<u>TREASURY MANAGEMENT PRACTICE NOTES</u>

TMP 1 – RISK MANAGEMENT

General Statement

This organisation 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 Section 151 Officer will oversee the design, implementation and monitoring of all arrangements for the identification, management and control of treasury management risk. The Section 151 Officer will ensure that reports are presented 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 Council's objectives.

In respect of each of the following risks, the arrangements that seek to ensure compliance with these objectives are set out in this document and consider the risk appetite statement in the Council's Treasury Management Strategy Statement, available via the following link:

http://www.chichester.gov.uk/article/24169/Treasury-Management-Strategy

This document is integral to the Council's treasury management practices and all staff involved in treasury management activities should familiarise themselves with its contents.

[1] Credit and Counter party risk management

This risk is the risk of a third party failing to meet its contractual obligations (for example, to pay any investment money or interest back in full, on time)

Statutory guidance restricts the types of investments that local authorities can use and forms the structure of the Council's policy, which is contained in the Council's treasury management strategy.

The Council's key objective is to invest prudently, giving priority to security, then liquidity before yield.

The Council also has regard to the CIPFA publications Treasury Management in Public Services: Code of Practice and Cross-Sectoral Guidance Notes and the sector specific guidance; Guidance Notes for Local Authorities including Police Authorities and Fire Authorities.

The Council ensures that its counter party lists and limits;

- reflect a prudent attitude towards organisations with whom funds may be deposited, and

- limit its investment activities to the instruments, methods and techniques referred to in TMP4 and in the Council's Treasury Management Strategy, published at the link above.

The Council also maintains a formal counter party policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements. This is contained within the Council's Treasury management policy statement and approved each year by the Council.

The Council's credit and counterparty policy relating to environmental, social and governance (ESG) investment considerations is at section 8, below.

Monitoring Investment Counterparties

The assessment of credit worthiness or credit rating of investment counterparties will be monitored regularly.

The Council obtains credit rating information from its treasury advisers who monitor leading credit rating agencies and notify the Council of any changes in ratings as they occur. This includes and takes account of changes; ratings watches and rating outlooks as necessary.

The Council has established minimum credit rating criteria and compliance with the Council's counterparty list is reviewed before any investment decision is made.

In considering credit rating, the lowest rating issued by three main agencies (above) is used, unless an investment-specific rating is available when this will be used.

The Council considers other possible sources of information available to assess the credit worthiness of counterparties. This includes information direct from brokers, news agencies and its treasury advisers monitoring the Credit Default Swaps (CDS) market.

On occasions ratings may be downgraded after an investment has been made, however, 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 or due to adverse information in the public domain, will be removed from the approved list immediately by the Section 151 Officer, and if required new counterparties which meet the criteria will be added to the list.

[2] Liquidity Risk Management

This risk is the risk that cash will not be available when needed.

The Council ensures it has adequate though not excessive cash resources, borrowing arrangements, overdraft facilities to always enable it to have a level of funds available to it which are necessary for the achievement of its business/service objectives.

This organisation will not borrow earlier than required to meet cash flow needs unless there is a clear business case for doing so and will only do so for the current capital programme, to fund future debt maturities, or to ensure an adequate level of short-term investments to provide liquidity for the organisation.

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. Forecasts are compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

To ensure adequate liquidity is maintained, 'worst case' estimates of cash flows are used when considering the Council's medium term investment position.

[3] Interest rate, inflation, and market risk management

This risk is the risk of fluctuations in interest rates and other market factors that create unexpected and unbudgeted burdens on Council finances.

The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 (Reporting requirements and managing information arrangements).

The effects of varying levels of inflation, so far as they can be identified, will be controlled by the Council as an integral part of its strategy for managing its exposure to inflation.

It will achieve this by the prudent use of its approved financing and investment instruments, methods, and techniques, to create stability and certainty of costs and revenues, whilst retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

To achieve this objective the following specific policies are followed:

- retaining an appropriate minimum level of reserves to maintain flexibility in the use of interest earned from deposits.
- lending surplus funds only to approved counterparties as specified by the Council's Treasury Management Strategy
- minimising short term borrowing by efficient cash flow management
- ensuring that the use of any hedging tools such as derivatives are only used for the management of risk and prudent management of the financial affairs of the council, as set out in the Council's Treasury Management Strategy

The most significant risk relates to price movements and interest rate risk for to the Council's investment in external pooled funds.

To measure the significance of these risks, the Council calculates the effect of a 1% change in interest rates and a 5% change in property prices on the Fair Value of the external funds when preparing its Statement of Accounts.

We compare these figures against the individual counterparty limits set out in its annual Treasury strategy, which are seen as representative of a measure of the maximum amount that the council is willing to risk.

The Council will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs, and that the policy for the use of derivatives is clearly detailed in the annual strategy.

The council will also calculate prior to setting its annual budget and financial strategy the risk that current reserves held for price risk mitigation will not be significant to cover any loss in the next financial period. This I will be calculated as follows:

1. Total value of portfolio invested
2. Expected standard normal deviation of capital returns of portfolio

Worked example:

Nominal value of portfolio	£34m
Volatility – standard deviation	5.1%
Revenue reserve for price risk	£2.89m

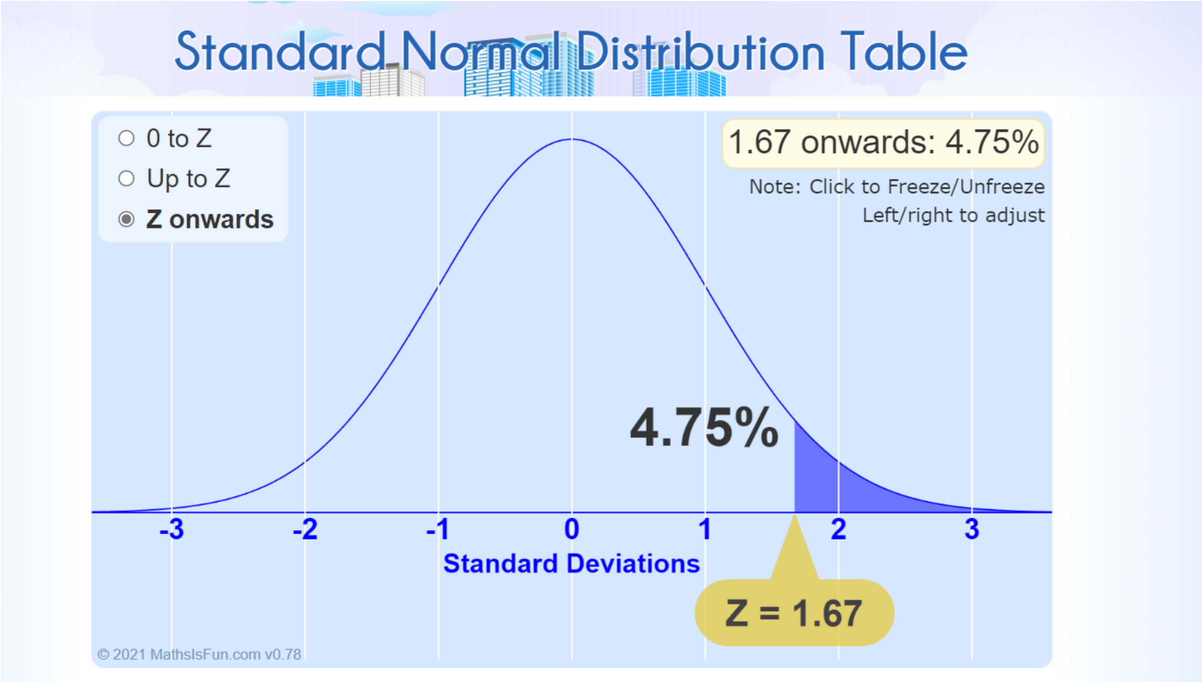
STRATEGIC POOLED FUND PORTFOLIO							CHICHESTER		From:	31/10/2022	To:	31/10/2023
FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility		
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	4,418,978	4,031,880	-68,790	255,015	1.0	-1.68%	6.22%	4.54%	7.4%		
CCLA - DIVERSIFIED INCOME FUND	MULTI ASSET	3,912,347	5,275,018	-256,259	183,880	1.0	-4.63%	3.32%	-1.31%	6.4%		
CCLA - LAMIT PROPERTY FUND	PROPERTY	3,268,201	9,089,194	-1,519,060	438,481	1.0	-14.32%	4.13%	-10.19%	7.6%		
M&G STRATEGIC CORPORATE BOND FUND	BOND	3,975,350	3,295,167	35,381	153,166	1.0	1.09%	4.70%	5.78%	7.5%		
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	4,843,652	4,220,328	-30,539	192,177	1.0	-0.72%	4.52%	3.80%	3.8%		
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	11,187,364	4,262,386	85,024	323,237	1.0	2.04%	7.74%	9.77%	14.9%		
THREADNEEDLE STERLING SHORT-DATED CORPORATE BOND FUND	BOND	2,332,345	2,129,846	55,587	66,001	1.0	2.68%	3.18%	5.86%	3.7%		
THREADNEEDLE STRATEGIC BOND FUND	BOND	2,561,534	2,305,380	51,231	97,205	1.0	2.27%	4.31%	6.59%	5.6%		
GRAND TOTAL			34,609,199	-1,647,426	1,709,162	1.0	-4.54%	4.71%	0.17%	5.1%		
		Unrealised capital loss since purchase:		-5,390,844	Annualised income return:			4.71%				
							Average Bank Rate:	4.32%				

Calculation

1. Revenue reserve/ nominal value 8.5% = figure 1
2. Z value (figure 1/ SD of portfolio) 8.5/5.1 = 1.67

Use 'z onwards' analysis, here: https://www.mathsisfun.com/data/standard-normal-distribution-table.html

Result: A £2.89m reserve for this portfolio is expected cover annual losses in any one year >95 of the time.



[4] Exchange rate Risk Management

The Council does not invest in foreign denominations but does occasionally make payments to foreign suppliers. In so doing we will manage our exposure to fluctuations in exchange rates to minimise any detrimental impact on budgeted income expenditure levels.

Any large contracts let by the Council must be denominated in £Sterling and the Section 151 Officer consulted on any proposed departure from this policy.

[5] Refinancing risk management

The Council ensures that any borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies are managed, with a view to obtaining offer terms for renewal or refinancing, which are competitive and as favourable to the Council as can reasonably be achieved in the light of market conditions prevailing at the time.

The Council will actively manage its relationship with counter parties in these transactions in such a manner as to secure this objective and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.

[6] Legal and regulatory risk management

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements.

It will demonstrate such compliance if required to do so, to all parties with whom it deals in such activities. In framing its credit and counter party policy the Council will ensure that there is evidence of counter parties' powers, authority and compliance in transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

The Council manages the risk of 'Bail-in' by limiting its exposure to unsecured deposits and also by specifying counterparty investment limits. See TMP4 for further information.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, in so far as it is reasonable to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[7] Fraud error and corruption, and contingency management

The Council ensures that it has identified the circumstances that may expose it to the loss through fraud, error, corruption or other eventualities in its treasury management dealings. It employs suitable systems and procedures and maintains effective contingency management arrangements, to these ends.

The Council's treasury management system is considered sufficiently resilient to contingencies as it is a hosted solution operated by Logotech. Data is backed up to off-site servers operated by the software supplier.

The Council has a business continuity plan and key functions, including cash management and payments are included in that plan.

[8] Environmental, Social and Governance (ESG) Risk

The overriding priorities of treasury management must remain security, liquidity, and yield in that order. However, once these priorities are met preference will be given to placing investments with banks or institutions who have demonstrated a significant interest is sustainability by being a signatory to the UN Environment Finance Initiative's (UNEFI) Principles for Responsible Banking/ Investment. This requirement will not extend to investments with the UK public sector.

Before a direct investment is made with an institution that is not a participant in the UNEFI initiative, approval will be sought from the section 151 or deputy section 151 officer setting out why no reasonable alternative at that particular time is available. This 'comply or explain' approach recognises that, whilst ESG is a desirable objective for treasury investing, to comply with Statutory Guidance it must be ranked behind security, liquidity and yield.

Where the Council does not have direct control over the individual investments, (for example, for investments in money market or external pooled funds), the Council will seek to understand and evaluate the Environmental, Social and Governance policies of money market and external pooled funds when considering making an initial investment. This evaluation will include a review of any reports prepared by prospective fund managers under the UK Stewardship Code issued by the Financial

Reporting Council and of the institution’s commitment to the UNEFI Principles for Responsible Investment.

[9] Price risk management

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the sums it invests and will accordingly seek to protect itself from the effects of such fluctuations. Some funds are used for longer term investments.

Management information on price movements will be prepared and presented to relevant bodies during the year in accordance with TMP6 and an assessment will be made of the need to add to (or withdraw from) the Council’s investment risk reserve each budgetary year. The statutory override protection exists until March 2025. The Investment Risk Reserve will be maintained to smooth out the impact of fluctuations in Fair Value of relevant investments on the taxpayer.

[10] Reputational Risk management

Due to the continued financial challenges with inter authority lending, and the potential perceived reputational risk for lending to authorities that go on to issue a Section 114 notice. Procedures have been developed to help manage this risk. Further due diligence of balance sheet analysis, maintaining a list of all authorities that have either issued a S.114 notice or in the public domain a warning of a possible S.114 notice. Lending to these authorities will be avoided unless the council is already in a contractual commitment to do so. The S.151 Officer will obtain the necessary assurances that the monies will be returned on the due date in the contract agreed.