AGENDA ITEM 6

TRANSPORT FOR LONDON

BOARD

SUBJECT: TREASURY MANAGEMENT STRATEGY 2011/12

DATE: 30 MARCH 2011

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1 PURPOSE AND DECISION REQUIRED

1.1 This paper proposes the TfL Treasury Management Strategy (TMS) for 2011/12, including the borrowing, investment, and financial risk management strategies.

1.2 The Board is asked to note this paper and make various approvals.

2 OVERVIEW OF THE PROPOSED TMS

2.1 The TMS has been prepared in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice (the Code) and the revised investment guidance issued by the Department for Communities and Local Government which came into effect from 1 April 2010. The revised TMS is in Appendix 1.

2.2 The revised TfL Treasury Management Policy Statement and Treasury Management Practices (together, the TM Policy) are included in Appendix 2.

2.3 The TfL Group Policy relating to the use of Derivative Investments for 2011/12 is included in Appendix 3.

2.4 Under the Code, TfL is required to adopt Prudential Indicators and Treasury Management Indicators (‘Prudential Indicators’) which support planned capital expenditure, borrowing and treasury management activities. TfL’s Prudential Indicators for the period 2011 to 2014 are included as a separate item on the agenda to this meeting.

2.5 Under the TM Policy, TfL is required to have a TMS approved by the Board on at least an annual basis.

2.6 The TMS sets out the framework under which TfL manages its treasury management activities. In accordance with the Code, TfL defines treasury activities as the management of its investments and cash flows, banking, borrowing, money market, capital market and derivatives transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.7 The proposed TMS focuses on providing the optimal liquidity and financial risk profile for TfL, by linking TfL's funding and risk management strategies to mitigation of the financial risks impacting TfL's revenues and costs.

2.8 In summary, the TMS for 2011/12 proposes the following:

(a) to adopt for 2011/12 the revised 2010/11 investment strategy approved by the Board in February 2011, with a clarification that investments may be made in any wholly owned and guaranteed UK subsidiary of the counterparties in the Approved Investment List in Appendix 4;

(b) to undertake £425m of incremental Prudential Borrowing, to be sourced from any combination of borrowing sources approved by the Board (as described in Appendix 1), subject to the limits set out in the 2011/12 Prudential Indicators and after discussion with and approval from the Finance and Policy Committee during the year;

(c) to explore the refinancing or restructuring of existing borrowings; and

(d) that entry into certain borrowing and derivative transactions will be carried out after discussion with and approval from the Finance and Policy Committee during the year.

3 RECOMMENDATIONS

3.1 The Board is asked to:

(a) NOTE the paper;

(b) APPROVE:

(i) the Treasury Management Strategy for 2011/12, including the borrowing strategy, the cash investment strategy, the financial risk management strategy and the TfL Policy on Minimum Revenue Provision as outlined in Appendix 1;

(ii) the Treasury Management Policy Statement and the Treasury Management Practices in Appendix 2;

(iii) the TfL Group Policy Relating To The Use Of Derivative Investments in Appendix 3; and

(c) DELEGATE to the Finance and Policy Committee authority to approve amendments to the Treasury Management Strategy and the Policy Relating To The Use Of Derivative Investments, so far as required to facilitate a restructuring or refinancing of existing borrowings.

4 CONTACT

4.1 Contact: Peter Regan, Director of Corporate Finance
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APPENDIX 1

TRANSPORT FOR LONDON

TREASURY MANAGEMENT STRATEGY FOR 2011/12

1 SUMMARY

1.1 This report sets out the Treasury Management Strategy (TMS) for 2011/12.

2 BACKGROUND INFORMATION

2.1 TfL has adopted the key recommendations of CIPFA's Code of Practice and Cross-Sectoral Guidance Notes for Treasury Management in the Public Services 2009 (the 'Code').

2.2 In accordance with the Code, the Board will receive an annual Treasury Management Strategy for approval in advance of the start of the relevant financial year.

2.3 TfL complies with the revised investment guidance issued by the Department for Communities and Local Government (DCLG) which came into effect from 1 April 2010. This guidance requires an Annual Investment Strategy that contains specific reference to the security and liquidity of investments. This TMS incorporates those requirements.

2.4 None of the above legal requirements has changed since the adoption of the last Treasury Management Strategy.

2.5 The following statement of strategy renews the Treasury Management Strategy approved by the Board for 2010/11, as revised in February 2011 to broaden the list of Approved Investments and increase the investment limits and tenor of the deposits to help reduce net interest costs and return greater value for money on cash balances. The revised TMS also includes a section on borrowing and financial risk management.

2.6 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 six months.

2.7 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.

3 STRATEGIC OBJECTIVES

3.1 The objectives underpinning the TMS for 2011/12 are:

(a) to undertake treasury management operations with primary regard for the security and liquidity of capital invested with reference to DCLG Guidance;

(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; and

(d) to undertake treasury management activity having regard to Prudential Indicators.

4 THE INVESTMENT STRATEGY

4.1 All cash balances will be invested in accordance with the Code and with regard to DCLG Guidance, which requires a prudent approach to the investment of surplus funds with priority given to security and liquidity. 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);

(c) the investment does not involve the acquisition of share or loan capital in any body corporate; and

(d) 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 that have been placed on a TfL 'Approved Investment List' (see Appendix 4). Investments may be made in any wholly owned and guaranteed UK subsidiary of the counterparties in the Approved Investment List, within the parent institution's aggregate investment limit. The

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 Investments in Money Market Funds (MMFs) are subject to the following criteria and restrictions:

(a) only money market funds that are AAA-rated by at least two of the three main rating agencies;

(b) a member of the Institutional Money Market Funds Association;

(c) owned or backed by a UK clearing bank;

(d) minimum size of fund of £1bn;

(e) the funds do not invest in equities, alternative assets, asset backed commercial paper, derivatives or structured investment vehicles;

(f) maximum investment by TfL per fund to be five per cent of fund size;

(g) maximum notice to access the funds of seven days, though likely to be intra-day access;

(h) weighted average maturity (WAM) of investments in the funds being no greater than 60 days; and

(i) weighted average final maturity (WAFM) of investments in the funds being no greater than 150 days.

NON-SPECIFIED INVESTMENTS

4.6 Non-specified investments do not, by definition, meet the requirements of a specified investment. The DCLG Guidance requires an articulated risk management strategy and greater detail of the intended use of non-specified investments due to greater potential risk.

4.7 The possible non-specified investments in the TMS for 2011/12 are for investments in instruments and with entities on the Approved Investment List where:

(a) the maximum maturity is greater than one year:

(i) all these 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) these investments have been chosen as 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 it is expected to have costs in those currencies in the future.

LIQUIDITY OF INVESTMENTS

4.8 To ensure TfL has immediate access to the £250m Minimum Cash Balance required to ensure TfL has sufficient liquidity to meet its financial obligations, at least £250m will be kept available for redemption on any business day.

4.9 Each investment decision is made with regard to cash flow requirements resulting in a range of maturity periods within the investment portfolio.

COUNTERPARTY INVESTMENT LIMITS AND MATURITY LIMITS

4.10 The maximum limits per investment per institution for 2011/12 are shown in the table below:

Institution	S&P	Moodys	Fitch	Investment limit per party (£m)	Maximum tenor of deposit
UK Sovereign	AAA	Aaa	AAA	Unlimited	Unlimited
UK Govt Guaranteed	AAA	Aaa	AAA	200	4yr
Supra-National	AAA	Aaa	AAA	200	4yr
Money Market Fund	AAA	Aaa	AAA	5% of fund	Instant access
UK Bank	AAA	Aaa	AAA	300	2yr*
UK Bank	AA+	Aa1	AA+	250	2yr*
UK Bank	AA	Aa2	AA	200	2yr*
UK Bank	AA-	Aa3	AA-	175	2yr*
UK Bank	A+	A1	A+	150	12 months
UK Bank	A	A2	A	125	12 months
UK Bank	A-	A3	A-	100	12 months
UK Bank	BBB	Baa	BBB	0	n.a.

*subject to the following caps – if rating is AA-/Aa3/AA- or stronger, 50% of the investment limit may be invested for up to two years and up to 100 per cent may be invested for up to 12 months.

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

4.12 Where a counterparty has a split credit rating, the Investment Limit for each rating is calculated as one third of the relevant Investment Limit for each rating level and the aggregate amount forms the total Investment Limit for that counterparty. The maximum tenor of deposit will be that of the lowest rating.

5 INVESTMENT MATURITY LIMIT

5.1 As an additional measure, the Code requires that a limit is set for sums that are invested for periods longer than 364 days. These are described in the separate Prudential Indicators paper for 2011 to 2014.

6 BORROWING STRATEGY

6.1 The 2010 funding settlement provided for TfL to increase its Prudential Borrowing in 2011/12 by up to £425m, of which £200m is already committed European Investment Bank (EIB) fixed rate borrowing to be drawn down on in March 2012.

6.2 Following a fundamental review of TfL's borrowing strategy in 2010 and in particular as a result of the increase in the cost of borrowing from the Public Works Loans Board (PWLB) announced in the Comprehensive Spending Review on 20 October 2010, TfL's borrowing sources (together the 'Approved Borrowing Sources') were expanded to introduce greater flexibility and diversity into the borrowing programme and currently comprise:

(a) PWLB;

(b) £5bn Euro Medium Term Note (EMTN) programme (increased from the £3.3bn original programme);

(c) £2bn Euro Commercial Paper (ECP) programme;

(d) £1.7bn in EIB facilities; and

(e) £200m bank overdraft facility with HSBC.

6.3 Additional sources of borrowing that can provide funding at a lower cost or on more flexible terms that the PWLB may only be added to the Approved Borrowing Sources following approval from the Finance and Policy Committee.

6.4 In order to ensure that TfL is able to borrow efficiently and to demonstrate value for money, it is proposed that TfL will fund the in year incremental Prudential Borrowing requirement from any combination of the above Approved Borrowing Sources, where the maximum cost of borrowing does not exceed the prevailing equivalent PWLB rate, unless sufficient additional benefits or flexibility are provided by the alternative borrowing source.

6.5 The Code requires that Upper and Lower limits are set for the mix of fixed and variable rate borrowing; and for the maturity profile of borrowings to reduce refinancing risk. These are described in the separate Prudential Indicators paper for 2011 to 2014.

6.6 Approval will be sought from the Finance and Policy Committee at the time each individual or programme of borrowing transactions is arranged, with the exception of the EIB drawdown of £200m that has already been approved and arranged for March 2012.

6.7 TfL's £200m standby overdraft facility will continue to provide sufficient liquidity in the event of a delayed receipt of revenues, Grant or Prudential Borrowing proceeds. Approval from the Managing Director, Finance will be sought prior to TfL borrowing more than £20m from the overdraft facility at any time. The overdraft facility will not be used in the normal course of business, but only for short periods until longer term borrowing can be arranged from the Approved Borrowing Sources.

7 RISK MANAGEMENT

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 It is therefore proposed that the TMS for 2011/12 adopts a number of high level principles for managing specific, identifiable financial risks, as 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 procurements for the capital investment programmes for London Underground Limited (LUL); Crossrail (CRL); London Rail (Rail); and Surface Transport (Surface); and from European Union (EU) subsidies, payable in Euros, where applicable; 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 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 Under the TfL Group Policy on the Use of Derivative Investments, the Finance and Policy Committee have delegated authority to approve derivative transactions. It is expected that during the year, TfL will propose a number of specific risk management programmes to the Finance and Policy Committee.

8 MINIMUM REVENUE PROVISION

8.1 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.

8.2 TfL has a duty to determine for the current financial year an amount of minimum revenue provision which it considers to be ‘prudent’ in relation to debt service obligations.

8.3 The TfL’s policy on MRP remains unchanged from 2010/11. 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 forecasts are in balance.

TRANSPORT FOR LONDON

TREASURY MANAGEMENT POLICY STATEMENT AND TREASURY MANAGEMENT PRACTICES

1 INTRODUCTION

1.1 The establishment and review of a policy for TfL in relation to Treasury Management is a matter reserved to the Board. This document (including the Treasury Management Policy Statement and the Treasury Management Practices) is therefore subject to Board approval.

1.2 This document was drafted after taking into account the CIPFA recommendations contained in the Code of Practice and Cross-Sectoral Guidance Notes (the 'Code') issued in December 2009 for Treasury Management in the Public Services, the Fully Revised CLG Investments Guidance issued in March 2010, the Local Government Act 2003, the Capital Finance and Accounts Regulations 2003 (as amended) and the revised CIPFA Prudential Code issued in December 2009 ('The Prudential Code').

1.3 This document sets out the policies, objectives and approach to risk management of its treasury management activities and the manner in which TfL will seek to achieve those policies and objectives.

1.4 This document also sets out TfL's treasury management reporting requirements, delegation of responsibility for the implementation and monitoring of the policy and practices and for the execution and administration of the treasury management decisions.

2 RESPONSIBLE OFFICERS

2.1 The Managing Director, Finance is responsible for advising the Board on investments, borrowing, derivatives, capital financing and also for the establishment and operation of banking arrangements necessary for the TfL Group business. The Chief Finance Officer is responsible for ensuring the execution of this policy, as the designated Section 127 officer under the Greater London Authority Act 1999. On an operational basis, he will discharge this through the Group Treasurer.

2.2 The Treasury Management Policy and Practices will be operated through Group Treasury and will be applied to TfL and all its subsidiaries. The subsidiaries and Chief Officers will have no authority to invest, borrow, enter into credit arrangements, or enter into or use of any banking services/arrangements (including the use of any payment or revenue collection method within the TfL Group) without the written consent of the Group Treasurer.

2.3 In addition, all schemes using payment cards must be compliant with Payment Card Industry Data Security Standards (PCI DSS) prior to public launch, with any derogation to this policy agreed by the Managing Director, Finance or the Chief Finance Officer.

2.4 The Group Treasurer shall as and when necessary be authorised to:

(a) supply to the Bank lists of officials authorised to sign in respect of each and any account(s) of TfL together with specimen signatures;

(b) open further accounts for and on behalf of TfL and supply to the Bank details of the signatories together with specimen signatures in respect of such account(s); and

(c) notify the Bank of any restrictions on the operation of any such accounts.

The Bank shall be entitled to rely on any such details or notification supplied by the Group Treasurer.

3 TFL TREASURY MANAGEMENT POLICY STATEMENT

3.1 TfL defines its treasury management activities as:

> "The management of the organisation's investments and cash flows, its banking, money market, capital market and derivative transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

3.2 TfL regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3.3 TfL also acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, always in the context of effective risk management.

TREASURY MANAGEMENT PRACTICES (TMPs)

1 TREASURY RISK MANAGEMENT – TMP1

1.1 The Group Treasurer will:

(a) design, implement and monitor all arrangements for the identification, management and control of treasury management risk;

(b) report annually to the Finance and Policy Committee on the adequacy/suitability thereof, and on any specific issues as directed by the Finance and Policy Committee; and

(c) report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect to the Managing Director, Finance and the Chief Finance Officer.

2 PERFORMANCE MEASUREMENT – TMP2

2.1 TfL is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim within the framework set out in its treasury management policy statement.

2.2 The actual performance of the treasury management function will be measured using criteria to be agreed by the Managing Director, Finance.

3 DECISION-MAKING AND ANALYSIS – TMP3

3.1 TfL will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions. This is for the purpose of creating an audit trail, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES – TMP4

4.1 TfL will undertake its treasury management activities by employing recognised and approved instruments, methods and techniques and within the limits and parameters defined in its risk management policies and practices.

4.2 All decisions on capital/project financing, borrowing, investment and derivatives will be made in accordance with standing orders and relevant policies and strategies.

5. ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITES, AND DEALING ARRANGEMENTS – TMP5

5.1 TfL considers it essential, for the purposes of effective control and monitoring of its treasury management activities, for the pursuit of optimum performance, and for the reduction of the risk of fraud or error, that activities are structured and managed in a fully integrated manner, and that there is at all time clarity of treasury management responsibilities.

5.2 The principle on which this will be based is a clear distinction between those charged with setting Treasury Management Policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

5.3 If and when TfL intends, as a result of lack of resources or other circumstances, to depart from these principles, the Group Treasurer will ensure that the reasons are properly reported and the implications properly considered and evaluated.

5.4 The Group Treasurer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and that arrangements are in place for absence cover. The Group Treasurer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out.

5.5 The Group Treasurer will ensure there is proper documentation for all transactions, and that procedures exist for the effective transmission of funds. The Group Treasurer will fulfil all such responsibilities in accordance with the organisation’s policy statement and TMPs.

6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS – TMP6

6.1 TfL will ensure that regular reports are prepared and considered on the implementation of its Treasury Management policies; on the effects of decisions taken and the transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the Treasury Management function.

6.2 As a minimum, the following reports will be produced:

(a) Weekly reports to the Chief Finance Officer and Director of Corporate Finance; Periodic Treasury Management update in the Business Management Review;

(b) Annual monitoring reports to the Finance and Policy Committee on treasury management activities and risks, the performance of the treasury management function and the strategy to be pursued in the coming months;

(c) An annual report to the Board on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, and on any non-compliance with the organisation’s Treasury Management Policy Statement and Practices; and

(d) An annual report to the Board on the strategy to be pursued in the coming year.

The Audit Committee will have responsibility for the scrutiny of treasury management policies and practices.

7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS – TMP7

7.1 The Group Treasurer will prepare and, and if necessary, from time to time will amend an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income.

7.2 TfL will account for its treasury management activities, for decisions made and transactions executed, in accordance with accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

7.3 TfL will ensure that its auditors, and those charged with regulatory review, have access to all information, and papers supporting the activities of the treasury management function for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.

8 CASH AND CASH FLOW MANAGEMENT – TMP8

8.1 Unless statutory or regulatory requirements demand otherwise, all monies (with the exception of the Guernsey insurance company) in the hands of the TfL Group will be under the control of the Group Treasurer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Group Treasurer will ensure that these are adequate for the purposes of monitoring compliance with this policy statement.

8.2 The Group Treasurer should be consulted on all matters relating to banking relationships and advice including payment card data security issues.

9 MONEY LAUNDERING – TMP9

9.1 TfL is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, if required by law or regulation, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this, are properly trained.

10 STAFF TRAINING ARRANGEMENTS AND QUALIFICATIONS – TMP10

10.1 TfL recognises 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 will therefore seek to appoint individuals with suitable qualifications and experience, and will provide training for staff to enable them to maintain an appropriate level of expertise, knowledge and skills. The Group Treasurer will recommend and implement the necessary arrangements.

11 USE OF EXTERNAL SERVICE PROVIDERS – TMP11

11.1 TfL recognises that responsibility for treasury management decisions remains with the organisation at all times. TfL recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons, which will have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods, by which their value will be assessed, are properly agreed, documented, monitored and subjected to regular review. The monitoring of such arrangements rests with the Group Treasurer.

12 CORPORATE GOVERNANCE – TMP12

12.1 TfL is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

12.2 TfL has adopted and implemented the principles and recommendations of the Treasury Management Code. This document is considered vital to the achievement of proper corporate governance in treasury management. The Group Treasurer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

APPENDIX 3

TRANSPORT FOR LONDON GROUP

POLICY RELATING TO THE USE OF DERIVATIVE INVESTMENTS

1 INTRODUCTION

1.1 TfL promoted a Bill in Parliament which included a range of provisions clarifying existing legislation and introducing new powers. The Bill completed its passage through Parliament in April 2008 and was granted Royal Assent on 22 May 2008 to become the Transport for London Act 2008 (TfL Act). Section 49 of the TfL Act relates to powers to make arrangements for risk mitigation in respect of prudent management of the financial affairs of TfL and its subsidiaries. The provision came into force on 22 July 2008.

1.2 TfL agreed with the House of Commons Committee considering the TfL Bill that a TfL Board approved annual policy on the use and governance of derivative investments to be entered into pursuant to section 49 of the TfL Act would be put in place.

1.3 Any amendments to this policy are subject to prior approval from the TfL Board. Compliance with this policy is mandatory. It is primarily for the internal use and guidance of TfL and its subsidiaries only.

2 USE OF POWERS OF DERIVATIVE INVESTMENT

2.1 The TfL Act confers powers to prudently manage certain financial risks. Any derivative investment entered into must be entered into solely for the purpose of managing such a risk and speculative investment in derivative investments is not permitted. The power is subject to various restrictions and safeguards as set out in this policy.

3 RESTRICTIONS ON THE POWER TO ENTER INTO DERIVATIVE INVESTMENTS

3.1 The power to enter into derivative investments is subject to the following restrictions:

(a) the power is only exercisable for the purposes of the prudent management of the financial affairs of TfL and its subsidiaries and of limiting the extent to which any TfL body[1] would be affected by changes in the following:

(i) interest rates;

(ii) exchange rates;

[1] TfL body means TfL, any subsidiary of TfL, a joint venture of TfL or an associated undertaking of TfL.

(iii) any index reflecting inflation of the United Kingdom or elsewhere;

(iv) rates or prices applicable to oil, electricity or any commodity which is used by any TfL body; or

(v) rates or prices applicable to any securities creating or acknowledging indebtedness issued by or on behalf of:

- the government of the United Kingdom;
- any state outside the United Kingdom;
- any body the members of which comprise states which include the United Kingdom or another EEA State; or
- any body the members of which comprise bodies whose members comprise states which include the United Kingdom or another EEA State.

(b) only qualifying TfL subsidiaries (as defined in section 49) can enter into derivative investments and TfL itself cannot; and

(c) a qualifying TfL subsidiary can only enter into a derivative investment with TfL's consent and in accordance with any guidance or special or general directions given by TfL.

3.2 TfL is accountable for its subsidiaries' exercise of the powers and the usual TfL statutory requirements and safeguards apply. In particular, the exercise of the powers will fall within the statutory remit of TfL's Chief Finance Officer under sections 114 and 115 of the Local Government and Finance Act 1988.

4 CORPORATE GOVERNANCE

4.1 The following governance controls and oversight of the use of the powers apply:

(a) any derivative investment must be in accordance with this Policy;

(b) the Finance and Policy Committee is authorised to give consent on behalf of TfL to any derivative investment;

(c) the prior consent of the Finance and Policy Committee is required before a qualifying TfL subsidiary can enter into (a) any individual derivative investment; or (b) a programme of derivative investments;

(d) the Finance and Policy Committee can issue any guidance or specific or general directions to any qualifying TfL subsidiary as to the manner in which it is to exercise its functions in relation to derivative investments;

(e) the TfL Board and Finance and Policy Committee will be provided with professional financial and legal advice, as required, in respect of their functions relating to the examination and approval of the exercise of the powers;

(f) the approval of the Chief Finance Officer is required before any derivative investment is entered into, in recognition of his statutory role under local authority finance legislation;

(g) the approval of the Managing Director, Finance is required before any derivative investment is entered into;

(h) any use of derivative investments will be monitored on a regular basis by the Chief Finance Officer;

(i) any use of derivative investments will be reported in the TfL Group accounts in accordance with Financial Reporting Standards (FRS) 25, 26 and 29 <u>and from 1 April 2010, in accordance with International Financial Reporting Standards (IFRS);</u>

(j) the reporting of all derivative investments in the TfL Group accounts will be subject to audit by the TfL Group's auditors; and

(k) the recognised market standard legal documentation processes for derivative investments produced by the International Swaps and Derivatives Association will be used where appropriate with suitable TfL bespoke amendments.

5 RESPONSIBLE OFFICERS

5.1 The Group Treasurer will be responsible for:

(a) the proposal of all matters relating to the exercise of powers under section 49 of the TfL Act;

(b) reporting on a regular basis to the Finance and Policy Committee on the adequacy / suitability of the exercise of these powers, and on any specific issues as directed by the Finance and Policy Committee;

(c) reporting, as a matter of urgency, to the Chief Finance Officer, the circumstances of any actual or likely difficulty in achieving TfL's objectives in this respect; and

(d) responding to any queries of the Chief Finance Officer following the Chief Finance Officer's review of the regular reports.

5.2 The approval of the Chief Finance Officer and Managing Director, Finance is required before any derivative investment or other derivative investment strategy is proposed to the Finance and Policy Committee and TfL Board.

5.3 The Group Treasurer will propose exposure limits to counterparties with whom TfL may enter into derivative investments. The approval of the Finance and Policy Committee will be required for these limits.

5.4 In order to ensure compliance with the legal controls set out in section 49, the Chief Finance Officer and Managing Director, Finance are required to state that all legal controls in section 49 will be met before a transaction can be executed. In giving their approvals, they must seek the advice of General Counsel and other professional advisers as may be required.

6 REPORTING REQUIREMENTS, MONITORING AND MANAGEMENT INFORMATION ARRANGEMENTS

6.1 TfL will ensure that regular reports are prepared and considered on the implementation of this Policy; on the effects of decisions taken and the transactions executed in pursuit of this Policy; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its derivative investment activities; and on the performance of the use of derivative investments.

6.2 As a minimum, the following reports will be produced:

(a) periodic reports to the Chief Finance Officer;

(b) bi-annual reports to the Finance and Policy Committee on the status of the hedges in place; on the strategy to be pursued in the coming months; on the effects of decisions taken and the transactions executed over the review period, and on any non-compliance with this policy and practices described; and

(c) an Annual Report to the TfL Board on the strategy to be pursued in the coming year.

6.3 The Chief Finance Officer will monitor the use of derivative investments on a regular basis and part of this process will include the review of the Periodic reports.

7 ACCOUNTING AND AUDIT ARRANGEMENTS

7.1 TfL will account for derivative investments, for decisions made and transactions executed, in accordance with best practice and commercial and accounting practices and standards, and with statutory and regulatory requirements in force at the time.

7.2 The proposed accounting treatment of any transaction will be reviewed by TfL’s external auditors prior to entering into that transaction.

7.3 TfL will ensure that its auditors, and those charged with regulatory review, have access to all information, and papers supporting the activities of the use of derivative investments for the proper fulfilment of their roles.

Policy Custodian and Owner

7.4 The owner of this policy is the Group Treasurer but its content and any amendments to it must be approved by the TfL Board.

7.5 This Policy will be reviewed annually.

APPENDIX 4

TRANSPORT FOR LONDON

Approved Investment List

(a) UK Government and its executive agency, the Debt Management Office (DMO)

(b) European Investment Bank

(c) Network Rail

(d) Barclays

(e) HSBC

(f) Lloyds Banking Group

(g) RBS

(h) Standard Chartered

(i) HSBC Global Liquidity Fund

(j) RBS Global Treasury Funds

(k) Scottish Widows Investment Partnership (SWIP – part of the Lloyds Banking Group)

Including any wholly owned UK subsidiary of the counterparties listed above.