

Board

Date: 5 November 2014

Item 11: Review of TfL's Approved Counterparties and proposed amendments to the Treasury Management Strategy 2014/15

This paper will be considered in public

1 Summary

- 1.1 As highlighted in the Treasury Management Strategy (TMS) 2014/15, by continuing to diversify its investment counterparties, TfL will benefit from obtaining greater direct control and transparency of investments while maintaining appropriate levels of liquidity. Therefore, it is considered important that Group Treasury continues to review both existing and possible future counterparties on an ongoing basis.
- 1.2 As with TfL's investment counterparties, Group Treasury also continues to seek diversification of TfL's credit risks arising from its approved risk management programmes. This will allow TfL to benefit from reduced transaction costs and greater bank credit risk diversification associated with entering into derivatives more competitively with a greater number of high credit quality derivative counterparties. Group Treasury will therefore continue to review both existing and possible future derivative counterparties on an ongoing basis.
- 1.3 As part of the continuous development of the TMS, Group Treasury proposes a small number of amendments to the TMS 2014/15 for the purposes of good housekeeping or removing redundant clauses that have been superseded by the Committee's direct approval of counterparties on a named basis.
- 1.4 At its meeting on 14 October 2014, the Finance and Policy Committee considered this paper and recommended that the Board approve the outlined amendments to the Approved Investments List 2014/15, the Approved Derivatives Counterparties List 2014/15 and the TfL Treasury Management Strategy (TMS) 2014/15.
- 1.5 A paper is included on Part 2 of the agenda, which contains exempt supplemental information and documentation. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the financial affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendations

- 2.1 **That the Board notes the paper and the supplemental information on Part 2 of the agenda and approves:**
 - (a) **additions and amendments to the Approved Investment List 2014/15 as set out in Appendix 1 to the paper on Part 2 of the agenda;**

- (b) additions and amendments to the Approved Derivative Counterparties List 2014/15 as set out in Appendix 2 of the paper on Part 2 of the agenda; and
- (c) amendments to the Treasury Management Strategy 2014/15, as set out in Appendix 1.

Recommendations 2.1 (a) and (b) are discussed in more detail in the relevant sections contained in the paper on Part 2 of the agenda.

3 Amendments to the TMS 2014/15

- 3.1 For the purposes of good housekeeping, Group Treasury has identified some language within the text of the TMS 2014/15 which is either no longer applicable or requires modification to ensure consistency with the approach taken to manage TfL's counterparty credit risk.
- 3.2 Group Treasury recommends the following changes to the TMS 2014/15:
 - (a) the wording contained in section 4.3 of Appendix 1 of the existing TMS 2014/15 referring to permitted investments in "any wholly owned and guaranteed UK subsidiary" be replaced (in order to add clarity) with "any wholly owned subsidiary or its debt which either a) has the same or better credit rating as, or b) is guaranteed by";
 - (b) the wording in the note to both the Approved Investment List 2014/15 and the Approved Derivative Counterparty List 2014/15 reflect the above recommendation in 3.2(a) to remain consistent across all sections; and
 - (c) the wording contained in section 4.17 of Appendix 1 of the existing TMS 2014/15 referring to the calculation of the maximum investment tenor "will be that of the lowest credit rating" be replaced with "calculation will follow the same approach" in order to be consistent with how Group Treasury currently determines the overall investment limit.
- 3.3 The updated TMS 2014/15, which includes the recommendations above, is contained in Appendix 1 and the previous version of the TMS approved in March 2014 with the proposed changes marked-up is contained in Appendix 2.

List of appendices to this report:

Appendix 1: Amended Treasury Management Strategy 2014/15

Appendix 2: Treasury Management Strategy 2014/15 with amendments compared to the previous version approved 26 March 2014

Exempt supplemental information is included in a paper on Part 2 of the agenda.

List of Background Papers:

None

Contact Officer: Simon Kilonback, Director of Group Treasury

Number: 020 7535 5300

Email: SimonKilonback@tfl.gov.uk

TRANSPORT FOR LONDON

TREASURY MANAGEMENT STRATEGY 2014/15

1 SUMMARY

1.1 This TfL Treasury Management Strategy (TMS) 2014/15 comprises the:

- (a) Investment Strategy 2014/15;
- (b) Borrowing Strategy 2014/15; and,
- (c) Risk Management Strategy 2014/15.

2 BACKGROUND INFORMATION

- 2.1 TfL has had regard to the key recommendations of CIPFA's Code of Practice and Cross-Sectoral Guidance Notes for Treasury Management in the Public Services 2011 (the 'Code') and the revised investment guidance issued by the Department for Communities and Local Government (DCLG) which came into effect from 1 April 2010 (DCLG Guidance) in preparing this Treasury Management Strategy.
- 2.2 As recommended by the Code, this strategy will be updated at least annually and submitted for the approval of the TfL Board.
- 2.3 TfL has considered the implications of its overall asset and liability management, taking into account its overall exposure to inflation and interest rates as they affect its commercial markets (passenger levels, fare revenues, and costs) and in its financial activities (financing costs and investment returns on cash balances). TfL has also reviewed its exposure to default risk in the investment of its surplus cash given the instability of the financial markets over the last year.
- 2.4 TfL continues to add to its sources of market information to enable it to support its future investment decisions and continues to seek prudent opportunities to maintain yield without risking underlying security.
- 2.5 The Director of Group Treasury and TfL Group Treasury officers will implement, operate and administer the Treasury Management Strategy (including entering into any documentation where appropriate).

3 STRATEGIC OBJECTIVES

3.1 The objectives underpinning the TMS 2014/15 are:

- (a) to undertake treasury management operations with primary regard for the security and liquidity of capital invested;
- (b) to maximise the yield from investments consistent with the security and liquidity objectives identified above;
- (c) to ensure that sufficient cash is available to enable TfL to discharge its financial obligations when they become due, in accordance with approved spending plans;
- (d) to undertake treasury management activity having regard to Prudential Indicators;
- (e) to secure TfL's funding requirements by accessing the most cost efficient source of finance, while ensuring TfL has flexibility and sufficient alternatives not to be dependent on any particular source; and
- (f) to use TfL's statutory power relating to risk management to achieve greater value for money through reducing costs or protecting revenues, reducing volatility / increasing certainty in the Business Plan and to holistically manage financial risks across the whole of TfL.

4 INVESTMENT STRATEGY 2014/15

4.1 All cash balances will be invested in accordance with this Investment Strategy . Under the DCLG Guidance, investments fall into two categories:

- (a) Specified Investments; and
- (b) Non-specified investments.

SPECIFIED INVESTMENTS

4.2 Specified investments offer high security and high liquidity and must satisfy the conditions set out below:

- (a) the investment is denominated in Sterling and any payments or repayments in respect of the investment are payable in Sterling only;
- (b) the investment is not a long-term investment (i.e. has a maturity of less than one year); and
- (c) the investment is either:
 - (i) made with the UK Government; or
 - (ii) made with a body or in an investment scheme which has been awarded a high (investment grade) credit rating by a credit rating agency.

- 4.3 Specified investments are limited to institutions and types of investment that have been placed on a TfL 'Approved Investment List'. Investments may be made in any wholly owned subsidiary or its debt which either (a) has the same or better credit rating as, or (b) is guaranteed by the counterparty listed in the Approved Investments List, within the parent institution's aggregate investment limit. The Finance and Policy Committee will approve entities and types of investment that may be added to the Approved Investment List.
- 4.4 In determining whether to recommend to the Finance and Policy Committee to place an institution on the Approved Investment List, TfL Officers will consider:
- (a) the financial position and jurisdiction of the institution;
 - (b) the market pricing of credit default swaps for the institution;
 - (c) any implicit or explicit Government support for the institution;
 - (d) Standard & Poor's, Moody's and Fitch's short and long term credit ratings; and
 - (e) Tier 1 capital ratios of those institutions.
- 4.5 TfL's maximum investment in any fund will be three point five per cent of fund size.

NON-SPECIFIED INVESTMENTS

- 4.6 Non-specified investments do not, by definition, meet the requirements of a specified investment. The DCLG Guidance recommends an articulated risk management strategy and greater detail of the intended use of non-specified investments due to greater potential risk.
- 4.7 Non-specified investments approved for use by TfL under this strategy are investments in instruments and with entities on the Approved Investment List where:
- (a) the maximum maturity is one year or greater than one year:
 - (i) any such investments would be in Sterling, so the potential risk for TfL is one of liquidity – that TfL requires the funds that are tied up in longer term deposits. Given the nature of the institutions (in some cases government or government guaranteed) the risk of default is very low;
 - (ii) before placing such longer term deposits, TfL would carry out a detailed cash forecast to determine the need for funds over a longer time period, and only place funds for longer than one year where it was confident on the most conservative basis that the monies would not be required in the meantime; and,
 - (iii) any such investments will be in instruments which would be readily accepted as collateral to obtain liquidity facilities, should such a need arise; and

- (b) investments are in currencies other than Sterling:
- (i) deposits denominated in US Dollars (USD) or Euros, to a maximum amount of £100m, when funds are received in those currencies in the normal course of business and where TfL is expected to have costs in those currencies in the future;
 - (ii) deposits in any currency where the currency is bought in advance of a payment or payments in that currency (for example, if TfL has several payments in Euros within a matter of weeks and it is more cost effective to buy a single tranche of Euros to cover all of the payments rather than buy several smaller amounts on the days each payment is required); or
 - (iii) investments denominated in EUR or USD and swapped back to GBP as a matter of course after taking into account of any natural offsets TfL has to the foreign currency as appropriate.

LIQUIDITY OF INVESTMENTS

- 4.8 TfL will manage its cash to ensure that a minimum of £250m is available for redemption on any business day to ensure TfL has sufficient liquidity to meet its financial obligations.
- 4.9 Each investment decision will be made with regard to expected cash flow requirements resulting in a range of maturity periods within the investment portfolio.
- 4.10 Where the Director of Group Treasury, in consultation with Managing Director, Finance and/or Chief Finance Officer, deems such a step is appropriate in order to protect TfL against potential losses, TfL may break or resell fixed term investments early, including where doing so will result in TfL incurring penalties or crystallising a loss.
- 4.11 Where the Director of Group Treasury, in consultation with the Chief Finance Officer, deems it appropriate, TfL may break or sell fixed term investment instruments as part of a switch into similar instruments where doing so offers a positive investment return. For example, TfL may have the opportunity to sell a holding of T-bills of a particular maturity and buy T-bills with a slightly different maturity with a better return. Market opportunities such as this arise reasonably frequently where market dynamics result in high demand for particular instruments.

COUNTERPARTY INVESTMENT LIMITS AND MATURITY LIMITS

- 4.12 The maximum limits per investment per institution for 2014/15 are shown in the table below:

	S&P	Moody's	Fitch	Investment Limit per counterparty (£m)	Maximum tenor of deposit
UK Sovereign and UK Government Guaranteed				Unlimited	Unlimited
Money Market Fund	AAA	Aaa	AAA	3.5% of fund	Max 7 day (normally Instant access)
Non-UK Sovereigns and SSAs	AAA	Aaa	AAA	300	3 years
	AA+	Aa1	AA+	250	3 years
	AA	Aa2	AA	200	3 years
	AA-	Aa3	AA-	175	3 years
	A+	A1	A+	150	2 years
	A	A2	A	125	12 months
	A-	A3	A-	100	12 months
	BBB+	Baa	BBB+	0	n.a.
Banks	AAA	Aaa	AAA	300	12 months
	AA+	Aa1	AA+	250	12 months
	AA	Aa2	AA	200	12 months
	AA-	Aa3	AA-	175	12 months
	A+	A1	A+	150	12 months
	A	A2	A	125	12 months
	A-	A3	A-	100	12 months
	BBB+	Baa	BBB+	0	n.a.
Corporates	AAA	Aaa	AAA	150	12 months
	AA+	Aa1	AA+	125	12 months
	AA	Aa2	AA	100	12 months
	AA-	Aa3	AA-	87.5	12 months
	A+	A1	A+	75	6 months
	A	A2	A	62.5	6 months
	A-	A3	A-	50	6 months
	BBB+	Baa	BBB+	n.a	n.a.

- 4.13 The counterparty credit limits apply solely to institutions on the Approved Investment List.
- 4.14 Where an instrument benefits from a UK Government Guarantee, the investment limit will be that for UK Government Guaranteed rather than the entity guaranteed by the UK Government.
- 4.15 Where an instrument benefits from collateral arrangements, for example Repos, the investment exposure will be calculated based on maximum expected movements in the value of collateral with a 99% confidence level and not the face value of the sum invested. For example the exposure on daily adjusted repo arrangements will £2.3m per £100m.
- 4.16 In exceptional circumstances the applicable limit for TfL's clearing bank may be temporarily exceeded, for example where cash is available for investment after the daily deadline for deposits with the DMO has passed. Any such circumstance will be immediately notified to the Managing Director, Finance and Chief Finance Officer.
- 4.17 Where a counterparty has a split rating, the Investment Limit for each rating is calculated as the average of the relevant Investment Limits for each rating available, i.e. the limit is derived by taking the sum of one third of the applicable limit for each rating agency. The maximum tenor of deposit calculation will follow the same manner.
- 4.18 If the Investment Limit applicable to a counterparty changes while TfL has an outstanding investment with that counterparty, TfL may seek to bring its exposure down to within the revised limits but a breach of limits caused by such a change will not be considered a breach of this policy. TfL may at the Director of Group Treasury's discretion (in consultation with the Managing Director, Finance and/or Chief Finance Officer) decide to allow an investment to run its course for economic reasons.

5 INVESTMENT MATURITY LIMIT / INVESTMENT DOCUMENTATION

- 5.1 As recommended by the Code, TfL establishes a limit on sums that are invested for periods longer than 364 days. These are established by a separate Prudential Indicators document approved by the Mayor.
- 5.2 Without further reference to the Finance and Policy Committee, the Director of Group Treasury and/or TfL Group Treasury officers may enter into any investment related agreements and/or documentation required to execute the Investment Strategy.

6 BORROWING STRATEGY 2014/15

- 6.1 TfL's objective is to manage its borrowing in a manner that combines flexibility, security of access to funds, diversity of funding sources and value for money. TfL seeks to achieve this by maintaining access to capital markets through its Euro Commercial Paper (ECP) programme and Euro Medium Term Note (EMTN) programme, and complementing this with loans and other facilities

from banks where appropriate. TfL's borrowing plans are ultimately underpinned by access to the Public Works Loan Board (PWLB); other sources of funding will be used where they further TfL's stated objectives (i.e. offer better value for money, flexibility, security of access or diversity of funding sources).

- 6.2 TfL recognises the value of its strong credit rating in facilitating low cost debt finance and other financial instruments and intends to maintain its credit rating relative to that of the UK Government.
- 6.3 TfL intends to build upon the success of the liquid, benchmark sized bonds issued under its EMTN programme where this represents good value for money.
- 6.4 TfL intends to borrow an additional £650m in 2014/15 (in accordance with the 2010 funding settlement). £100m of this borrowing has already been arranged and approved and will be drawn in April 2014 from the European Investment Bank (EIB) under the fixed rate loan in support of Crossrail. The balance of TfL's borrowing for the year will be drawn from TfL's Approved Borrowing Sources.
- 6.5 TfL's Approved Borrowing Sources comprise:
 - (a) the PWLB;
 - (b) TfL's EMTN programme;
 - (c) TfL Notes issued under standalone documentation;
 - (d) TfL's ECP programme;
 - (e) EIB or commercial bank loans; and
 - (f) A £200m overdraft facility with HSBC;
- 6.6 Additional sources of borrowing may only be added to the Approved Borrowing Sources with the approval of the Finance and Policy Committee.
- 6.7 The Finance and Policy Committee's approval is required for any newly arranged facility (but not facilities being renewed) through the EIB or commercial banks.
- 6.8 Issuance under TfL's EMTN programme or the issuance of Notes using standalone documentation are both permitted subject to the prior written approval of Managing Director, Finance or Chief Finance Officer provided that:
 - (a) any such issuance is in accordance with any relevant parameters set out in the Treasury Management Strategy 2014/15; and,
 - (b) Officers consult with as many Members of the Finance and Policy Committee as are available, on:
 - (i) the proposed term and amount of such Note issuance in advance of issuance; and

- (ii) the need for any Supplemental Prospectus prior to the proposed Note issuance.
- 6.9 The prior written approval of Managing Director, Finance or Chief Finance Officer is required for any new borrowing from the PWLB.
- 6.10 Without further reference to the Finance and Policy Committee, TfL will use the ECP programme and any other short-term facilities approved by the Finance and Policy Committee e.g. overdraft or commercial paper back-stop facilities, to meet its short-term liquidity requirements pending the execution of longer-term borrowing agreed with the Finance and Policy Committee.
- 6.11 TfL will normally arrange new short-term borrowings to replace short-term borrowings falling due for repayment. In order to limit the liquidity risk that this creates TfL manages maturities such that no more than £200m of short-term borrowings falls due for repayment in any three day period.
- 6.12 The overdraft facility will not be used in the normal course of business, but only for short periods to meet unexpected liquidity requirements. The Managing Director, Finance will be notified immediately of any drawing of more than £20m on the overdraft facility.
- 6.13 As required by the Local Government Act 2003, at all times, the aggregate of all of TfL's liabilities will be within the Authorised Limit set by the Mayor and adopted by the Board.
- 6.14 Where TfL is issuing new medium or long-term debt, or refinancing existing debt, it may be necessary or commercially desirable to draw the new debt prior to the repayment of the debt being refinanced, which may result in a temporary increase in liabilities above the planned incremental borrowing for the year. Borrowing in excess of the planned incremental borrowing is permitted provided the position is temporary and that TfL remains within the Authorised Limit at all times (i.e. it reflects the temporary utilisation of headroom between the planned incremental borrowing and the legal limit on TfL's liabilities).
- 6.15 The Code requires that upper and lower limits are set for the mix of fixed and variable rate borrowing, and for the maturity structure of fixed rate borrowings to manage interest rate risk. These are established by a separate Prudential Indicators document approved by the Mayor.

LIABILITY MANAGEMENT

- 6.16 TfL will seek to buyback, refinance, or otherwise restructure, existing liabilities (including finance leases) where doing so represents value for money, or will improve the structure of TfL's liabilities, or facilitate changes to TfL's corporate structure.
- 6.17 TfL may pre-pay or refinance loans or re-purchase or redeem existing debt instruments in accordance with the delegated authorities set out in TfL Standing Orders
- 6.18 Any liability management exercise in excess of these limits will be subject to the approval of the Finance and Policy Committee.

MINIMUM REVENUE PROVISION

- 6.19 The Minimum Revenue Provision (MRP) is a Government mandated mechanism requiring local authorities to set aside an amount from current revenue resources in relation to future debt repayment. The MRP policy has to be approved by the Board each year.
- 6.20 TfL has a duty to determine for the current financial year an amount of minimum revenue provision that it considers to be 'prudent' in relation to debt service obligations.
- 6.21 TfL's policy on MRP remains unchanged from 2013/14. That is to treat debt service (interest and principal) in its business plan as an in-year operating cost. As TfL has a legal requirement to produce a balanced budget (and this approach had been extended to the full business plan), the cost of debt service is taken into account when determining whether annual budget and business plans are in balance.

7 RISK MANAGEMENT STRATEGY 2014/15

- 7.1 TfL is materially exposed to a number of specific financial risks in the ordinary course of business, arising from the borrowing programme, the capital investment programme and certain ongoing contractual obligations. There is significant potential to reduce costs and add value to TfL by managing financial risks more effectively.
- 7.2 Under Section 49 of the Transport for London Act 2008 (the TfL Act), TfL was conferred powers to make arrangements for risk mitigation.
- 7.3 This Risk Management Strategy 2014/15 provides for measures to address identifiable financial risks that fall within the categories outlined below:
- (a) interest rate risk related to TfL's planned future borrowing requirements;
 - (b) exchange rate risk related to specific currency exposures arising from the procurement of goods or services by the TfL Group; and from receipts of European Union (EU) subsidies or other grants / revenues payable other than in Sterling; and,
 - (c) commodity price risk related to specific procurements containing a significant cost element for a commodity component and ongoing operational procurements such as power and fuel.
- 7.4 The high level principles established by this Risk Management Strategy 2014/15 are to:
- (a) achieve greater value for money through reducing costs or protecting revenues;
 - (b) reduce volatility / increase certainty relating to the impact of financial risks upon the business plan; and
 - (c) holistically manage financial risks across the whole of TfL.

- 7.5 Where TfL arranges derivative investments through its subsidiary, Transport for London Finance Limited, it may put in place intra-group arrangements to confer the benefit of those derivative investments to the TfL entity bearing the underlying risk.
- 7.6 Under the TfL Group Policy relating to the use of Derivative Investments, the Finance and Policy Committee have delegated authority to approve derivative transactions.

TRANSPORT FOR LONDON

TREASURY MANAGEMENT STRATEGY 2014/15

1 SUMMARY

1.1 This TfL Treasury Management Strategy (TMS) 2014/15 comprises the:

- (a) Investment Strategy 2014/15;
- (b) Borrowing Strategy 2014/15; and,
- (c) Risk Management Strategy 2014/15.

2 BACKGROUND INFORMATION

- 2.1 TfL has had regard to the key recommendations of CIPFA's Code of Practice and Cross-Sectoral Guidance Notes for Treasury Management in the Public Services 2011 (the 'Code') and the revised investment guidance issued by the Department for Communities and Local Government (DCLG) which came into effect from 1 April 2010 (DCLG Guidance) in preparing this Treasury Management Strategy.
- 2.2 As recommended by the Code, this strategy will be updated at least annually and submitted for the approval of the TfL Board.
- 2.3 TfL has considered the implications of its overall asset and liability management, taking into account its overall exposure to inflation and interest rates as they affect its commercial markets (passenger levels, fare revenues, and costs) and in its financial activities (financing costs and investment returns on cash balances). TfL has also reviewed its exposure to default risk in the investment of its surplus cash given the instability of the financial markets over the last year.
- 2.4 TfL continues to add to its sources of market information to enable it to support its future investment decisions and continues to seek prudent opportunities to maintain yield without risking underlying security.
- 2.5 The Director of Group Treasury and TfL Group Treasury officers will implement, operate and administer the Treasury Management Strategy (including entering into any documentation where appropriate).

3 STRATEGIC OBJECTIVES

3.1 The objectives underpinning the TMS 2014/15 are:

- (a) to undertake treasury management operations with primary regard for the security and liquidity of capital invested;
- (b) to maximise the yield from investments consistent with the security and liquidity objectives identified above;
- (c) to ensure that sufficient cash is available to enable TfL to discharge its financial obligations when they become due, in accordance with approved spending plans;
- (d) to undertake treasury management activity having regard to Prudential Indicators;
- (e) to secure TfL's funding requirements by accessing the most cost efficient source of finance, while ensuring TfL has flexibility and sufficient alternatives not to be dependent on any particular source; and
- (f) to use TfL's statutory power relating to risk management to achieve greater value for money through reducing costs or protecting revenues, reducing volatility / increasing certainty in the Business Plan and to holistically manage financial risks across the whole of TfL.

4 INVESTMENT STRATEGY 2014/15

4.1 All cash balances will be invested in accordance with this Investment Strategy . Under the DCLG Guidance, investments fall into two categories:

- (a) Specified Investments; and
- (b) Non-specified investments.

SPECIFIED INVESTMENTS

4.2 Specified investments offer high security and high liquidity and must satisfy the conditions set out below:

- (a) the investment is denominated in Sterling and any payments or repayments in respect of the investment are payable in Sterling only;
- (b) the investment is not a long-term investment (i.e. has a maturity of less than one year); and
- (c) the investment is either:
 - (i) made with the UK Government; or
 - (ii) made with a body or in an investment scheme which has been awarded a high (investment grade) credit rating by a credit rating agency.

- 4.3 Specified investments are limited to institutions and types of investment that have been placed on a TfL 'Approved Investment List'. Investments may be made in any wholly owned subsidiary or its debt which either (a) has the same credit rating as, or (b) is and guaranteed ~~UK subsidiary by of~~ the counterparties in the Approved Investments List, within the parent institution's aggregate investment limit. The Finance and Policy Committee will approve entities and types of investment that may be added to the Approved Investment List.
- 4.4 In determining whether to recommend to the Finance and Policy Committee to place an institution on the Approved Investment List, TfL Officers will consider:
- (a) the financial position and jurisdiction of the institution;
 - (b) the market pricing of credit default swaps for the institution;
 - (c) any implicit or explicit Government support for the institution;
 - (d) Standard & Poor's, Moody's and Fitch's short and long term credit ratings; and
 - (e) Tier 1 capital ratios of those institutions.
- 4.5 TfL's maximum investment in any fund will be three point five per cent of fund size.

NON-SPECIFIED INVESTMENTS

- 4.6 Non-specified investments do not, by definition, meet the requirements of a specified investment. The DCLG Guidance recommends an articulated risk management strategy and greater detail of the intended use of non-specified investments due to greater potential risk.
- 4.7 Non-specified investments approved for use by TfL under this strategy are investments in instruments and with entities on the Approved Investment List where:
- (a) the maximum maturity is one year or greater than one year:
 - (i) any such investments would be in Sterling, so the potential risk for TfL is one of liquidity – that TfL requires the funds that are tied up in longer term deposits. Given the nature of the institutions (in some cases government or government guaranteed) the risk of default is very low;
 - (ii) before placing such longer term deposits, TfL would carry out a detailed cash forecast to determine the need for funds over a longer time period, and only place funds for longer than one year where it was confident on the most conservative basis that the monies would not be required in the meantime; and,
 - (iii) any such investments will be in instruments which would be readily accepted as collateral to obtain liquidity facilities, should such a need arise; and

- (b) investments are in currencies other than Sterling:
- (i) deposits denominated in US Dollars (USD) or Euros, to a maximum amount of £100m, when funds are received in those currencies in the normal course of business and where TfL is expected to have costs in those currencies in the future;
 - (ii) deposits in any currency where the currency is bought in advance of a payment or payments in that currency (for example, if TfL has several payments in Euros within a matter of weeks and it is more cost effective to buy a single tranche of Euros to cover all of the payments rather than buy several smaller amounts on the days each payment is required); or
 - (iii) investments denominated in EUR or USD and swapped back to GBP as a matter of course after taking into account of any natural offsets TfL has to the foreign currency as appropriate.

LIQUIDITY OF INVESTMENTS

- 4.8 TfL will manage its cash to ensure that a minimum of £250m is available for redemption on any business day to ensure TfL has sufficient liquidity to meet its financial obligations.
- 4.9 Each investment decision will be made with regard to expected cash flow requirements resulting in a range of maturity periods within the investment portfolio.
- 4.10 Where the Director of Group Treasury, in consultation with Managing Director, Finance and/or Chief Finance Officer, deems such a step is appropriate in order to protect TfL against potential losses, TfL may break or resell fixed term investments early, including where doing so will result in TfL incurring penalties or crystallising a loss.
- 4.11 Where the Director of Group Treasury, in consultation with the Chief Finance Officer, deems it appropriate, TfL may break or sell fixed term investment instruments as part of a switch into similar instruments where doing so offers a positive investment return. For example, TfL may have the opportunity to sell a holding of T-bills of a particular maturity and buy T-bills with a slightly different maturity with a better return. Market opportunities such as this arise reasonably frequently where market dynamics result in high demand for particular instruments.

COUNTERPARTY INVESTMENT LIMITS AND MATURITY LIMITS

- 4.12 The maximum limits per investment per institution for 2014/15 are shown in the table below:

	S&P	Moody's	Fitch	Investment Limit per counterparty	Maximum tenor of deposit

				(£m)	
UK Sovereign and UK Government Guaranteed				Unlimited	Unlimited
Money Market Fund	AAA	Aaa	AAA	3.5% of fund	Max 7 day (normally Instant access)
Non-UK Sovereigns and SSAs	AAA	Aaa	AAA	300	3 years
	AA+	Aa1	AA+	250	3 years
	AA	Aa2	AA	200	3 years
	AA-	Aa3	AA-	175	3 years
	A+	A1	A+	150	2 years
	A	A2	A	125	12 months
	A-	A3	A-	100	12 months
	BBB+	Baa	BBB+	0	n.a.
Banks	AAA	Aaa	AAA	300	12 months
	AA+	Aa1	AA+	250	12 months
	AA	Aa2	AA	200	12 months
	AA-	Aa3	AA-	175	12 months
	A+	A1	A+	150	12 months
	A	A2	A	125	12 months
	A-	A3	A-	100	12 months
	BBB+	Baa	BBB+	0	n.a.
Corporates	AAA	Aaa	AAA	150	12 months
	AA+	Aa1	AA+	125	12 months
	AA	Aa2	AA	100	12 months
	AA-	Aa3	AA-	87.5	12 months
	A+	A1	A+	75	6 months
	A	A2	A	62.5	6 months
	A-	A3	A-	50	6 months
	BBB+	Baa	BBB+	n.a.	n.a.

4.13 The counterparty credit limits apply solely to institutions on the Approved Investment List.

- 4.14 Where an instrument benefits from a UK Government Guarantee, the investment limit will be that for UK Government Guaranteed rather than the entity guaranteed by the UK Government.
- 4.15 Where an instrument benefits from collateral arrangements, for example Repos, the investment exposure will be calculated based on maximum expected movements in the value of collateral with a 99% confidence level and not the face value of the sum invested. For example the exposure on daily adjusted repo arrangements will £2.3m per £100m.
- 4.16 In exceptional circumstances the applicable limit for TfL's clearing bank may be temporarily exceeded, for example where cash is available for investment after the daily deadline for deposits with the DMO has passed. Any such circumstance will be immediately notified to the Managing Director, Finance and Chief Finance Officer.

~~4.17~~ Where a counterparty has a split rating, the Investment Limit for each rating is calculated as the average of the relevant Investment Limits for each rating available, i.e. the limit is derived by taking the sum of one third of the applicable limit for each rating agency. The maximum tenor of deposit calculation will follow the same manner ~~will be that of the lowest rating.~~

~~4.18~~ 4.17 If the Investment Limit applicable to a counterparty changes while TfL has an outstanding investment with that counterparty, TfL may seek to bring its exposure down to within the revised limits but a breach of limits caused by such a change will not be considered a breach of this policy. TfL may at the Director of Group Treasury's discretion (in consultation with the Managing Director, Finance and/or Chief Finance Officer) decide to allow an investment to run its course for economic reasons.

Formatted: Tab stops: Not at 1.25 cm

5 INVESTMENT MATURITY LIMIT / INVESTMENT DOCUMENTATION

- 5.1 As recommended by the Code, TfL establishes a limit on sums that are invested for periods longer than 364 days. These are established by a separate Prudential Indicators document approved by the Mayor.
- 5.2 Without further reference to the Finance and Policy Committee, the Director of Group Treasury and/or TfL Group Treasury officers may enter into any investment related agreements and/or documentation required to execute the Investment Strategy.

6 BORROWING STRATEGY 2014/15

- 6.1 TfL's objective is to manage its borrowing in a manner that combines flexibility, security of access to funds, diversity of funding sources and value for money. TfL seeks to achieve this by maintaining access to capital markets through its Euro Commercial Paper (ECP) programme and Euro Medium Term Note (EMTN) programme, and complementing this with loans and other facilities from banks where appropriate. TfL's borrowing plans are ultimately underpinned by access to the Public Works Loan Board (PWLB); other sources of funding will be used where they further TfL's stated objectives (i.e. offer

better value for money, flexibility, security of access or diversity of funding sources).

- 6.2 TfL recognises the value of its strong credit rating in facilitating low cost debt finance and other financial instruments and intends to maintain its credit rating relative to that of the UK Government.
- 6.3 TfL intends to build upon the success of the liquid, benchmark sized bonds issued under its EMTN programme where this represents good value for money.
- 6.4 TfL intends to borrow an additional £650m in 2014/15 (in accordance with the 2010 funding settlement). £100m of this borrowing has already been arranged and approved and will be drawn in April 2014 from the European Investment Bank (EIB) under the fixed rate loan in support of Crossrail. The balance of TfL's borrowing for the year will be drawn from TfL's Approved Borrowing Sources.
- 6.5 TfL's Approved Borrowing Sources comprise:
 - (a) the PWLB;
 - (b) TfL's EMTN programme;
 - (c) TfL Notes issued under standalone documentation;
 - (d) TfL's ECP programme;
 - (e) EIB or commercial bank loans; and
 - (f) A £200m overdraft facility with HSBC;
- 6.6 Additional sources of borrowing may only be added to the Approved Borrowing Sources with the approval of the Finance and Policy Committee.
- 6.7 The Finance and Policy Committee's approval is required for any newly arranged facility (but not facilities being renewed) through the EIB or commercial banks.
- 6.8 Issuance under TfL's EMTN programme or the issuance of Notes using standalone documentation are both permitted subject to the prior written approval of Managing Director, Finance or Chief Finance Officer provided that:
 - (a) any such issuance is in accordance with any relevant parameters set out in the Treasury Management Strategy 2014/15; and,
 - (b) Officers consult with as many Members of the Finance and Policy Committee as are available, on:
 - (i) the proposed term and amount of such Note issuance in advance of issuance; and
 - (ii) the need for any Supplemental Prospectus prior to the proposed Note issuance.

- 6.9 The prior written approval of Managing Director, Finance or Chief Finance Officer is required for any new borrowing from the PWLB.
- 6.10 Without further reference to the Finance and Policy Committee, TfL will use the ECP programme and any other short-term facilities approved by the Finance and Policy Committee e.g. overdraft or commercial paper back-stop facilities, to meet its short-term liquidity requirements pending the execution of longer-term borrowing agreed with the Finance and Policy Committee.
- 6.11 TfL will normally arrange new short-term borrowings to replace short-term borrowings falling due for repayment. In order to limit the liquidity risk that this creates TfL manages maturities such that no more than £200m of short-term borrowings falls due for repayment in any three day period.
- 6.12 The overdraft facility will not be used in the normal course of business, but only for short periods to meet unexpected liquidity requirements. The Managing Director, Finance will be notified immediately of any drawing of more than £20m on the overdraft facility.
- 6.13 As required by the Local Government Act 2003, at all times, the aggregate of all of TfL's liabilities will be within the Authorised Limit set by the Mayor and adopted by the Board.
- 6.14 Where TfL is issuing new medium or long-term debt, or refinancing existing debt, it may be necessary or commercially desirable to draw the new debt prior to the repayment of the debt being refinanced, which may result in a temporary increase in liabilities above the planned incremental borrowing for the year. Borrowing in excess of the planned incremental borrowing is permitted provided the position is temporary and that TfL remains within the Authorised Limit at all times (i.e. it reflects the temporary utilisation of headroom between the planned incremental borrowing and the legal limit on TfL's liabilities).
- 6.15 The Code requires that upper and lower limits are set for the mix of fixed and variable rate borrowing, and for the maturity structure of fixed rate borrowings to manage interest rate risk. These are established by a separate Prudential Indicators document approved by the Mayor.

LIABILITY MANAGEMENT

- 6.16 TfL will seek to buyback, refinance, or otherwise restructure, existing liabilities (including finance leases) where doing so represents value for money, or will improve the structure of TfL's liabilities, or facilitate changes to TfL's corporate structure.
- 6.17 TfL may pre-pay or refinance loans or re-purchase or redeem existing debt instruments in accordance with the delegated authorities set out in TfL Standing Orders
- 6.18 Any liability management exercise in excess of these limits will be subject to the approval of the Finance and Policy Committee.

MINIMUM REVENUE PROVISION

- 6.19 The Minimum Revenue Provision (MRP) is a Government mandated mechanism requiring local authorities to set aside an amount from current revenue resources in relation to future debt repayment. The MRP policy has to be approved by the Board each year.
- 6.20 TfL has a duty to determine for the current financial year an amount of minimum revenue provision that it considers to be 'prudent' in relation to debt service obligations.
- 6.21 TfL's policy on MRP remains unchanged from 2013/14. That is to treat debt service (interest and principal) in its business plan as an in-year operating cost. As TfL has a legal requirement to produce a balanced budget (and this approach had been extended to the full business plan), the cost of debt service is taken into account when determining whether annual budget and business plans are in balance.

7 RISK MANAGEMENT STRATEGY 2014/15

- 7.1 TfL is materially exposed to a number of specific financial risks in the ordinary course of business, arising from the borrowing programme, the capital investment programme and certain ongoing contractual obligations. There is significant potential to reduce costs and add value to TfL by managing financial risks more effectively.
- 7.2 Under Section 49 of the Transport for London Act 2008 (the TfL Act), TfL was conferred powers to make arrangements for risk mitigation.
- 7.3 This Risk Management Strategy 2014/15 provides for measures to address identifiable financial risks that fall within the categories outlined below:
- (a) interest rate risk related to TfL's planned future borrowing requirements;
 - (b) exchange rate risk related to specific currency exposures arising from the procurement of goods or services by the TfL Group; and from receipts of European Union (EU) subsidies or other grants / revenues payable other than in Sterling; and,
 - (c) commodity price risk related to specific procurements containing a significant cost element for a commodity component and ongoing operational procurements such as power and fuel.
- 7.4 The high level principles established by this Risk Management Strategy 2014/15 are to:
- (a) achieve greater value for money through reducing costs or protecting revenues;
 - (b) reduce volatility / increase certainty relating to the impact of financial risks upon the business plan; and
 - (c) holistically manage financial risks across the whole of TfL.

- 7.5 Where TfL arranges derivative investments through its subsidiary, Transport for London Finance Limited, it may put in place intra-group arrangements to confer the benefit of those derivative investments to the TfL entity bearing the underlying risk.
- 7.6 Under the TfL Group Policy relating to the use of Derivative Investments, the Finance and Policy Committee have delegated authority to approve derivative transactions.