Shaping healthcare finance...

HFMA Briefing

Treasury Management Survey Report

March 2012

During February and March of 2012, the HFMA conducted a survey of foundation trust finance directors in relation to current treasury management arrangements. In total 71 organisations from the HFMA's FT Finance Faculty took part.

This survey was initiated by the HFMA's Foundation Trust Technical Issues Group and it was agreed to survey a wide audience to identify the key issues encountered with achieving an appropriate balance between risk and reward in Treasury Management policies in the light of the economic downturn.

It is envisaged that the combined responses will provide useful information for foundation trusts and support further discussions within the faculty. It is also anticipated that the survey will continue to be undertaken annually to maintain the body of information available to members.

Overview

One of the key findings from the survey is the high level of review and scrutiny of Treasury Management policies undertaken within the last twelve months. The survey also indicated that good governance arrangements are in place with audit or investment committees reviewing policies prior to adoption by boards of directors. Respondents also reported making use of information from business news, agencies such as Reuters and other research rather than placing sole reliance on the published credit ratings of investment institutions. This approach is consistent with examples given in the Audit Commission's review of Treasury Management quality *Risk and Return – English Local Authorities and the Icelandic Banks* following the banking crisis and Local Authorities' exposure to losses when Icelandic banks went into administration.

Investment activity appears to increase with higher cash balances - 80% of respondents reported surplus cash including investments in excess of £10m. However, an unexpected finding from the survey is the 2% of respondents with average cash balances during January 2012 in excess of £40m excluding investments and 50% with average cash balances excluding investments exceeding £10m. They may be further potential for returns to be maximised on surplus cash where overnight rates may achieve returns in excess of the resource requirement to place the investment.

There appears to be little reliance by respondents on external brokers and no evidence that brokers can achieve improved returns for the associated risk. The investment products used were consistent with the cautious attitude to risk demonstrated throughout the survey with no respondents making use of gilts, Treasury bills or government bonds.

The survey revealed an unexpectedly wide range of interest rates achieved during January 2012 which did not appear to correlate with either the investment concentration or maturity date.

The resource requirements for operating Treasury Management activities do not appear to be onerous for respondents with the most activities being undertaken by finance teams within Trusts.

The survey has highlighted the potential for further work in this area in conjunction with a review of how the management of cash flows between NHS organisations could be strengthened. Consideration could also be given to the improved accuracy of cash flow forecasting to provide more certainty for finance teams to plan surplus cash investments. Therefore it may be beneficial for organisations to review the management of cash flows alongside the agreement of balances exercise with a view to providing an integrated approach to these processes if this is not already the case.

Survey results

Not all organisations answered every question and the percentages referred to are percentages of respondents answering that specific question. (Some tables may not add up to 100% due to rounding.)

Annual income

The annual income of the organisations responding to the survey can be seen in the table below:

Annual income	2011/12
<£100m	8
£100<£300m	46
£300<£500m	14
£500m and above	3

Surplus cash available for investment

The survey asked respondents to identify the level of surplus cash available for investment at the last month end including and excluding investments. This produced the following results:

Surplus cash	Including investments	Excluding investments
<£10m	22%	54%
£10m<£30m	54%	28%
£30m<£50m	16%	9%
£50m<£70m	6%	0%
£70m and above	1%	0%

Policy review

81% of respondents had reviewed their treasury management policy within the last twelve months. Additional comments revealed that polices were reviewed by audit committees or investment committees prior to approval by the board of directors.

Comments included:

'Due to the generally lower rates of return available on deposit accounts (as base rates remain 0.5%) - policy updated to allow investment period to be extended from 3 months to up to 12 months - increases rates of return available.'

'Finance Committee also make short term changes / decisions in between full reviews for example - all cash was pulled from Irish banks before credit ratings dipped below required minimum.'

'We reviewed our policy to take account of safe harbour investments, allowing for a maximum period of 12 months with a view to maximis(ing) investment income. We also increased our threshold with each bank to maximise the interest earned, particularly because we were getting some good competitive rates for overnight deposits.'

Response to market conditions

The survey asked respondents to identify how recent market conditions have influenced their treasury management polices and where changes had been made, they were temporary or permanent in nature. Key issues arising here include:

- Spreading deposits more widely
- Imposing maximum deposits with individual banks
- Imposing maximum investment terms
- Using a broker to access better rates of return
- Moving deposits from those banks whose credit ratings have fallen
- Restricting investments to banks with a AA- (or equivalent) credit rating until market conditions improve
- Restricting investments to UK banks
- Regularly testing the market to ensure value for money from banking arrangements
- Regular review of 'safe' institutions by finance committee.

For example, one organisation has updated their treasury management policy as follows:

- Maximum deposit with any single institution up to 1 month - £10m
- Maximum deposit with any single institution between 1 and 3 months - £8m
- Maximum deposit with any single institution between 3 and 6 months - £6m
- Maximum deposit with any single institution over 6 and up to 12 months - £5m.

This cautious approach is reflected in the following comments:

'With the down grading of many high street banks etc, and with the Trust keeping within Monitor`s "safe haven " remit the Trust has remained cautious regarding deposits and will continue to do so in the future.'

'We changed our TM policy to take account of the fact that there are no AAA rated organisations/banks. We will go with AA rated banks; maximum deposit limit with each organisation was increased and also the time scales. We see our …changes as temporary and will tweak it by addendums to the policy when market conditions change.'

Review of credit ratings/ institutions

Respondents were asked the frequency with which the credit ratings and/ or institutions for investment are reviewed. 57% review prior to each investment.

Comments included:

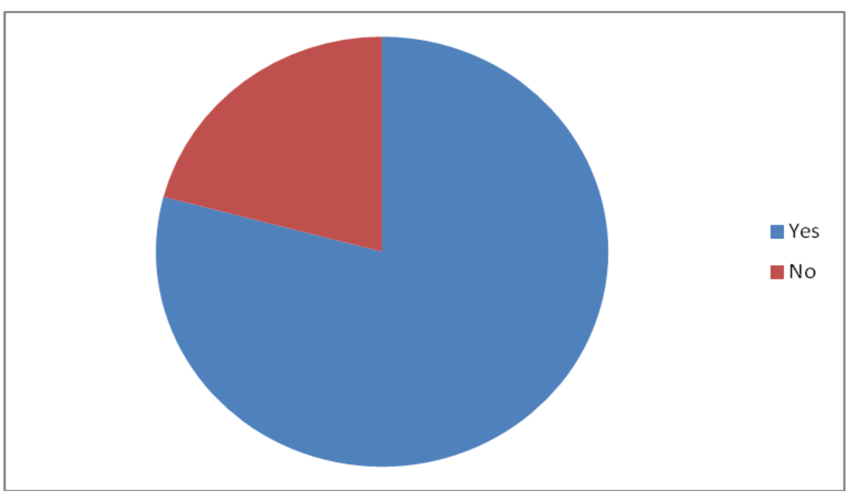
'We review Moody's ratings at the time of each quarterly treasury management report.'

'We also monitor media reports to keep watch of events unfolding with regards to bank credit worthiness and ratings.'

'Daily we look at business news for changes either in the climate and or changes to ratings and these will then influence investments. As and when we look at whether we need to introduce new institutions, but in general these are only large banking institutions, UK based.'

Safe harbour investments

79% of respondents use Monitor's definition of safe harbour investments in relation to permitted rating requirements, permitted institutions and maturity.



Comments from organisations where the treasury management policy has moved away from this definition included:

'Monitor's minimum credit ratings are too restrictive (they have not changed since 2005). We use our own concentration limits. We invest for up to 12 months (not restricted to just 3 months).'

'We follow Monitors definition of safe harbour deposits but we allow investments for longer maturity periods.'

Single institution investments

The survey asked respondents to identify the maximum amount of surplus cash for investment/deposit that can be invested with a single financial institution. The results were as follows:

	Response Percent
Discretionary – no specific policy	6%
Up to 25%	3%
Up to 33%	0%
Up to 50%	0%
Up to £1m	2%
£1m<£5m	31%
Over £5m	38%
Varies according to credit rating/ net worth	20%

Comments included:

'Up to £5m in AA (or equivalent) rated institution. Up to £10m in AAA institution at discretion of Financial Accountant in association with authorising manager.'

'Trust policy allows up to £5m with one counterparty but this can be increased with the agreement of either the Chief Exec or DoF.'

'We currently use a £5m limit but plan to increase this to £7.5m as long as the credit rating is A1 or better. Investments have to be split so that no more than 50% of our investments at a given time are with one institution.'

'AA rated banks up to £14m A+ rated banks up to £3m A rated banks up to £1m Banks below this have £nil limits. In addition up to £7m can be with one institution, £7m to £14m must be with at least 2 institutions, £14m to £20m must be with at least 3 institutions, £20m to £25m must be with at least 4 institutions.'

Minimum cash balances

The survey went on to ask respondents to identify the minimum cash balances they aim to hold at any point in time. 69% of respondents aim to hold a fixed amount of cash as a minimum balance.

Of those organisations using different approaches, comments included:

'Keep one week's operating expenditure in liquid cash with Citi bank.'

'We do not aim at a particular minimum balance at present but we monitor our cash flow by updating a daily forecast looking ahead 1 month and also weekly and monthly forecasts.'

'Sufficient cash (held) to achieve a liquidity rating of 4 as part of the Financial Risk Rating.'

'Based on cash forecast with a tolerance (i.e. £0.5m) depending on when investments coming off deposit.'

'All held on instant access as cash with current bankers up to £15 million and any surplus to this also with a UK clearing bank on instant access i.e. as cash.'

'Based on cash flow projections but averages at about £1m, which all earns interest higher than GBS rate.'

Maximum maturity of investments

The survey went on to ask respondents to identify the maximum maturity of investments with more than half of respondents identifying 3 months as the maximum period. Results were as follows:

	Response Percent
Discretionary – no specific policy	4%
Up to one week	3%
Up to one month	2%
Up to three months	51%
Up to six months	15%
Up to twelve months	25%
More than twelve months	0%

Comments included:

'Up to three months but in light of current uncertainties the Trust has chosen to shorten this to a month or instant access.'

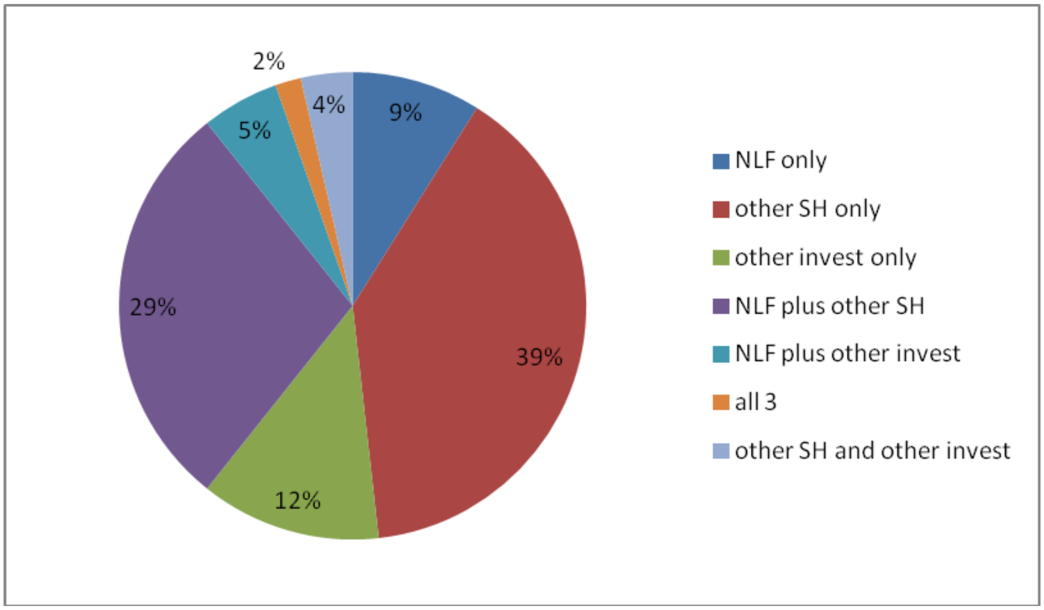
'Normally based at looking at the balance between interest rate and cash requirement. Recently short term interest rates have been so close to longer term rates the Trust has been disinclined to opt for the longer terms.'

'The policy allows up to 12 months providing this does not bridge a year end, due to PDC. We are however favouring instant access funds.'

'The main concern with investments over 12 months was whether or not these impacted on the quarterly monitoring liquidity ratings, as investments over 3 months are strictly not liquid.'

Investment products

The most common product invested in by respondents is safe harbour investments other than the national loans fund, gilts, Treasury bills and government/ local authority bonds. Surprisingly, no organisations within the survey make use of gilts, Treasury bills or government bonds. The detailed results were as follows:



Organisations make use of a number of other investment products including:

- Term deposits/ investments with commercial banks
- Investment bonds with commercial banks
- Government Banking Service
- Money market deposits.

Comments included:

'In the past we have invested in fixed term deposits but only with relationship banks. Although we have set up an account with a broker to date they have not been able to offer better rates for risk attached.'

'Fixed term investments with organisations meeting the treasury criteria. Instant access accounts with organisations meeting the treasury criteria that offer a higher interest rate than some fixed rate products.'

'Short term deposits with UK clearing banks with highest credit ratings.'

'Certificates of Deposit held by UK banks - and Barclays fixed term deposit accounts.'

It should be noted that only 1 organisation responding has a separate policy for the investment of surplus cash that isn't required for operational purposes for 12 months or longer.

January 2012 sample data

The next section of the survey asked respondents specific questions in relation to the investments made in January 2012. The survey asked respondents to complete information in relation to the highest and lowest rates achieved for an investment, and then went on to ask for the amount of the investment, the notice period and the institution with which the investment had been made.

Key conclusions can be drawn as follows:

- The highest interest rate peaked at 2.2% on a 12 month investment with Lloyds
- The lowest interest rate related to an investment with instant access placed with the Government Banking Service (0.025%)
- There is a considerable range of rates in use by institutions irrespective of deposit size or period of investment including different rates for the same period of investment. The range of returns for a 30 day investment was from 0.25% to 1.5%.

Respondents were then asked to indicate the average daily cash balances including and excluding investments during January 2012. The results were as follows:

Average cash balances	**Including investments**	**Excluding investments**
<£1m	0%	7%
£1m<£10m	19%	43%
£10m<£20m	28%	29%
£20m<£40m	36%	19%
£40m and above	16%	2%

Treasury management arrangements

The survey showed that for the majority of respondents (95%) treasury management activities are undertaken by the finance team. Results were as follows:

Treasury activities managed by:	**Response Percent**
Finance team	95%
Treasury qualified manager	3%
Separate treasury/ investment committee	12%
Existing finance (or similar) committee	46%

Information reported to either the board or a committee of the board in relation to surplus cash balances included the following:

- Comparison of rate achieved compared to base rate and London Interbank Bid Rate (LIBID)
- Activities to control and check cash balances
- Daily and quarterly investment balances and performance
- Interest receivable versus that planned
- Average investment value over the month
- Return on each investment and cash balances
- Current agency ratings
- Cash flow summary and projections
- Market conditions
- Commentary on interest rate risks, financial covenants and foreign exchange risk

- o Duration of investments
- o Brief comparison of interest rates to Government Banking Service (GBS), London Interbank Offer Rate (LIBOR) and other market rates achievable.

Many organisations make use of graphs to show the performance of their investment portfolio, monthly cash movements, actual month end cash balance to that planned, and cash flow information (receivables, payables).

Treasury management is invariably incorporated into the roles of various members of the finance team. Comments included:

'Treasury management is included as part of our Debtors and Creditors supervisor roles, and more strategic view is held as part of the Financial Controller post'.

'1 calculates and 1 approves amount and length of time. Board decision only to use National Loans Fund half hour per investment and generally 1 investment per week.'

'Band 4 - 0.4 WTE Band 5 - 0.25 WTE Band 7 - 0.15 WTE.'

'2 staff-chief cashier and financial accountant . Time spent variable but maximum half day per month.'

'Internal resources include 0.2WTE band 5 prepare cash flow data 0.1WTE band 8 reviewing cash data, liaising with external cash manager and preparing reports for Investment Committee. Total 0.3WTE spread over 2 staff.'