

Date: 11 March 2015

**Item 21: Treasury Management and Derivative Investments
Policies 2015/16**

This paper will be considered in public

1 Summary

- 1.1 The purpose of this paper is to ask the Committee to recommend to the Board that it approves the proposed TfL Treasury Management Policy and Treasury Management Practices (together, the TM Policy), and the proposed TfL Group Policy relating to the use of Derivative Investments for 2015/16.

2 Recommendations

2.1 The Committee is asked to:

(a) note the paper; and

(b) recommend that the Board:

(i) approves the proposed TfL Treasury Management Policy and Treasury Management Practices in Appendix 1; and

(ii) approves the proposed TfL Group Policy Relating to the use of Derivative Investments in Appendix 2.

3 Treasury Management Policy Statement and Treasury Management Practices

- 3.1 The TM Policy 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) (updated in 2011) and the revised investment guidance (effective 1 April 2010) issued by the Department for Communities and Local Government (DCLG guidance).

- 3.2 CIPFA recommends that all public service organisations adopt a series of clauses for effective treasury management. Such clauses include the need for public service organisations to create and maintain:

(a) a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and

(b) suitable treasury management practices, setting out the manner in which

the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

- 3.3 The revised TM Policy is included in Appendix 1 (with changes highlighted from the TM Policy approved by the Board in March 2014). The proposed changes to the document are mostly minor amendments:
- (a) wording is added in paragraph 2.3 to clarify that finance leases are considered to be a credit arrangement for the purposes of the TM Policy;
 - (b) a reference to Payment Card Industry Data Security (PCI DSS) compliance is proposed to be deleted as the responsibility for this area has been transferred to Internal Audit; and
 - (c) other minor drafting changes have been made and are tracked in the draft document.
- 3.4 Under the Code, TfL is required to adopt Prudential Indicators and Treasury Management Indicators (Prudential Indicators) that support planned capital expenditure, borrowing and treasury management activities. TfL's Prudential Indicators are the subject of a separate item on the agenda for this meeting.
- 3.5 The TM Policy requires TfL to have a Treasury Management Strategy (TMS) approved by the Board on at least an annual basis. The TMS for 2015/16 is included as a separate item on the agenda for this meeting.

4 TfL Group Policy on Derivatives

- 4.1 The TfL Group Policy relating to the use of Derivative Investments (Derivatives Policy) must be reviewed annually.
- 4.2 The policy has been reviewed and the proposed changes from the policy approved by the Board in March 2013 are for clarification purposes only and are highlighted in the proposed policy included in Appendix 2.
- 4.3 In order to provide clarification of authorities and to maintain consistency between the Treasury Management Strategy and the Derivative Policy, it is recommended that:
- (a) the wording "individual" be deleted from 4.1(c);
 - (b) a new paragraph in 4.1(d) be added to provide clarity on the Committee's delegated authority from the Board to approve new derivative counterparties;
 - (c) the wording "or programme of derivative investments" be added to 4.1(g), 4.1(h) and the proposed new 5.2 (a) of the Derivatives Policy 2015/16;
 - (d) for clarification purposes, 5.2 be split into (a) and (b) sub-sections, and the wording "Risk Management Strategy" replace "derivative investment strategy";

- (e) the wording “will be approved annually by the TfL Board as part of the Treasury Management Strategy, prior to the start of the relevant financial year” be added to 5.3 to replace “approval of the Finance and Policy Committee will be required for these” in order to align with the approval process for investments; and
- (f) new wording in paragraph 5.5 be added to address the responsibilities of the Director of Group Treasury and Group Treasury officers once all other approvals have been satisfied.

List of appendices to this report:

Appendix 1: TfL Treasury Management Policy Statement and Treasury Management Practices

Appendix 2: TfL Group Policy Relating to the Use of Derivative Investments

List of Background Papers:

None

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TRANSPORT FOR LONDON

TREASURY MANAGEMENT POLICY AND TREASURY MANAGEMENT PRACTICES

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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 November 2011 for Treasury Management in the Public Services, the Fully Revised CLG Investments Guidance issued in March 2010 ('DCLG Guidance'), the Local Government Act 2003, the Capital Finance and Accounts Regulations 2003 (as amended) and the revised CIPFA Prudential Code issued in November 2011 ('The Prudential Code').
- 1.3 This document sets out TfL's 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.

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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, they will discharge this through the Director of Group Treasury.
- 2.2 The Treasury Management Policy and Practices will be operated, implemented and administered through Group Treasury and will be applied to TfL and all its subsidiaries.

2.3 The subsidiaries and Chief Officers will have no authority to invest, borrow, enter into credit arrangements ~~(including, but not limited to finance leases or other such arrangements that might be counted as borrowing under relevant accounting standards)~~, or enter into or use any banking services/arrangements (including the use of any payment or revenue collection method within the TfL Group) without the consent of the Director of Group Treasury.

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2.4 ~~The Director of Group Treasury will issue guidance for accepting~~ Financial Guarantees, Performance Bonds, Letters of Credit and other credit enhancing products, ~~and this must be followed~~ by TfL and/or its subsidiary companies ~~at all times~~.

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2.4 . In addition,

2.5 The Director of Group Treasury shall as and when necessary be authorised to:

(a) supply to TfL's ~~banks~~ lists of officials authorised to sign in respect of each and any account(s) of TfL and/or any TfL subsidiary together with specimen signatures;

Deleted: 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.

(b) open further accounts for and on behalf of TfL and/or any TfL subsidiary and supply to the ~~banks~~ details of the signatories together with specimen signatures in respect of such account(s);

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(c) notify the ~~banks~~ of any restrictions on the operation of any such accounts; and,

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(d) agree on behalf of TfL and/or any TfL subsidiary the terms of any facility or service provided by the ~~banks~~ including but not limited to bonds, guarantees and credit limits.

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The ~~banks~~ shall be entitled to rely on any such details or notification supplied by the Director of Group Treasury or any TfL Officer confirmed in writing as having the same authority in the absence of the Director of Group Treasury.

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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 financing, 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 value for money in treasury management, and to employing suitable performance measurement techniques, always in the context of effective risk management.

- 3.4 TfL will invest its cash balances in accordance with the Code and with regard to the DCLG Guidance, which requires a prudent approach to the investment of surplus funds with priority given to security and liquidity. TfL will manage its borrowing in a manner which combines flexibility, security of access to funds, diversity of funding sources and value for money.

TREASURY MANAGEMENT PRACTICES (TMPs)

1 TREASURY RISK MANAGEMENT – TMP1

1.1 The Director of Group Treasury 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 key treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, 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 TfL Standing Orders and relevant policies and strategies.

5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, 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 times 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 for any reason there is intended to be or has been any departure from these principles, the Director of Group Treasury will ensure that the reasons are properly reported in accordance with TMP 6 Reporting requirements and management information arrangements (below), and the implications properly considered and evaluated.
- 5.4 The Director of Group Treasury will ensure that there are clear lines of responsibilities, objectives and guidance for each post engaged in treasury management, and that arrangements are in place for absence cover. The Director of Group Treasury will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out.
- 5.5 The Director of Group Treasury will ensure there is proper documentation for all transactions, and that procedures exist for the effective transmission of funds. The Director of Group Treasury will fulfil all such responsibilities in accordance with the organisation's policy statement and TMPs.

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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 Managing Director, Finance;
 - (b) Periodic Treasury Management update in the Business Management Review;
 - (c) 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;
 - (d) 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;
 - (e) an annual report to the Board on the strategy to be pursued in the coming year; and

- (f) a mid-year monitoring report to the Finance and Policy Committee on treasury management activities and risks, and the performance of the treasury management function.

6.3 In addition to the regular reporting requirements set out above, any non-compliance with the Treasury Management Policy Statement and Treasury Management Practices or the Treasury Management Strategy must be immediately reported to the Managing Director, Finance and the Chief Finance Officer. If the breach is material in the view of the Managing Director, Finance and Chief Finance Officer, it must be reported to the Finance and Policy Committee as soon as practicable.

7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS – TMP7

- 7.1 The Director of Group Treasury will prepare 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.
- 7.4 The Audit and Assurance Committee will have responsibility for the scrutiny of treasury management policies and practices and this responsibility will be discharged through its regular scrutiny of the reports received from internal audit.

8 CASH AND CASH FLOW MANAGEMENT – TMP8

- 8.1 Unless statutory or regulatory requirements demand otherwise, all monies (with the exception of London Transport Insurance (Guernsey) Limited) in the hands of the TfL Group will be under the control of the Director of Group Treasury, 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 Director of Group Treasury will ensure that these are adequate for the purposes of monitoring compliance with this policy statement.

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 TRAINING 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 who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Group Treasury will recommend and implement the necessary arrangements.

11 USE OF EXTERNAL SERVICE PROVIDERS – TMP11

11.1 TfL recognises that it retains responsibility for treasury management decisions 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 and documented, and subjected to regular review. The monitoring of such arrangements rests with the Director of Group Treasury.

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

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 body¹ 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 derivative investment; or (b) a programme of derivative investments;
- (d) the Finance and Policy Committee is authorised by the TfL Board to give consent on behalf of TfL to approve derivative Counterparties;
- (e) 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;
- (f) 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;

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- (g) the approval of the Chief Finance Officer is required before any derivative investment or programme of derivative investments is entered into, in recognition of his statutory role under local authority finance legislation;
- (h) the approval of the Managing Director, Finance is required before any derivative investment or programme of derivative investments is entered into;
- (i) any use of derivative investments will be monitored on a regular basis by the Chief Finance Officer;
- (j) 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 in accordance with International Financial Reporting Standards (IFRS);
- (k) the reporting of all derivative investments in the TfL Group accounts will be subject to audit by the TfL Group's auditors; and
- (l) 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 Group Treasury 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:

- (a) any derivative investment or programme of derivative investments is proposed to the Finance and Policy Committee; or
- (b) any changes to the Risk Management Strategy is proposed to the TfL Board.

Deleted: any derivative investment or other derivative investment strategy is proposed to the Finance and Policy Committee and TfL Board.

5.3 The Director of Group Treasury will propose exposure limits to counterparties with whom TfL may enter into derivative investments. These limits will be approved by the TfL Board as part of the Treasury Management Strategy, prior to the start of the relevant financial year.

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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.

5.5 Once all the necessary approvals required under this Policy have been obtained, the Director of Group Treasury and Group Treasury officers will be authorised to agree and execute any related documentation required in relation to the approved derivative investments or programme of derivative investments.

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 Director of Group Treasury but its content and any amendments to it must be approved by the TfL Board.
- 7.5 This Policy will be reviewed annually.