

TRANSPORT FOR LONDON

BOARD

**SUBJECT: TREASURY MANAGEMENT STRATEGY 2010/11**

**DATE: 24 MARCH 2010**

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**1 PURPOSE AND DECISION REQUIRED**

- 1.1 This paper proposes the TfL Treasury Management Strategy ('TMS') for the financial year 2010/11 and the renewal of the annual TfL Group Policy relating to the use of Derivative Investments.

**2 TREASURY MANAGEMENT STRATEGY**

- 2.1 Under the TfL Treasury Management Policy (produced in accordance with CIPFA's Code of Practice for Treasury Management in the Public Services), TfL is required to have a TMS approved by the Board on at least an annual basis.
- 2.2 The proposed TMS for 2010/11 is attached as Appendix 1. The Finance and Policy Committee considered this strategy in detail at its meeting on 9 March 2010 and agreed to recommend to the Board that it approve the TMS.

**3 TFL GROUP POLICY ON DERIVATIVES**

- 3.1 In March 2009, the Board approved the TfL Group Policy Relating To The Use Of Derivative Investments ("Derivatives Policy"). The Derivatives Policy requires annual approval by the Board and is attached at Appendix 2.
- 3.2 Apart from some minor formatting changes and updating the name of the Finance and Policy Committee, the only amendment from the previous policy is a technical one at paragraph 3(i) to reflect the change in relevant accounting standards for TfL. The additional sentence is underlined for ease of reference.
- 3.3 The Derivatives Policy requires that Finance and Policy Committee approval is required prior to the execution of transactions under that policy.
- 3.4 The Finance and Policy Committee agreed at its meeting on 9 March 2010 to recommend that the Board approve the Derivatives Policy.

**4 MINIMUM REVENUE PROVISION**

- 4.1 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.
- 4.2 It is proposed that TfL's policy on MRP remains the same as in 2009/10. In summary this means 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 account of in determining whether annual budget and business forecasts are in balance

- 4.3 The MRP policy has to be approved by the Board each year. The Finance and Policy Committee agreed at its meeting on 9 March 2010 to recommend that the Board approve the TfL policy on Minimum Revenue Provision for 2010/11.

## **5 RECOMMENDATIONS**

- 5.1 The Board is asked to:

- (a) APPROVE the Treasury Management Strategy, attached as Appendix 1;
- (b) APPROVE the TfL Group Policy Relating To The Use Of Derivative Investments as attached in Appendix 2; and
- (c) APPROVE the TfL policy on Minimum Revenue Provision.

## **6 CONTACT**

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# TRANSPORT FOR LONDON

## TREASURY MANAGEMENT STRATEGY FOR 2010/11

### 1 SUMMARY

- 1.1 This report sets out the Treasury Management Strategy (TMS) for 2010/11.

### 2 BACKGROUND INFORMATION

- 2.1 TfL has adopted the key recommendations of CIPFA's Code of Practice for Treasury Management in the Public Services 2009 (the "TM Code").
- 2.2 In accordance with the TM 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 follows the investment guidance issued by the Secretary of State under Section 15(1)(a) of the Local Government Act 2003. This guidance issued by the then Office of the Deputy Prime Minister (ODPM 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 amends the Treasury Management Strategy approved by the Board for 2009/10, to broaden the range of prudent highly rated investment instruments to help reduce net interest costs and return greater value for money on cash balances.
- 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 2010/11 are:
- (a) to undertake treasury management operations with primary regard for the security and liquidity of capital invested with reference to ODPM 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 TM Code and with regard to the ODPM Guidance, which requires a prudent approach to the investment of surplus funds with priority given to security and liquidity. Under the ODPM Guidance, investments fall into two separate categories, either specified or non-specified investments, which take into account the required liquidity levels of the business.
- 4.2 TfL's liquidity levels are substantial and this TMS for 2010/11 will maintain the investment policy of short-term, high-security specified investments (as described below). In addition, the 2010/11 TMS will include a limited amount of prudent non-specified investments in UK Government, supra-national and government guaranteed corporate bonds with maturities greater than one year. It is only the maturity of over 1 year that defines these instruments as "non-specified" investments.

#### **5 SPECIFIED INVESTMENTS**

- 5.1 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.
- 5.2 Specified investments are limited to institutions that have been placed on a TfL "Approved Investment List".
- 5.3 A "Treasury Group", comprising the Managing Director Finance, Chief Finance Officer, Director of Corporate Finance and Group Treasurer, will make recommendations to the Finance and Policy Committee of entities and investments that may be added to the Approved Investment List.

- 5.4 Until otherwise agreed with the Finance and Policy Committee, the Treasury Group will only place further entities and investments on the Approved Investment List after agreement of the Finance and Policy Committee.
- 5.5 In determining whether to recommend placing an institution on the Approved Investment List, the Treasury Group 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 and 2 capital ratios for the institution (where appropriate).
- 5.6 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 £1 billion;
  - (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 the lesser of £200 million or 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.

5.7 The maximum limits per deposit / investment / institution are shown in the table below:

<b>Institution</b>	<b>Credit rating (S&amp;P / Fitch / Moodys)</b>	<b>Investment limit (£m)</b>	<b>Maximum tenor of deposit</b>
DMO deposits	AAA / AAA / Aaa	Unlimited	Unlimited
DMO repos	AAA / AAA / Aaa	Unlimited	Unlimited
UK Government T-Bills & Gilts	AAA / AAA / Aaa	Unlimited	Unlimited
Supra-National CP & Bonds	AAA / AAA / Aaa	200	Three years
UK Government Guaranteed Corporate CP & Bonds	AAA / AAA / Aaa	100	Three years
Money Market Funds	AAA / AAA / Aaa	200	Seven day notice
UK Banks	AA / AA / Aa2	150	12 months
UK Banks	AA- / AA- / Aa3	100	Six months
UK Banks	A+ / AA- / Aa3	75	Three months
UK Banks	A / AA- / A1	75	Three months

## **6 NON-SPECIFIED INVESTMENTS**

- 6.1 Non-specified investments do not, by definition, meet the requirements of a specified investment. The ODPM Guidance requires an articulated risk management strategy and greater detail of the intended use of non-specified investments due to greater potential risk.
- 6.2 The possible non-specified investments in the TMS for 2010/11 are for the following investments, with maximum maturities greater than one year: DMO deposits and repos, UK Government debt issues, Supra-national organisation bonds and Corporate bonds guaranteed by UK Government.
- 6.3 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 the risk of default is very low.
- 6.4 Before placing such longer term deposits, TfL would carry out detailed cash forecasts 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.
- 6.5 These investments have been chosen as instruments which would be readily accepted as collateral to obtain liquidity facilities, should such a need arise.

## **7 LIQUIDITY OF INVESTMENTS**

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

## **8 INVESTMENT MATURITY LIMIT**

- 8.1 As an additional measure, the TM Code requires that a limit is set for sums that are invested for periods longer than 364 days. This limit has been set as £250m for 2010/11.

## **9 FINANCIAL IMPLICATIONS**

- 9.1 The budgetary assumptions identified in this TMS are consistent with those in the budget proposals for 2010/11.

# 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<sup>1</sup>

- 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<sup>11</sup> would be affected by changes in the following:
- I. interest rates;
  - II. exchange rates;

<sup>1</sup> This is a basic summary only. It is not a substitute for and must be read in conjunction with Section 49 of the TfL Act.

<sup>11</sup> 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 (i) any individual derivative investment; or (ii) 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 and from 1 April 2010, in accordance with International Financial Reporting Standards (“IFRS”);
- (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 Director of Corporate Finance 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 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 Director of Corporate Finance 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.

## **8 FINANCIAL ASSISTANCE POLICY**

- 8.1 The prohibition on the provision of financial assistance by a TfL subsidiary contained in the TfL Financial Assistance policy (approved by the TfL Board on 25 September 2001) is by this policy disapplied in relation to the passing on of any funding by a qualifying TfL subsidiary to a TfL body in connection with a derivative investment.

### **Policy Custodian and Owner**

- 8.2 The owner of this policy is the Director of Corporate Finance but its content and any amendments to it must be approved by the TfL Board.
- 8.3 This Policy will be reviewed annually.