Finance Committee

Date: **9 March 2022**

Item: **Treasury Management Strategy 2022/23**

This paper will be considered in public

1 Summary

1.1 This paper sets out the proposed Treasury Management Strategy (TMS) for 2022/23. The TMS 2022/23 comprises the Investment Strategy, the Borrowing Strategy, the Liquidity Strategy, the Risk Management Strategy and the Counterparty Exposure Limits.

1.2 Approval of the TMS is a matter reserved to the Board. On 29 July 2020, the Board delegated to the Committee approval of the TMS and any changes to the TMS during any year. The Committee is asked to exercise that authority in relation to the TMS for 2022/23.

1.3 This paper also asks the Committee to note the proposed draft TTL Properties Limited (TTLP) Treasury Management Strategy. We intend to return to the Committee for approval of this strategy in due course once TTLP's future arrangements have been finalised. This strategy can be found in Appendix 2.

1.4 A paper is included on Part 2 of the agenda, which contains exempt supplemental information and documentation. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the financial affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendations

2.1 **Under the authority delegated by the Board, the Committee is asked to note the paper and the supplementary information on Part 2 of the agenda and:**

(a) approve the Treasury Management Strategy (TMS) 2022/23, attached in Appendix 1, including the Investment Strategy, the Borrowing Strategy, the Liquidity Strategy, the Risk Management Strategy and the Counterparty Exposure Limits;

(b) subject to the approval of the TMS 2022/23 and approval of the TfL Group Policy Relating to the Use of Derivative Investments (Derivatives Policy) by the Committee (pursuant to a separate item on the agenda), approve, pursuant to Section 49 of the Transport for London Act 2008 (as amended by the Transport for London Act 2016, together the Act), and in accordance with the Derivatives Policy for 2022/23, Transport for London Finance Limited (as a qualifying TfL subsidiary for the purposes of the Act) entering into derivative investment(s) in relation to:

(i) mitigating exchange rate risk related to specific currency exposures arising from the procurement of goods or services by any member of the TfL Group or grants or revenues payable in currencies other than Sterling to any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of exchange rate risk to any member of the TfL Group is established;

(ii) mitigating exchange rate risk arising from any TfL Group investments in foreign currencies in accordance with the TMS 2022/23;

(iii) mitigating commodity rate and/or price risk related to specific commodity (including fuel and electricity) exposures arising from the procurement of goods or services by any member of the TfL Group in the ordinary course of business as soon as practicable once the quantum of commodity risk to any member of the TfL Group is established;

(iv) mitigating interest rate risk and if applicable currency risk related to any existing, imminent and future TfL Group borrowing (including any leases), once the borrowing has become certain and authorised in accordance with the TMS 2022/23;

(v) mitigating inflation risk related to specific exposures arising from the procurement of goods or services by any member of the TfL Group once the quantum of inflation risk to any member of the TfL Group is established; and

(vi) mitigating risk related to any index reflecting any of the above matters referred to in paragraphs 2.1(b)(i) to (v) above.

3 Treasury Management Strategy 2022/23

3.1 The TMS 2022/23 includes TfL’s proposed strategies for investment, borrowing, liquidity and risk management for the financial year 2022/23, as well as proposed counterparty exposure limits. It sets out TfL’s borrowing requirement for 2022/23.

3.2 On 20 December 2021, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued new versions of its Treasury Management Code and the Prudential Code, which have been reflected in the TMS for 2022/23. Accordingly, environmental, social and governance investment considerations have been introduced to the counterparty credit review process. Changes have been proposed to the commercial paper maturity limit in response to the changes in Public Works Loan Board (PWLB) lending terms. Changes have also been proposed to the derivative counterparty exposure limits. These are discussed later in this paper.

3.3 TTL Properties Limited (TTLP) will start to become more financially independent from TfL on 1 April 2022. TfL will manage treasury related tasks on its behalf. The draft TTLP Treasury Management Strategy comprises of the Borrowing Strategy; the Investment Strategy; the Liquidity Strategy and Banking and Cash Management and are included in draft form in Appendix 2. We intend to return to the Committee for approval of this strategy in due course once TTLP’s future arrangements have been finalised.

3.4 There are no other material changes proposed for the TMS 2022/23.

3.5 All references to 'investments' in the TMS 2022/23 refer to investments held for treasury management purposes only and do not cover non-treasury related investments.

3.6 The proposals to the Committee for derivative investments set out in Recommendation 2.1(b) have been approved by the statutory and managing Chief Finance Officers[11], as required under the Derivatives Policy.

4 Market outlook

4.1 On 3 February 2022 the Monetary Policy Committee increased the Bank of England Bank Rate by 0.25 per cent to 0.50 per cent. Minutes from the meeting state that UK Gross Domestic Product growth is expected to slow, as higher energy and goods prices adversely impact real income and spending. The UK Consumer Price Index rose to 5.5 per cent in December, the highest since 2008 and is expected to continue rising, peaking in April 2022 at 7.25 per cent.

4.2 Financial markets expect interest rates to increase to 1.25 per cent in 2022. Any increases in TfL's interest income will be partially offset by increases in TfL's interest expenditure on outstanding floating rate debt.

5 Investments

Money Market Fund (MMF) regulation

5.1 Following the severe market disruption brought on by the coronavirus pandemic, regulators across Europe and the United States are reviewing the rules under which MMFs operate. The European Commission has received two reports from the European Securities and Markets Authority and the European Systemic Risk Board recommending the replacement of low volatility net asset value funds to variable net asset value funds, recoupling of gates and fees from liquidity thresholds and a requirement for more overnight liquidity. After reviewing the report, the European Commission will provide final recommendations to the European Council that will require agreement from all member states before it is adopted. If adopted, there will likely be an implementation period of one to two years, meaning changes will not take place until at least mid-2024.

Environmental, social and governance (ESG) investment funds

5.2 The ESG performance and policies of investment counterparties will now be assessed as part of the counterparty credit review process. Counterparties are assessed prior to being added or kept on TfL's Approved Investment Counterparty List and are approved or rejected individually by either the Director of Corporate Finance or the Group Treasurer. The ESG assessment will consider qualitative

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[1] References to statutory Chief Finance Officer in this document mean the Chief Finance Officer under sections 114 and 115 of the Local Government and Finance Act 1988 and section 127 of the Greater London Authority Act 1999. References to managing Chief Finance Officer in this document mean the managing (non-statutory) Chief Finance Officer.

information such as company commitments to reducing the impact of climate change and independent quantitative data for example Standard and Poor's Credit Indicator Report Cards, where available.

5.3 We will consider the appropriateness of investing in ESG MMFs to support investment in counterparties with strong ESG policies and commitments. ESG money market funds will also be assessed against existing (non ESG) investment criteria before being approved as an eligible investment counterparty.

Investment yield benchmark

5.4 Following the cessation of London Interbank Offered Rate (LIBOR) publication on 31 December 2021, MMFs are now using Sterling Overnight Index Average (SONIA) instead of the seven-day London Interbank Bid Rate (LIBID) to benchmark returns. To align with MMFs, we have elected to change our investment yield benchmark from seven-day LIBID, to SONIA.

6 Borrowing

2022/23 Borrowing requirement and sources

6.1 TfL’s refinancing requirement for 2022/23 is expected to be approximately £694.1m, excluding rolling commercial paper, as set out in the TMS. This requirement is driven by the expectation that TfL will refinance all of its maturing debt in 2022/23.

6.2 We retain several options for refinancing during the year, including public and private capital markets transactions, issuance under our commercial paper programme, and the PWLB. Borrowing from the capital markets would require an update to the relevant documentation before issuance is possible.

6.3 In addition to TfL’s expected refinancing, TTLP is expected to raise new borrowing to meet its capital requirements. Further detail is included in the draft TTLP Treasury Management Strategy, set out in Appendix 2. Otherwise, no additional borrowing is anticipated for TfL for 2022/23.

7 Liquidity management

Commercial Paper maturity limit change

7.1 Following the change to PWLB lending terms in September 2021, which increased the settlement period on new loans from two days to five days, we adapted our approach to short-term borrowing to aim to have no more than £200m maturing in any six-day period. This was an increase from no more than £200m in any three-day period that was stated in our TMS for 2021/22. It limits our liquidity risk and allows us to cap the maximum potential negative cash impact as a result of this change to £200m, at any one time. We propose to formalise this change and will continue to aim to have no more than £200m of short-term borrowing maturing in any six-business-day period during 2022/23.

8 Derivative exposure limits

8.1 Derivative counterparty exposure limits have been adjusted to align with investment counterparty exposure limits. While derivative limits will continue to reference long term credit ratings, consistent with the typical durations of derivatives used for risk management purposes, the equivalent short-term ratings will be used to calculate the exposure limit per counterparty. The exposure limits per counterparty will be derived from the same limits approved for investment purposes, with the exception of not permitting long term ratings of BBB+ or lower in respect of derivatives. The change in derivative counterparty exposure limits is shown in Table 1.

Table 1 – Derivative counterparty exposure limits

<table>
<tr><th colspan="2">Moody's</th><th colspan="2">Standard & Poor's</th><th colspan="2">Fitch</th><th>Existing derivative counterparty limit (£m)</th><th>New derivative counterparty limit (£m)</th></tr>
<tr><th>ST</th><th>LT</th><th>ST</th><th>LT</th><th>ST</th><th>LT</th><th></th><th></th></tr>
<tr><td rowspan="8">P-1</td><td>Aaa</td><td rowspan="5">A-1+</td><td>AAA</td><td rowspan="5">F1+</td><td>AAA</td><td>400</td><td>120</td></tr>
<tr><td>Aa1</td><td>AA+</td><td>AA+</td><td>400</td><td>115</td></tr>
<tr><td>Aa2</td><td>AA</td><td>AA</td><td>350</td><td>110</td></tr>
<tr><td>Aa3</td><td>AA-</td><td>AA-</td><td>250</td><td>105</td></tr>
<tr><td>A1</td><td></td><td>A+</td><td>200</td><td>100</td></tr>
<tr><td></td><td rowspan="3">A-1</td><td>A+</td><td rowspan="3">F1</td><td>A+</td><td>175</td><td>90</td></tr>
<tr><td>A2</td><td>A</td><td>A</td><td>175</td><td>80</td></tr>
<tr><td>A3</td><td></td><td>A-</td><td>150</td><td>70</td></tr>
<tr><td rowspan="3">P-2</td><td>A3</td><td rowspan="3">A-2</td><td>A-</td><td rowspan="3">F2</td><td>A-</td><td>150</td><td>60</td></tr>
<tr><td>Baa1</td><td>BBB+</td><td>BBB+</td><td>0</td><td>0</td></tr>
<tr><td>Baa2</td><td></td><td>BBB</td><td>0</td><td>0</td></tr>
</table>

8.2 Derivative counterparties will continue to be subject to agreed obligations under Credit Support Annexes (CSAs) determined by the derivative counterparties credit rating at the time of agreeing derivative documentation. The one-way CSAs obligate derivative counterparties to post collateral if the mark to market of outstanding derivatives exceeds a specified threshold. Practically, this reduces TfL derivative exposure to the CSA thresholds shown in Table 2

Table 2 – CSA thresholds

Moody's	Standard & Poor's	Fitch	CSA threshold for new derivative counterparties* (£m)
Aaa	AAA	AAA	50
Aa1	AA+	AA+	40
Aa2	AA	AA	40
Aa3	AA-	AA-	40
A1	A+	A+	25
A2	A	A	25
A3	A-	A-	20
Baa1	BBB+	BBB+	0

8.3 The new limit structure provides sufficient limit for all expected derivative activities in 2022/23.

List of appendices to this report:

Appendix 1: Treasury Management Strategy 2022/23

Appendix 2: Draft TTL Properties Limited Treasury Management Strategy 2022/23

A paper containing exempt supplemental information is included on Part 2 of the agenda.

List of background papers:

None

Contact Officer: Joanna Hawkes, Director of Corporate Finance
Email: JoannaHawkes@tfl.gov.uk