STRATEGIC GOVERNANCE BOARD

27 JANUARY 2014

REPORT OF THE CHIEF CONSTABLE

11C: PRUDENTIAL INDICATORS, MINIMUM REVENUE PROVISION, TREASURY MANAGEMENT AND INVESTMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 To consider and approve the Capital Prudential Indicators for 2014/15 to 2016/17 (incorporating the Minimum Revenue Provision Policy), the Treasury Management Strategy Statement 2014/17 and the Investment Strategy 2014/17.

2. INFORMATION AND ANALYSIS

2.1 As part of the budget setting process, it is a statutory requirement that the Police and Crime Commissioner (PCC) determines the Prudential Indicators and Treasury Management Policies and Procedures.

2.2 The PCC fulfils four key legislative requirements when setting prudential indicators and setting out the expected treasury operations:

2.3 The reporting of the prudential indicators considers the affordability and impact of capital expenditure decisions. They set out the organisations capital framework and capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities) shown at Annex A. The treasury management prudential indicators are included as treasury indicators in the CIPFA Treasury Management Code of Practice.

2.4 The Minimum Revenue Provision (MRP) Policy, which sets out how the organisation will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007) shown at Annex A.

2.5 The Treasury Management Strategy Statement sets out how the organisation intends to finance its capital programme. It shows how the treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit, the maximum amount of debt the organisation could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code shown at Annex B.

2.6 The Investment Strategy which sets out how the organisation will manage its investments and limit its exposure to risk. It sets out the criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Department for Communities and Local Government (CLG) Investment Guidance, and shown at Annex B.

2.7 The figures in the attached Annexes have been prepared on the basis that the 'maturity-only' loan (£457,000, maturing in 2028) relating to the previous North Midlands Helicopter Support Unit is repaid by the end of this year, 2013/14. This follows the transfer of the helicopter formerly jointly owned by Derbyshire and Nottinghamshire to the new NPAS. Although early repayment of the loan will incur a charge, the combined net saving to both forces from the avoidance of future interest payments is calculated as £0.232m.

2.8 A reserve has been built up over a number of years to provide for the eventual repayment of the loan. The balance on this reserve is currently £0.465m and if this is fully utilised to repay the loan before the end of 2013/14 it is estimated that both forces will need to find a further £0.012m each to meet all outstanding redemption costs. This figure is based on a penalty cost of £89,000 calculated as at 13 January 2014. The actual cost will depend on the redemption date and the force will liaise with its Treasury Management advisors regarding the optimum time to make the repayment.

2.9 Approval is being sought to repay the loan prior to 31 March 2014, subject to agreement by Nottinghamshire that they also wish to settle the loan early.

3. RECOMMENDATIONS

3.1 That the Prudential Indicators and Limits for 2014/15 to 2016/17 contained within Annex A of the report are approved.

3.2 That the Minimum Revenue Provision (MRP) Statement contained within Annex A which sets out the PCC's policy on MRP be approved.

3.3 That the Treasury Management Strategy 2014/15 to 2016/17 and the treasury Prudential Indicators contained within Annex B be approved.

3.4 That the Authorised Limit Prudential Indicator be approved.

3.5 That the Investment Strategy 2014/15 contained in the treasury management strategy (Annex B), the counterparties in Appendix B2 and detailed criteria included in Appendix B3 be approved.

3.6 That the adoption of the CIPFA Treasury Management Code of Practice be reaffirmed.

3.7 That as part of the Treasury Management strategy, the early repayment of debt relating to the former NMHSU be approved.

4. IMPLICATIONS

All implications are assessed and scored to the table below.
HIGH – supporting explanation and narrative required and to be contained within the report
MEDIUM – narrative to be contained within the report at the discretion of the author
LOW – no narrative required

	LOW	MEDIUM	HIGH
Crime and Disorder	x		
Environmental	x		
Equality and Diversity	x		
Financial		x	
Health and Safety	x		
Human Rights	x		
Legal	x		
Personnel	x		

Contact details in the event of enquiries	**Name: Chief Superintendent Sunita Gamblin** **External telephone number: 0300 122 4196** **Email address: sgbenquiries@derbyshire.pnn.police.uk**

ANNEX DETAILS

A The Capital Prudential Indicators 2014/15-2016/17

B Treasury Management Strategy 2014/15-2016/17

APPENDIX DETAILS

B1 Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

B2 Approved Counterparties (based on credit ratings as at January 2014)

B3 Detailed Criteria and Credit Ratings

The Capital Prudential Indicators 2014/15 – 2016/17

Introduction

1. The Local Government Act 2003 requires the PCC to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the PCC's underlying capital appraisal systems. This report updates currently approved indicators and introduces new indicators for 2016/17. Where appropriate Actual 2012/13 figures are provided for information.

2. Within this overall prudential framework there is an impact on the PCC's treasury management activity – as it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2014/15 to 2016/17 is included as Annex B to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Expenditure Plans

3. The PCC's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the PCC to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (eg strategic planning);
- Stewardship of assets (eg asset management planning);
- Value for money (eg option appraisal);
- Prudence and sustainability (eg implications for external borrowing and whole life costing);
- Affordability (eg implications for the police precept);
- Practicality (eg the achievability of the forward plan).

4. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the organisations own resources.

5. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc, or by revenue resources), but if these resources are insufficient any residual capital expenditure will add to the PCC's borrowing need.

6. The key risks to the plans are that the level of Government support has been estimated and therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to the impact of the recession on the property market. A report to this meeting shows the intended Capital Programme for 2014/15 to 2017/18.

7. The PCC is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

Capital Expenditure	**2012/13 Actual £m**	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Capital Expenditure	5.542	8.184	9.362	9.450	5.130
Financed by:					
Capital receipts	0.440	0	0.720	1.114	0.394
Capital grants/contributions	1.200	2.661	5.203	0.641	3.736
Capital reserves	3.151	2.618	2.439	1.685	0

Other reserves	0	0	0	5.010	0
Revenue Contributions	0.751	2.905	1.000	1.000	1.000
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

The PCC's Borrowing Need (the Capital Financing Requirement)

8. The second prudential indicator is the PCC's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the PCC's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

9. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with the MRP policy.

10. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes) brought onto the balance sheet. Whilst this increases the CFR, and therefore the PCC's borrowing requirement, these types of scheme include a borrowing facility and so the PCC is not required to separately borrow for these schemes. The PCC currently has £13.7m of such schemes within the CFR.

11. The PCC is asked to approve the CFR projections below:

	2012/13 Actual £m	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Capital Financing Requirement					
CFR	31.466	30.228	28.887	27.684	26.261
Total CFR	**31.466**	**30.228**	**28.887**	**27.684**	**26.261**
Movement in CFR	**(1.076)**	**(1.238)**	**(1.341)**	**(1.203)**	**(1.424)**
Movement in CFR represented by					
Net financing need for the year (above)	0.000	0.000	0.000	0.000	0.000
Less MRP/VRP and other financing movements	1.076	1.238	1.341	1.203	1.424
Movement in CFR	**(1.076)**	**(1.238)**	**(1.341)**	**(1.203)**	**(1.424)**

Note: The MRP/VRP will include PFI lease annual principal payments

Minimum Revenue Provision (MRP) policy statement

12. The PCC is required to pay off an element of the accumulated capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP). Early repayment of the helicopter debt will involve a VRP.

13. CLG Regulations have been issued which require the PCC to approve **an MRP Statement** in advance of each year. A variety of options are provided, so long as there is a prudent provision. The PCC is recommended to approve the following MRP Statement.

14. For capital expenditure incurred before 1 April 2008 or which in the future is Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR, 4% of the opening balance (Option 2).

15. From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- **Based on the Asset Life Method** – MRP will be based on the estimated life of the assets equal instalment method, in accordance with the regulations (Option 3). The only unsupported borrowing used previously has been for the CCMC, which has an asset life of 50 years.

16. For Finance leases and PFI contracts that are deemed to be on balance sheet, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability.

17. The intended Capital Programme reflects no new borrowing from 2014/15 to 2017/18.

The Use of the Commissioner's Resources and the Investment Position

18. The application of resources (capital receipts, reserves etc) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2012/13 Actual £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Fund balances	3.300	3.300	3.300	3.300	3.300
Capital receipts unapplied	0	0	0	0	0
Earmarked reserves	39.485	36.029	31.918	23.926	11.037
Earmarked reserves – regional	0.292	0.292	0.292	0.292	0.292
Provisions	1.069	1.000	1.000	1.000	1.000
Unapplied Capital Grants	7.265	6.157	2.574	3.453	1.237
Total Core Funds	**51.411**	**46.778**	**39.084**	**31.971**	**16.866**
Working Capital*	(0.836)	(1.000)	(1.000)	(1.000)	(1.000)
Under Borrowing	(9.645)	(9.659)	(9.647)	(9.651)	(9.673)
Expected Investments at year end	**40.930**	**36.119**	**28.437**	**21.320**	**6.193**

*Working capital balances shown are estimated year end; these may be higher at various points throughout the year and the average will be considerably higher. The revenue budget will reflect the estimated interest received on the average cash balance.
** Under borrowing balances are further explained in paragraph 6 of Annex B.

19. The table above shows under borrowing is estimated at £9.6m in 2014/15. Whilst interest rates for investments remains low and the PCC's longer term cash flow is favourable, it is cost effective to use our own resources to fund capital expenditure at least in the short term. This means we are not taking out external borrowing at the present time. This will be kept under review.

Affordability Prudential Indicators

20. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the PCC's overall finances. The PCC is asked to approve the following indicators:

21. **Actual and Estimates of the ratio of financing costs to net revenue stream** – This indicator identifies the trend in the cost of capital (net of investment income) against the net revenue stream. The indicator includes the cost of capital for PFI schemes.

	2012/13 Actual £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m

Cost of Capital (1)	2.654	2.751	2.781	2.551	2.713
Investment Income (2)	(0.404)	(0.290)	(0.280)	(0.280)	(0.280)
Financing Costs(1)-(2)	2.250	2.461	2.501	2.271	2.433
Net Revenue Stream based on frozen precept	165.739	167.210	164.012	161.211	158.763
Percentage	1.36%	1.46%	1.53%	1.41%	1.53%
Net Revenue Stream based on 1.96% precept increase			164.479	162.195	159.792
Percentage			1.52%	1.40%	1.52%

Note: 2014/15 Net Revenue Stream has been calculated based on two possible precept increases:-

- A frozen Police Precept for 2014/15 and 2015/16 and a 2.0% increase in Council Tax thereafter.
- A 1.96% increase in Council Tax in 2014/15 and a 2% increase in each subsequent year.

This is indicative only and is in no way meant to influence the actual future years funding.

22. The estimates of financing costs include current commitments and the capital programme. Investment income has been affected by the economic climate, the fall in interest rates and the more cautious approach to treasury strategy.

23. Financing costs still represent a relatively small proportion of the Authorities net revenue stream.

24. **Estimates of the incremental impact of capital investment decisions on the Police Precept** – This indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the PCC's existing approved commitments and current plans. The assumptions are based on the capital programme, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

25. **Incremental impact of capital investment decisions on the Band D Police Precept**

Police Precept – Band D		**Revised Budget 2013/14 £**	**Forward Projection 2014/15 £**	**Forward Projection 2015/16 £**	**Forward Projection 2016/17 £**
(i)	Existing Commitments	3.43	3.10	2.93	2.76
(ii)	Above plus SCE	3.43	3.10	2.93	2.76
(iii)	Above plus unsupported borrowing	3.43	3.10	2.93	2.76
(iv)	Difference between (iii) and (i)	0.00	0.00	0.00	0.00

Note - Changes to RCCO have been excluded.

26. As no new borrowing is intended from 2014/15 there is no incremental impact of capital investment decisions.

Treasury Management Strategy 2014/15 – 2016/17

1. The treasury management service is an important part of the overall financial management of the PCC's affairs. The prudential indicators in **Annex A** consider the affordability and impact of capital expenditure decisions, and set out the PCC's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the PCC meets its balanced budget requirement under the Local Government Finance Act 1992.

2. The PCC's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This organisation adopted the Code of Practice on Treasury Management in January 2013.

3. As a result of adopting the Code the organisation also adopted a Treasury Management Policy Statement (January 2013). This adoption is the requirements of one of the prudential indicators.

4. The PCC is required to receive and approve, as a minimum, three main reports each year

   - The annual strategy outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service.
   - A mid year treasury management report. This updates the PCC of progress against the indicators and Treasury Management performance. Monitoring reports will usually be taken to the Strategic Governance Board twice a year.
   - An annual treasury management report. This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to estimates within the strategy. The annual report is taken to the Strategic Governance Board in June.

5. This annual strategy covers:

   - The PCC's debt and investment projections;
   - The PCC's estimates and limits on future debt levels (limits to borrowing);
   - The expected movement in interest rates;
   - The PCC's borrowing and investment strategies;
   - Treasury performance indicators;
   - Specific limits on treasury activities;

Debt and Investment Projections 2014/15 – 2016/17

6. The PCC's treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table below shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2012/13 Actual £m	2013/14 Revised £m	2014/15 Estimated £m	2015/16 Estimated £m	2016/17 Estimated £m
External Debt					
Debt at 1 April	8.652	8.106	7.103	6.557	6.011

Expected change in debt	(0.546)	(1.003)	(0.546)	(0.546)	(0.546)
Other Long Term Liabilities	13.715	13.466	12.683	12.022	11.123
Gross Debt at 31 March	**21.821**	**20.569**	**19.240**	**18.033**	**16.588**
CFR	31.466	30.228	28.887	27.684	26.261
Under/ (over) borrowing	9.645	9.659	9.647	9.651	9.673

7. Within the prudential indicators there are a number of key indicators to ensure the PCC operates within well defined limits.

8. One of these is that the PCC needs to ensure that total gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

9. The Treasurer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this capital programme report.

Treasury Indicators - Limits to Borrowing Activity

10. The Operational Boundary – this is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. The limit is set using the start of year external debt figures plus a contingency for the overdraft limit plus long term liabilities (PFI).

Operational Boundary	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**
Borrowing	9.0	8.1	7.5	7.0
Other long term liabilities	13.8	13.5	12.7	12.0
Total	22.8	21.6	20.2	19.0

11. The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the PCC. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

12. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Authorities' plans, or those of a specific Authority, although no control has yet been exercised.

13. The PCC is asked to approve the following Authorised Limit:

Authorised limit	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	17.1	16.6	16.0	15.5
Other long term liabilities	13.5	12.7	12.0	11.1
Total	30.6	29.3	28.0	26.6

14. The figures for the proposed authorised limit for 2014/15 take into account:

(a) The estimated amount of outstanding borrowing approvals on capital expenditure at 31 March 2014 (£6.582m) plus borrowing of £0.520m regarding transferred debt from Derbyshire County Council and Derby City Council which remains outstanding, which arose upon reorganisation.

(b) New external borrowing for capital schemes during 2014/15 (it is not intended to take out any borrowing in 2014/15) less the estimated amount for debt redemption within 2014/15 loan charges (£0.546m).

(c) The amount of any short-term borrowing pending receipt of grant on capital schemes. The estimated maximum figure for 2014/15 is £1.0m.

(d) The amount of any short-term borrowing pending receipt of revenue income. This should be minimal, but in order to cover any unforeseen changes in cash flow patterns (for example the timing of receipt of Government Grants in 2014/15), it is suggested a figure of £9m be used.

(e) Other long-term liabilities are an allowance for items such as the capital value of qualifying property leases or finance leases which may arise. The figure for 2014/15 includes £12.684m for PFI Liabilities.

15. Based on the above, it is proposed that the authorised limit for outstanding debt should be set at £29.2m for 2014/15. Proposed limits for future years have been calculated in a similar manner taking into account the future borrowing requirements.

Expected Movement in Interest Rates

16. The PCC has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the PCC to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
Mar 2014	0.50	0.50	0.80	2.50	4.40	4.40
June 2014	0.50	0.50	0.80	2.60	4.50	4.50
Sept 2014	0.50	0.50	0.80	2.70	4.50	4.50
Dec 2014	0.50	0.50	0.80	2.70	4.60	4.60
Mar 2015	0.50	0.50	0.80	2.80	4.60	4.70
June 2015	0.50	0.50	0.80	2.80	4.70	4.80
Sept 2015	0.50	0.50	0.90	2.90	4.80	4.90
Dec 2015	0.50	0.50	1.00	3.00	4.90	5.00
Mar 2016	0.50	0.50	1.20	3.10	5.00	5.10

June 2016	0.75	0.60	1.40	3.20	5.10	5.20
Sept 2016	1.00	0.70	1.60	3.30	5.10	5.20
Dec 2016	1.00	0.90	1.80	3.40	5.10	5.20
Mar 2017	1.25	1.00	2.00	3.40	5.10	5.20

17. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations. Growth prospects remain strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. There are, therefore, concerns that a UK recovery currently based mainly on consumer spending and the housing market, may not endure much beyond 2014. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

18. The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

   - Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt to GDP ratios, in some countries, continues to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
   - Investment returns are likely to remain relatively low during 2014/15 and beyond;
   - Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, in the event that the PCC will not be able to avoid new borrowing to finance new capital expenditure in the near future.
   - There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

Borrowing Strategy 2014/15 – 2017/18

19. The PCC is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the PCC's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.

20. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the PCC will continue to take a cautious approach to its treasury strategy

21. It is assumed that no external borrowing will take place in 2014/15 to 2017/18.

22. External borrowing may be taken out in future years for capital purposes over a period to be determined at that time. The main source of new loans has previously been the Public Works Loans Board (PWLB), which it is estimated could provide all of the PCC's requirement. Historically the PWLB has offered the lowest rates, however, the banking sector may be competitive from time to time. Consequently it is recommended that the approved source of borrowing should be both PWLB loans and the London Money Market. In 2012/13 the Government introduced the certainty rate discount on PWLB loans which enables eligible local authorities to access cheaper borrowing, a 20 basis points discount on loans from the PWLB. Borrowing would have to feature in the force's long-term plans in order for it to qualify for this discount.

23. Borrowing in advance of need – Some Authorities may borrow funds in advance for use in future years. This may occur where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. A cautious approach should be adopted for any such borrowing, but where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. This is not an approach that has been adopted by this Derbyshire Police, if this was proposed in the future it would be reported to the Strategic Governance Board for approval.

24. Debt Rescheduling/Repayment – Consideration will be given to rescheduling or repayment of debt prematurely. Any savings from rescheduling/repayment of debt would have to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred). It is considered that the proposal to repay the outstanding loan for the Helicopter Unit in 2013/14 is sound and will benefit the force's Treasury Management position.

Treasury Management Limits on Activity

25. There are three further debt related treasury activity limits. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

Upper limits on variable and fixed interest rate exposure

Recommended upper limits on the percentage of borrowing and investments held at fixed and variable rates, as required by the Code, are set out below:

	2014/15 Upper	2015/16 Upper	2016/17 Upper
Borrowing			
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	30%	30%	30%

Investments			
Limits on fixed interest rates	20%	20%	20%
Limits on variable interest rates	100%	100%	100%

For investments, fixed interest rates are deemed to apply to loans for more than one year.

Limits set at these levels will provide for efficient debt management, within an acceptable degree of risk. For the purposes of the Code, investments are to be deducted from borrowing to produce adjusted limits, but within the above parameters.

26. **Maturity structures of borrowing**

The maturity profile is the rate at which long-term loans have to be repaid to the PWLB (or other lenders). It would be imprudent to have a large proportion of repayments in any one year, thus a spread of redemption's is desirable.

Currently most of the PCC's loan debt is repayable over the next 25 years. Two loans are repayable on maturity but one of these is for the Helicopter Unit and it is proposed that this is repaid early.

The maturity structure is a prudential indicator under the Code, with lower and upper limits recommended as shown in the table below.

Maturity Structure of fixed interest rate borrowing			
		2014/15	**Currently**
Under 12 months	Lower-Upper	0%-10%	7.1%
12 months to 2 years	Lower-Upper	0%-10%	7.1%
2 years to 5 years	Lower-Upper	0%-30%	21.2%
5 years to 10 years	Lower-Upper	0%-40%	32.6%
10 years and above	Lower-Upper	25%-90%	32.0%

Investment Strategy 2014/15 – 2016/17

27. **Investment Policy -** The PCC's investment policy has regard to the CLG'S Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The PCC's primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return then being a third objective.

28. In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the PCC has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agengy. Using the Capita Asset Services ratings service, banks' ratings are monitored on a real time basis

with knowledge of any changes notified electronically as the agencies notify modifications.

29. Further, the PCC's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets.

30. Other information sources used will include the financial press, share prices and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

31. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus the avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

32. Investment instruments identified for use in the financial year are listed in Appendix B1 under the 'Specified' and 'Non-Specified' Investments categories.

33. **Creditworthiness policy -** The primary principle governing the PCC's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the PCC will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the PCC's prudential indicators covering the maximum principal sums invested.

34. The Treasurer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the PCC for approval as necessary. These criteria are separate to those which determine Specified and Non-Specified investments (see Appendix B1) as they provide an overall pool of counterparties considered high quality the PCC may use rather than defining what types of investment instruments are to be used.

35. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the PCC's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies and one rating meets the PCC's criteria and the other does not, then the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes are provided to officers almost immediately after they occur and this information is considered before dealing.

36. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks/Building Societies 1 - Good Credit Quality** – the PCC will only use UK banks and Building Societies which have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
- **Short Term Rating-** F1 (or equivalent) from Fitch, Moody's (P-1) or S&P's (A-1)

1. **Long Term Rating-** A (single A category) or equivalent from Fitch, Moody's or S&P's.
2. **Viability/Financial Strength –** bb+ (Fitch/Moody's only)
   Note: Individual ratings previously supplied by Fitch have changed to a wider viability rating
3. **Support –** 3 (Fitch only)

- **Banks 2** – Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- **Banks 3** - The PCC's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **UK Government** (eg Debt Management Account Deposit Facility (DMADF))
- **Local Authorities**
- **Money Market Funds –** "AAA" rated by Fitch, Moody's and S&P

37. **Country and sector considerations** – the PCC will only invest in UK banks and building societies with the above ratings.

38. **Use of additional information other than credit ratings** – Additional requirements under the Code require the PCC to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, Capita Asset Services provide a colour coded counterparty list on a weekly basis. This incorporates credit ratings, rating watches, rating outlooks and market information such as Credit Default Swap prices which results in suggested investment durations. This additional market information (for example negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

39. **Time and Monetary Limits applying to Investments** – The time and monetary limits for institutions on the PCC's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	**Money Limit (group)**	**Time Limit**
Banks/Building Societies 1 - Upper Limit	*F1+ (S/T)* *AA- (L/T)*	£10m (£3m if > 365 days)	2yrs
Banks/Building Societies 1 – Middle Limit	F1 (S/T) A- (L/T)	£6m	1yr
Banks 2 Part nationalised banks	N/A	£10m	1yr
Banks 3 PCC's banker		£10m	1yr
Money Market Funds	AAA	£10m	1yr

Debt Management Account Deposit Facility		£35m	1yr
Local Authorities		£15m	1yr

Note – In addition to the above on a temporary basis and subject to approval by the Treasurer or the Director of Finance an additional £2m (increases amount to £12m) can be invested with Barclays Bank for a maximum of 5 days

40. The proposed criteria for Specified and Non-Specified investments are shown in Appendix B1 for approval.

41. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the PCC's liquidity requirements are safeguarded. This will also be limited by the longer term investment limits.

42. The list of counterparties (who currently meet these criteria) for approval is attached at Appendix B2 along with their current ratings and limits. Definitions of credit ratings are shown in Appendix B3.

Investment Strategy

43. **In house funds** - Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

44. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back up, there could be downside risk, particularly if Bank of England inflation forecasts or the rate of fall of unemployment were to prove to be too optimistic.

45. There is an operational difficulty arising from the banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

46. The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst the PCC is asked to approve this base criteria above, under the exceptional current market conditions the Treasurer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

Investment treasury indicator and limit

47. **Total principal funds invested for greater than 364 days**

These limits are set with regard to the PCC's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year end. A limit for lending for more than one year is set out below:

Maximum principal sums invested > 364 days			
£m	**2014/15**	**2015/16**	**2016/17**
Principal sums invested > 364 days	£3m	£3m	£3m

End of year investment report

48. At the end of the financial year, the PCC will report on its investment activity as part of its Annual Treasury Management report.

Policy on the use of external service providers

49. The PCC uses Capita Asset Services as its external Treasury management advisors. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies.

50. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the organisation. This service is subject to regular review.

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the PCC's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for organisations to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this PCC to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Police and Crime Commissioner adopted the Code in January 2013 and will apply its principles to all investment activity. In accordance with the Code, the Treasurer has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- The Specified investments the PCC will use, as defined below.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the PCC is:-

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority.
3. A body that is considered of a high credit quality (such as a bank or building society). For category 3 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Fitch, Moody's (P-1) or Standard and Poor's (A-1) rating agencies.
4. Part nationalised UK banks, if they continue to be part nationalised or they meet the criteria in (3) above.
5. Money Market Funds that have been awarded a high credit rating (AAA) by Fitch, Moody's or Standard and Poor's rating agencies.

Within these bodies, and in accordance with the Code, the PCC has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is shown in paragraph 41 of Annex B.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The PCC is required to look at non-specified investments in more detail. It must set out:

- procedures for determining which categories of non-specified investments should be used
- the categories deemed to be prudent
- the maximum amount to be held in each category

The Strategy must also set out procedures for determining the maximum period for committing funds.

It is recommended that the following procedure be adopted for determining which categories of non-specified investments should be used:

- the PCC should approve categories on an annual basis
- advice should be provided by the Treasurer to the PCC
- priority should be given to security and liquidity ahead of yield

On this basis the following categories of non-specified investments are currently considered as prudent and are recommended for use:

(a) investments in excess of 364 days but for not more than 2 years duration with counter-parties on the PCC's list provided that they have

Short Term - F1+ (or equivalent from Moody's and Standard & Poors)
Long Term – AA- or better (or equivalent from Moody's and Standard & Poors)

(b) the PCC's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.

It is recommended that the limit for category (a) should be set at £1m per counterparty subject to an overall limit of £3m. Whilst most of the PCC's surpluses are of a temporary nature, others, for example the insurance provision and PFI reserves, could reasonably be invested for periods in excess of one year. These instruments will only be used where the liquidity requirements are safeguarded. For category (b) balances will be minimized as far as is possible in the event of this happening.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The organisation receives credit rating information from Treasury Management Advisors on a daily basis, as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. No further investment will be made with any counterparty failing to meet the criteria. If required, new counterparties which meet the criteria will be added to the list under the delegated authority of the Treasurer and any changes will be reported to a later Strategic Governance Board.

SECTOR

Current Counterparty Report for
Derbyshire Constabulary (LCD) 13-14 (21/01/13)

Report run on: 13/01/2014 05:32:41

List of Approved Counterparties for Lending

	Fitch Ratings				Moody's Ratings			S&P Ratings		Limits	
	S. Term Outlook	L. Term	Viab.	Support	S. Term Outlook	L. Term	Fin.Stgth	S. Term Outlook	L. Term	Time	Money
UK BANKS											
United Kingdom	**F1+ STA**	**AA+**			** STA**	**Aa1**		**A-1+ NEG**	**AAA**		
HSBC GROUP											
HSBC Bank plc	F1+ STA (U)	AA- (D)	a+ (D)	1	P-1 NEG(m)	Aa3 (D)	C (D)	A-1+ NEG (D)	AA- (D)	2 YEARS	£10m
LLOYDS BANKING GROUP											
Bank of Scotland Plc	F1 (D) STA	A (D)		1	P-1 NEG(m)	A2 (D)	D+	A-1 NEG (D)	A (D)	1 YEARS	£10M (M)
Lloyds Bank Plc	F1 (D) STA	A (D)	bbb+ (U)	1	P-1 NEG(m)	A2 (D)	C-	A-1 NEG (D)	A (D)	1 YEARS	£10M (M)
ROYAL BANK OF SCOTLAND GROUP											
National Westminster Bank	F1 (D) STA	A (D)		1	P-2 (D) NEG(m)	A3 (D)	D+ (D)	A-2 (D) NEG (D)	A- (D)	1 YEARS	£10M (M)
Royal Bank of Scotland	F1 (D) STA	A (D)	bbb	1	P-2 (D) NEG(m)	A3 (D)	D+ (D)	A-2 (D) NEG (D)	A- (D)	1 YEARS	£10M (M)
SUMITOMO MITSUI CORPORATION GROUP											
Sumitomo Mitsui Banking Corporation Europe Limited	F1 STA (D)	A- (D)		1	P-1 STA (U)	Aa3 (D)	C	A-1 NEG (D)	A+	364 DAYS	£6m
Barclays Bank	F1 (D) STA (D)	A (D)	a	1	P-1 NEG(m)	A2 (D)	C- (D)	A-1 (D) STA (U)	A (D)	1 YEARS	£10m (Council's Bank)
Goldman Sachs International	F1 STA	A			P-1 (U) STA	A2 (U)		A-1 NEG	A	364 DAYS	£6m
Goldman Sachs International Bank	F1 STA	A						A-1 NEG	A	364 DAYS	£6m

List of Approved Counterparties for Lending

	Fitch Ratings				Moody's Ratings			S&P Ratings		Limits	
	S. Term Outlook	L. Term	Viab.	Support	S. Term Outlook	L. Term	Fin.Stgth	S. Term Outlook	L. Term	Time	Money
UK BANKS											
United Kingdom	**F1+** **STA**	**AA+**			 **STA**	**Aa1**		**A-1+** **NEG**	**AAA**		
MBNA Europe Bank	F1 (D) STA	A- (D)		1						364 DAYS	£6m
Merrill Lynch International	F1 STA	A		1				A-1 NEG	A	364 DAYS	£6m
Schroders Plc	F1 STA	A+						A-1 STA (D)	A+ (U)	364 DAYS	£6m
Standard Chartered Bank	F1+ STA (U)	AA-	aa-	1	P-1 STA	A1	B-	A-1+ (U) NEG (D)	AA- (U)	364 DAYS	£6m
UBS Ltd	F1 (D) STA	A (D)		1	P-1 STA (U)	A2 (D)		A-1 STA (U)	A (D)	364 DAYS	£6m
UK BUILDING SOCIETIES											
United Kingdom	**F1+** **STA**	**AA+**			 **STA**	**Aa1**		**A-1+** **NEG**	**AAA**		
1 Nationwide Building Society	F1 (D) STA (U)	A (D)	a (D)	1	P-1 STA	A2 (D)	C (U)	A-1 NEG (D)	A (D)	364 DAYS	£6m

List of Approved Counterparties for Lending

	Fitch Ratings				Moody's Ratings			S&P Ratings		Limits	
	S. Term Outlook	L. Term	Viab.	Support	S. Term Outlook	L. Term	Fin.Stgth	S. Term Outlook	L. Term	Time	Money
OTHERS											
United Kingdom	**F1+ STA**	**AA+**			**STA**	**Aa1**		**A-1+ NEG**	**AAA**		
DMO										6 MONTHS	£35m
Local Authorities										1 YEARS	£15m
Money Market Funds										1 YEARS	£10m

Key

Upgraded	(U)	Positive Rating Watch	(P)	Upgraded Positive Rating Watch	(U.P)	Upgraded Negative Rating Watch	(U.N)
Downgraded	(D)	Negative Rating Watch	(N)	Downgraded Positive Rating Watch	(D.P)	Downgraded Negative Rating Watch	(D.N)

(M) - Manual addition

Credit Ratings

<u>Definition - Short-Term Bank Deposit Ratings (Fitch)</u>

F1 - Highest credit quality.
Indicates the strongest capacity for timely payment of financial commitments; may have an added '+' to denote any exceptionally strong credit feature.

F2 - Good credit quality.
A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3 - Fair credit quality.
The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non-investment grade.

B - Speculative.
Minimal capacity for timely payment of financial commitments, plus vulnerability to near term adverse changes in financial and economic conditions.

C - High default risk.
Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment.

D - Default.
Indicates an entity or sovereign that has defaulted on all of its financial obligations.

<u>Definition - Long-Term Bank Deposit Ratings (Fitch)</u>

AAA – Highest credit quality.
'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA – Very high credit quality.
'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments . This capacity is not significantly vulnerable to foreseeable events.

A – High credit quality.
'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances and economic conditions than is the case for higher ratings. Susceptibility to long term risks appears somewhat greater.

BBB - Good credit quality.
'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in

circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.

Speculative Grade

BB - Speculative.
'BB' ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B - Highly speculative.
For issuers and performing obligations, 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.
For individual obligations, may indicate distressed or defaulted obligations with potential for extremely high recoveries. Such obligations would possess a Recovery Rating of 'RR1' (outstanding).

CCC – Substantial credit risk.
For issuers and performing obligations, default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favourable business or economic conditions.
For individual obligations, may indicate distressed or defaulted obligations with potential for average to superior levels of recovery. Differences in credit quality may be denoted by plus/minus distinctions. Such obligations typically would possess a Recovery Rating of 'RR2' (superior), or 'RR3' (good) or 'RR4' (average).

CC – Very High levels of credit risk.
For issuers and performing obligations, default of some kind appears probable.
For individual obligations, may indicate distressed or defaulted obligations with a Recovery Rating of 'RR4' (average) or 'RR5' (below average).

C – Exceptionally high levels of credit risk.
For issuers and performing obligations, default is imminent.
For individual obligations, may indicate distressed or defaulted obligations with potential for below-average to poor recoveries. Such obligations would possess a Recovery Rating of 'RR6' (poor).

RD – Restricted default.
Indicates an entity that has failed to make due payments (within the applicable grace period) on some but not all material financial obligations, but continues to honour other classes of obligations.

D – Default.
Indicates an entity or sovereign that has defaulted on all of its financial obligations. Default generally is defined as one of the following:

Failure of an obligor to make timely payment of principal and/or interest under the contractual terms of any financial obligation;
The bankruptcy filings, administration, receivership, liquidation or other winding-up or cessation of business of an obligor;
The distressed or other coercive exchange of an obligation, where creditors were offered securities with diminished structural or economic terms compared with the existing obligation.

Definition – Viability Ratings (Fitch only)

Viability Ratings are designed to be internationally comparable and represent Fitch's view as to the intrinsic creditworthiness of an issuer. The Viability Rating is a key component of a bank's Issuer Default Rating and considers various factors including:

- Industry profile and operating environment.
- Company profile and risk management.
- Financial profile.
- Management strategy and corporate governance.

Viability Ratings are assigned to banks and in limited cases, to similar legal entities where it is considered useful to clarify the source of an entity's financial strength. Notably, the Viability Rating excludes any extraordinary support that may be derived from outside of the entity as well as excluding potential benefits to a bank's financial position from other extraordinary measures, including a distressed restructuring of liabilities.

Viability Ratings represent the capacity of the bank to maintain on-going operations and to avoid failure, the latter being indicated by extraordinary and company specific measures becoming necessary to protect against a bank's default.

aaa - Highest fundamental credit quality.
The best prospects for on-going viability and lowest expectation of failure risk. They are assigned only to banks with extremely strong and stable fundamental characteristics, such that they are most unlikely to rely on extraordinary support to avoid default. This capacity is highly unlikely to be adversely affected by foreseeable events.

aa - Very high fundamental credit quality.
Very strong prospects for on-going viability. Fundamental characteristics are very strong and stable; such that it is considered highly unlikely that the bank would have to rely on extraordinary support to avoid default. This capacity is not significantly vulnerable to foreseeable events.

a - High fundamental credit quality.
Strong prospects for on-going viability. Fundamental characteristics are strong and stable, such that it is unlikely that the bank would have to rely on extraordinary support to avoid default. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

bbb - Good fundamental credit quality.

Good prospects for on-going viability. The bank's fundamentals are adequate, such that there is a low risk that it would have to rely on extraordinary support to avoid default. However, adverse business or economic conditions are more likely to impair this capacity.

bb – Speculative fundamental credit quality.
Moderate prospects for ongoing viability. A moderate degree of fundamental financial strength exists, which would have to be eroded before the bank would have to rely on extraordinary support to avoid default. However, an elevated vulnerability exists to adverse changes in business or economic conditions over time.

b - Highly speculative fundamental credit quality.
Weak prospects for on-going viability. Material failure risk is present but a limited margin of safety remains. The bank's capacity for continued unsupported operation is vulnerable to deterioration in the business and economic environment.

ccc - Substantial fundamental credit risk.
Failure of the bank is a real possibility. The capacity for continued unsupported operation is highly vulnerable to deterioration in the business and economic environment.

cc - Very high levels of fundamental credit risk.
Failure of the bank appears probable.

c - Exceptionally high levels of fundamental credit risk.
Failure of the bank is imminent or inevitable.

f
Indicates an issue, in Fitch's opinion, has failed, and that either has defaulted or would have defaulted had it not received extraordinary support or benefited from other extraordinary measures.

Notes: The modifiers "+" or "−" may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the 'aaa' Viability Rating category or to Viability Rating categories below 'b'. Outlooks are not assigned to Viability Ratings although at any point in time, a bank's position and prospects may have underlying trends, for example improving, deteriorating or stable.

Definition – Financial Strength (Moody's only)

The Financial Strength rating "can be understood as a measure of the likelihood that a bank will require assistance from third parties such as its owners, its industry group, or official institutions" – Moody's

Bank Financial Strength Rating Definitions

A

Banks rated A possess superior intrinsic financial strength. Typically, they will be institutions with highly valuable and defensible business franchises, strong financial fundamentals, and a very predictable and stable operating environment.

B

Banks rated B possess strong intrinsic financial strength. Typically, they will be institutions with valuable and defensible business franchises, good financial fundamentals, and a predictable and stable operating environment.

C

Banks rated C possess adequate intrinsic financial strength. Typically, they will be institutions with more limited but still valuable business franchises. These banks will display either acceptable financial fundamentals within a predictable and stable operating environment, or good financial fundamentals within a less predictable and stable operating environment.

D

Banks rated D display modest intrinsic financial strength, potentially requiring some outside support at times. Such institutions may be limited by one or more of the following factors: a weak business franchise; financial fundamentals that are deficient in one or more respects; or an unpredictable and unstable operating environment.

E

Banks rated E display very modest intrinsic financial strength, with a higher likelihood of periodic outside support or an eventual need for outside assistance. Such institutions may be limited by one or more of the following factors: a weak and limited business franchise; financial fundamentals that are materially deficient in one or more respects; or a highly unpredictable or unstable operating environment.

Note: Where appropriate, a "+" modifier will be appended to ratings below the "A" category and a "-" modifier will be appended to ratings above the "E" category to distinguish those banks that fall in intermediate categories.

Definition – Support (Fitch only)

The Support rating is " Fitch's assessment of a potential supporter's (either a sovereign state's or an institutional owner's) propensity to support a bank and of its ability to support it" - Fitch

1 denotes:
A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-',

4 denotes:
A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.

2 denotes:
A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.

3 denotes:
A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.

5 denotes:
A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.