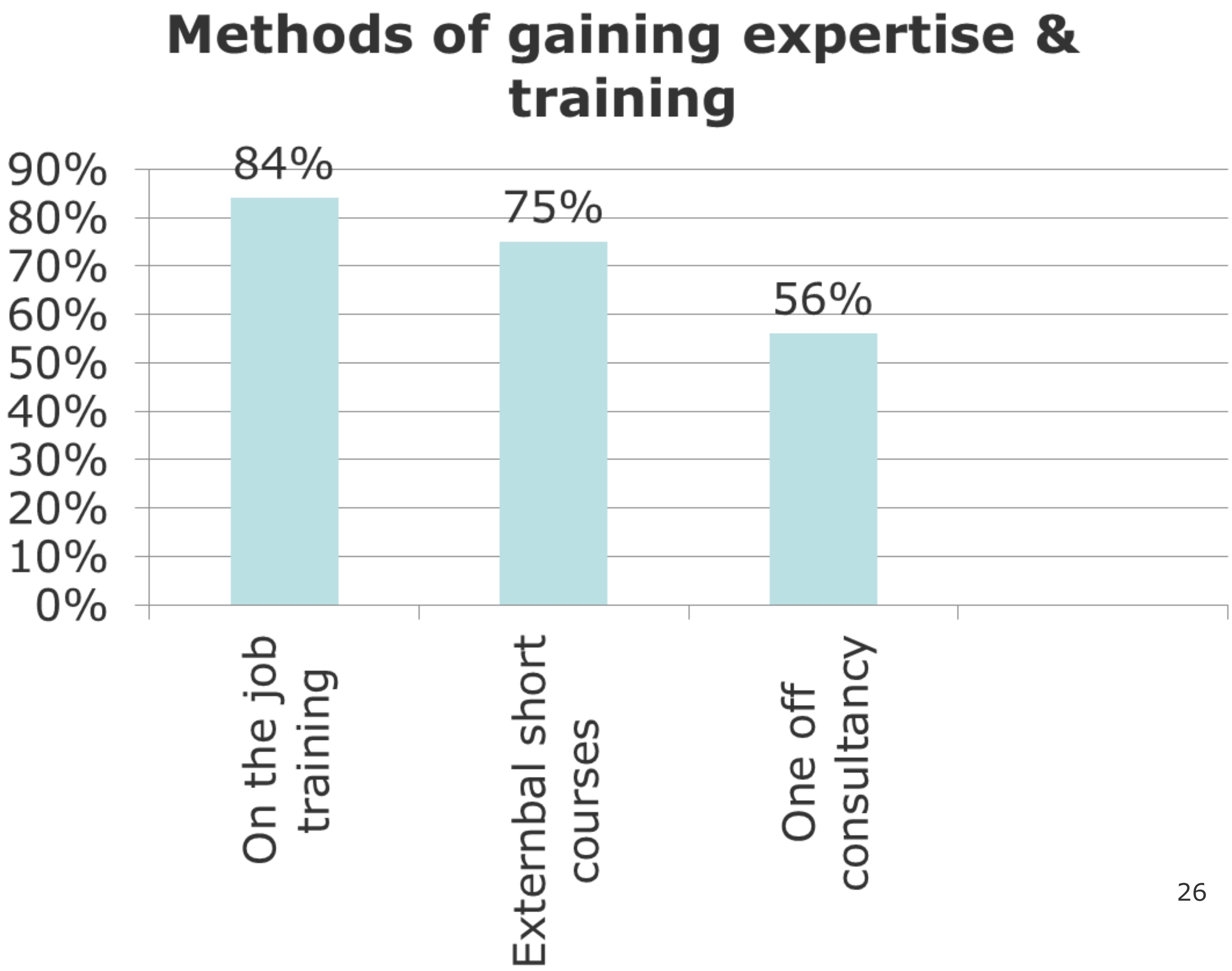
CIPFA /ACT Treasury Management Qualification

- Started October 2009
- 334 students across 236 organisations
- Ceased Autumn 2011

Since Autumn 2011

- Revised the syllabus for the Professional Qualification.
- Key Skills table to identify specific areas of knowledge and expertise for those responsible for TM.
- The CIPFA Network continues to tailor its support, e.g. Masterclass series on key topics such as investment, debt management and interest rate risk.
- The Risk Roadmap: Toolkit publication & Risk Study

Training


Methods of gaining expertise & training
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
84%
75%
56%
On the job training
Externbal short courses
One off consultancy

However….

- in recent years turnover of staff responsible for TM & concern about the availability of training
- So CIPFA is in the process of considering how best to support those involved in TM to ensure that they have the necessary skills and expertise to carry out their roles.

Need to ensure:

- Affordable
- Accessible
- Sustainable
- Relevant & Up to date

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CIPFA Scotland

- Referendum debate:

Balance Sheet for Scotland

Transparency & good financial management

- Audit Scotland is planning a national borrowing and treasury management report later this year