CIPFA The Chartered Institute of Public Finance & Accountancy

Treasury Management Panel Bulletin

Treasury Management Advisors – Regulation and Services

March 2010

Background

There are substantial numbers of service providers available to support the treasury management activities of public service organisations. These include Treasury Management Advisors (TMA's), brokers, external investment managers and independent specialist advisors.

The responsibility for treasury management must always remain with the organisation. It is essential that organisations understand the treasury management services being offered to them and must not over-rely on these services.

The Treasury Management Bulletin produced by CIPFA's Treasury Management Panel in December 2009[1] provided updates on the revised Prudential Codes and revised Treasury Management Code along with other specific areas. It also indicated that the next Bulletin would focus on the regulation, role and services of TMA's.

The initial Communities and Local Government Select Committee report recommended that 'the CIPFA Codes give more detailed advice to local authorities on the services which they may expect to receive from treasury management advisors, and how to use them effectively. The guidance should make clear that such advisors may give varying types and levels of information or advice'. Whilst it is not CIPFA's role to provide this type of information, CIPFA does have a role in the education and promotion of best practice for treasury management staff in public sector organisations. It is with this in mind that this Bulletin has been produced.

This Bulletin therefore considers the regulatory framework for TMA's and the typical services provided by TMA's. Authorities may find it useful to share this Bulletin with elected members with treasury management responsibilities.

Thanks are given to the Financial Services Authority and the TMA's themselves for their assistance in the development of this Bulletin.

Please note that this Bulletin should not be taken as an authoritative interpretation of the law. Whilst all reasonable care has been exercised in preparing it readers should always refer to the primary sources, and check any interpretation of the law and published guidance with their own professional advisors.

Regulation

The Financial Services Authority (FSA) is an independent body that regulates the financial services industry in the UK. The regulatory framework is set out in the Financial Services and Markets Act 2000 (FSMA), which underpins the regulation of certain services provided by FSA regulated firms to local authorities.

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[1] The December Bulletin can be accessed at: http://www.cipfa.org.uk/panels/treasury_management/download/TMP_Bulletin_09.pdf.

Regulated activities

The activities for which FSA authorisation is required (regulated activities) are set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. Firms undertaking regulated activities must apply to the FSA for authorisation. The FSA is then responsible for regulating those firms it has authorised. Some firms may provide regulated and unregulated activities.

Markets in Financial Instruments Directive (MiFID)

The other aspect to the regulation of financial services comes from the rules governing regulated activities derived from the Markets in Financial Instruments Directive (MiFID). MiFID requires EU countries to regulate firms providing services linked to the buying and selling of financial instruments. It is a cornerstone of the EU's Financial Services Action Plan. MiFID includes regulations covering organisational arrangements for investment firms, how they should conduct business and regulations around markets and transparency.

MiFID governs the classification of clients. Under MiFID local authorities are classified as 'professional clients'. These are considered to be more experienced, knowledgeable and sophisticated than 'retail clients' and able to assess their own risk. This also means that they have fewer regulatory protections. A regulated firm is entitled to assume that a professional client has the necessary level of experience and knowledge to understand the risks involved in the transaction and is financially able to bear any related investment risks.

Under MiFID, professional clients, as part of the categorisation review process, can request the additional regulatory protections afforded to retail clients in relation to one or more particular services or transactions, or in relation to one or more types of product or transaction. MiFID is clear that the professional client is responsible for making this request when it is unable to properly assess or manage the risks involved.

Local authorities considering this avenue should ensure that they consider all the potential implications, for example, the greater risk protection afforded to retail clients may result in a larger fee and some counterparties and brokers may choose not to deal with retail clients.

The firm and the client must enter into a written agreement confirming that the client will not be treated as a professional client and stating whether the retail classification relates to one or more particular services or transactions or one or more types of product or transaction.

There may be instances where local authorities seek independent specialist financial advice specifically in relation to certain distinct investment and / or deposit areas. This can provide an additional resource of advice, especially when delivered as if to a retail client, a service which some specialist advisors do provide.

Local Authority Treasury Management

Treasury management services within local authorities do not require authorisation by the FSA. An organisation providing services to a local authority to assist it in its treasury management requires authorisation from the FSA, depending on the services provided and whether they are a regulated activity as defined by FSMA.

The following should be noted:

1. A deposit by a local authority is not a regulated deposit under legislation.
2. Advising on deposits is not a regulated activity, so advising a local authority to place its deposits with a particular bank is not a regulated activity.
3. Carrying out deposit-broking services (for example, arranging for a client's money to be invested in deposits with particular banks) is not a regulated activity.
4. Broadly speaking, advising on buying and selling government or private sector debt securities require authorisation if the advice relates to specific transactions. Broader strategic or generic advice (for example 'we recommend that you invest in sterling denominated debt securities') are not regulated activities.
5. Broking and arranging activities in relation to these investments are usually regulated activities.

Broadly speaking, the FSA's rules do not apply to activities that are not regulated activities. However if the non-regulated activities are sufficiently connected to activities that are regulated, the non-regulated activities may be treated as part of the regulated services and hence subject to the FSA's rules and Principles.

For instance, if advice on deposits is given alongside advice on investments then certain FSA rules, such as the suitability rules, may apply to the advice on deposits, which is a non-regulated activity, as well as investment advice, which is a regulated activity (the suitability rules do, broadly speaking, require a firm to take reasonable steps to ensure that the advice it gives to its clients is suitable for that client).

Further, if a firm is buying an investment for a local authority, the arrangements made in relation to the money that the local authority will use to pay for them may fall within FSA regulation, for example, the controls used by the firm to protect the funds of the local authority whilst under the firm's custody.

FSA's supervisory approach

Some firms of treasury management advisors are part of a wider group, and they are then supervised as part of the group. For example, Sector Treasury Services Ltd is part of the Capita Group, Butlers is a division of ICAP Securities Ltd and Sterling Consultancy Services is a division of Sterling International Brokers Ltd, part of Skipton Building Society Group. The extent to which the FSA focus specifically on firms within a group depends upon their size and risk profile within the group. In their own right Sector Treasury Services Ltd, Butlers and Sterling International Brokers are significantly below the size threshold to warrant a risk assessment. However, as each firm is part of wider group its business is taken into account when the risk assessment of the wider group is carried out.

Arlingclose Ltd is an independent company, not part of a wider group. The FSA does not routinely carry out risk assessments of this size of firm but instead information provided by the firm on a regular basis is monitored (this includes for example, financial position, volume of business, number of complaints received).

No judgment on the relative merits of different structures is made in this Bulletin as it is a matter for individual local authorities to evaluate these as part of any tender process.

What does this mean for a local authority?

A local authority's status as a professional client assumes it possesses the experience, knowledge and expertise to make their own investment decisions and is able to properly assess the risks incurred. This is also stressed in the CIPFA Treasury Management Code which states the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It reminds organisations that overall responsibility for treasury management must always remain within the organisation.

There is therefore a clear need for authorities to understand the services being provided to them and to retain sufficient skills in-house in order to provide challenge.

Authorities should also be clear as to the payment structures for services and these should always be transparent to the authority. This is especially the case where, for example, an advisor is receiving a commission for a specific product: here the authority should be made aware of this.

Costs should be compared with other organisations - however such comparison should be treated with caution. It is important to establish whether the characteristics of the other organisation's treasury management activities are truly comparable. It is misleading, for example, to draw conclusions about the respective performances of different organisations without first establishing the positions they take with regard to risk, since this can materially influence investment performance.

Authorities are reminded that:

- The range of services offered is only one element
- The quality of service provision is key, but of course difficult to measure and compare

Managing Potential Conflicts of Interest

The FSA takes potential conflicts of interest within firms very seriously. Principle 8 of the FSA Principles for Business states “A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client”. The FSA Handbook requires that the relevant authorised firms must take reasonable steps to:

1. identify conflicts of interest;
2. manage those conflicts to prevent them from harming their clients interests; and
3. in the case that conflicts cannot be managed, firms must disclose them to clients.

The Treasury Management Panel believes that there may be potential conflicts of interest in many areas of treasury management. It is therefore essential that local authorities clearly understand the relationship and associated fee arrangements between their advisors and any potential counterparties. Where a broker or counterparty is used, normal best practice regarding the selection should apply. Authorities should consider carefully the independence of the advice they receive relating to particular treasury products or strategies.

TMA services

The list in the Appendix details those services typically offered by TMA’s, although varying types and levels of information and advice may be given by each. Generally authorities who engage the services of a TMA will have an agreed core set of services and have a call-off arrangement for any additional services which may be required on a more ad hoc basis. This is because some services may only be required intermittently when the circumstances arise, for example, advice on leasing and to include all services in the base contract may prove prohibitively expensive and unnecessary.

TMA’s are likely to provide different types of services with different levels of detail.

For that reason, the services listed in Appendix A may be used to **inform** a service specification for TMA services, but should not be considered a draft specification. The list is only current as at the date of issue of the Bulletin and new services will develop in response to market requirements.

Communities and Local Government Select Committee Second Report

The Communities and Local Government Select Committee published their second report ‘Local authority investments: the role of the Financial Services Authority’ on 26 January 2010[2]. This report recommends that the Government legislate to bring the provision of advice or information in relation to deposits under the remit of the FSA.

CIPFA’s response to the initial report supported the suggestion that the regulation of treasury management advisors should be within the remit of the FSA. CIPFA therefore welcomes this second report.

[2] The report can be accessed at: http://www.publications.parliament.uk/pa/cm200910/cmselect/cmcomloc/287/287.pdf

Appendix

Services

Strategic advice

- Advice and guidance on preparation of treasury management and investment strategy, prudential indicators, minimum revenue provision (MRP) policy, capital financing requirement and MRP calculations
- Risk appraisal
- Appraisal of different investment products and debt instruments
- Financial appraisal of options
- Advice on the structure and timing of investment and borrowing decisions
- Investment parameters / limits
- Liquidity considerations
- Use of fund managers and the monitoring of performance

Technical and capital finance advice

- Review of compliance with regulations; CIPFA Code of Practice, Prudential Code and government and devolved administrations' investment guidance
- Guidance on accounting transactions
- Guidance and assistance with closure of accounts and accounting for financial instruments, leasing, Private Finance Initiative (PFI) and implications of International Financial Reporting Standards
- Treasury Management Practices reviews / procedure reviews
- Cash flow forecasting including the assistance in the development of models
- Balance sheet reviews
- Year end review of treasury operations
- Housing advice (in relation to treasury management issues) including Large Scale Voluntary Transfer and Arms Length Management Organisation and Housing review implications
- Information and advice on PFI / Public Private Partnership

Training

- Including local tailored training for officers and members
- Seminars

Interest rate forecasts

- Including short and medium term forecasts of Bank of England Base Rate, Public Works Loans Board (PWLB), London Inter-Bank Offer Rate (LIBOR), inflation and investment returns
- Economic analysis, including commentary on market movements, Monetary Policy Committee meetings and Bank of England inflation reports

Historical market data

- Information on the movements over time of rates such as base rate, PWLB and LIBOR

Debt portfolio management

- Advice on restructuring options
- Portfolio risk management
- Interest rate alerts
- Yield curve analysis
- Market updates

Credit risk information

- Live updates of market information
- Interpretation of rating criteria and methodology
- Notification of credit ratings from rating agencies
- Provision of sovereign ratings
- Ratings outlooks
- Credit default swap price information
- Equity price data

Performance monitoring

- Review of activity
- Cross authority comparison
- Annual economic review
- Compliance with prudential indicators
- Weekly provision of interest rate benchmark statistics

Reporting

- Advice on reporting requirements
- Draft templates for strategy, prudential indicators, MRP policy, mid year and end of year required reports and statement of accounts disclosure notes

It is important that organisations are clear about the services received and mandates detailing these should be signed by both parties. Contracts should be reviewed, and re-tendered on a regular formal basis in accordance with the client organisations standing orders.