

## **Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management**

The Ministry of Housing, Communities and Local Government issue Investment Guidance and this informs the structure and content of the Council's policy below.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires Councils to have regard to the CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*. This Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Section 151 Officer has produced Treasury Management Practices (TMPs). This part, TMP 1, covering investment counterparty policy requires approval each year.

Oxford City Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment. The Council will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk in the context of the whole organisation's inflation exposure.

### **Investments that are not part of treasury management activity**

The following principles are required to be adopted as part of the Council's TMP1 in accordance with the Treasury Management Code of Practice:

- The Council recognises that investment in other financial assets and property primarily for financial return and not treasury management purposes requires careful management and monitoring. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.
- The Council has ensured that all of its non treasury investments are covered in its Capital Strategy, and has set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It is recognised that the risk appetite for these activities may differ from that for treasury management.
- The Council has compiled information setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the Council's associated risk exposure. These are included in the Capital Strategy in the relevant section.

### **Environmental, Social and Governance (ESG) Considerations**

These are included within Appendix 4 and shall be considered alongside and forms part of the restrictions included in this Treasury Management Strategy.

**Annual Investment Strategy** - The key requirements of both the Code and the investment guidance are that Councils set an annual Investment Strategy, as part of their Treasury Strategy for the following year, covering the identification and approval of the following:

- The guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use.
- Non-specified investments the Council will use, clarifying the greater risk implications, and the overall amount of various categories that can be held at any time.

Maturity periods are defined as the remaining length of an investment period. Arranging a deal in advance by up to four weeks is not considered to add to the duration of the investment.

In addition to the investments identified below as Specified and Non-specified investments, the Council may provide loans to a company in which it has an interest. These loans are outside the limits specified in the tables below and may be matched by equivalent external borrowing. The loans will then be given at a rate that at least covers the Council's costs and that is compliant with State Aid requirements.

**Specified Investments** – These investments are sterling investments that would not be defined as capital expenditure and don't exceed a maturity period of one year, or where the maturity period is longer, the Council has the right to be repaid within twelve months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. They include investments with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or Gilts with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A Local Authority, Parish Council, Community Council, Fire or Police Authority
4. Pooled investment vehicles that have been awarded a high credit rating by a credit rating agency, e.g. money market funds, rated AA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society) meeting the minimum 'high' quality criteria where applicable.

Trades arranged up to four weeks in advance of the start date are still classified as Specified Investments provided the duration of the investment from the start date to the maturity is no longer than 364 days. Trade dates are factored into the duration of the investment if arranged more than four weeks in advance because there is an increased risk due to funds being contractually committed. Where the date of trade is reached and the interest rate is market equivalent or better, these forward deals will be considered as being specified investments from that point.

Additionally, and in accordance with the Code, the Council has set duration and value limits as follows:

**Specified Investments - Limits on value and period**

|   | <b>Minimum credit criteria/colour banding</b> | <b>Max % of total investments / £ limit per institution</b>     | <b>Max maturity period</b>                                       |
|---|---|---|--|
| Debt Management Office – UK Government                                      | Not applicable                                | 100%  | 364 days   |
| UK Government Gilts   | UK Sovereign rating                           | 20%   | 364 days   |
| UK Government Treasury Bills  | UK Sovereign rating                           | 20%   | 364 days   |
| Bonds issued by multilateral development banks                              | UK Sovereign rating                           | 20%   | 6 months   |
| Money Market Funds  | AA  | £25m  | Liquid   |
| Local Authorities, Fire and Police Authorities                              |   | 20%   | 364 days   |
| Term deposits with banks and rated building societies                       | Blue<br>Orange<br>Red<br>Green                | £15m or<br>20% of total investments<br>whichever is the greater | Up to 1 year<br>Up to 1 year<br>Up to 6 Months<br>Up to 100 days |
| Certificate of Deposit or corporate bonds with banks and building societies | Blue<br>Orange<br>Red<br>Green                | £10m or<br>20% of total investments<br>whichever is the greater | Up to 1 year<br>Up to 1 year<br>Up to 6 Months<br>Up to 100 days |
| Enhanced Cash funds   |   | 20%   | 6 months   |
| Corporate bond funds  |   | 20%   | 6 months   |
| Gilt Funds  | UK sovereign rating                           | 20%   | 6 months   |

The colour ratings above for the Term Deposits with banks and rated building societies and Certificates of Deposit or Corporate Bonds with banks and building societies link the durations in the right hand column to colour coding used in MUFG Corporate Markets' Credit List i.e. blue and orange coloured institutions recommend investments of upto a year according to the MUFG Corporate Markets Credit List

**Non-Specified Investments** – Non-specified investments are any other type of investment not defined as Specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Overall Non-specified investments (excluding loans to a company in which the Council has an interest) will not exceed more than 30% of the previous calendar year's total investment portfolio or £30 million, whichever is the greater. The level of investment in a particular counterparty will be measured based on the amount of the initial investment. Non specified Investments would include any sterling investments with:

**Non-Specified Investments - Limits on value and period**

|  | <b>Minimum Credit Criteria</b> | <b>Max % of total investments/£ limit per institution</b>         | <b>Max maturity period</b>     |
|--|--------------------------------|---|--------------------------------|
| Local Authorities, Fire and Police Authorities                                     |                                | 15% of total investments  | Up to 2 years                  |
| Fixed term deposits with variable rate and variable maturities                     | Orange                         | 15% of total investments  | Up to 1 year                   |
| Fixed term deposits with variable rate and variable maturities                     | Yellow<br>Purple               | £10m or 20% of total investments                                  | Up to 5 years<br>Up to 2 years |
| Commercial paper issuance covered by a specific UK Government (explicit) guarantee |                                | 10% of total investments  | Up to 1 year                   |
| Fixed term deposits with unrated Building Societies                                | Asset Base over £9bn           | £3m – 20% of total investments                                    | 100 days                       |
| Commercial paper other   |                                | 15% of total investments  | Up to 1 year                   |
| Corporate and other bonds  |                                | 15% of total investments  | Medium to long term            |
| Other debt issuance by UK banks covered by UK Government (explicit) guarantee      |                                | 15% of total investments  | Up to 1 year                   |
| Floating rate notes  |                                | 15% of total investments  | Up to 1 year                   |
| Pooled Investment funds  |                                | 25% of total investments or £25 million, whichever is the greater | Medium to long term            |

The colour ratings above for the Term Deposits with banks and rated building societies and Certificates of Deposit or Corporate Bonds with banks and building societies link the durations in the right hand column to colour coding used in MUFG Corporate Markets's Credit List i.e. investments with yellow coloured institutions are recommended for upto 60 months (5 years) according to the MUFG Corporate Markets Credit List.

The durational bands adopted in detail are:

- Yellow 5 years \*
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

The MUFG Corporate Markets' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

### **UK banks – ring fencing**

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

**The Monitoring of Investment Counterparties** - The Council receives credit rating information (changes, rating watches and rating outlooks) from MUFG Corporate Markets on a weekly basis, and counterparties are checked promptly. On occasion

ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Section 151 Officer, and if required new counterparties which meet the criteria will be added to the list. The Council also monitors counterparties against the limits specified below:

| Duration Limits (based on Fitch ratings) |                   |          |
|--|-------------------|----------|
| Long Term Rating                         | Short Term Rating |          |
|  | F1+               | F1       |
| AAA                                      | 2 years           | 365 days |
| AA+                                      | 2 years           | 365 days |
| AA                                       | 2 years           | 9 months |
| AA-                                      | 2 years           | 9 months |
| A+                                       | 365 days          | 9 months |
| A  | 9 months          | 6 months |
| A-                                       | 6 months          | 3 months |