

# TRANSPORT FOR LONDON GROUP

## TFL 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 (as amended by the Transport for London Act 2016, the TfL Act). Section 49 of the TfL Act relates to powers to make arrangements for risk mitigation in respect of the 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 original Bill promoted by TfL that an 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 Finance Committee. 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 INVESTMENTS

- 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 powers are subject to various restrictions and safeguards as set out in this policy.

### 3 RESTRICTIONS ON THE POWERS TO ENTER INTO DERIVATIVE INVESTMENTS

- 3.1 The powers to enter into derivative investments are subject to the following restrictions:
  - (a) the powers are only exercisable for the purposes of the prudent management of the financial affairs of TfL and its subsidiaries and of limiting the extent to which any TfL body<sup>1</sup> would be affected by changes in the following:
    - (i) interest rates;
    - (ii) exchange rates;
    - (iii) inflation of the United Kingdom or elsewhere;

---

<sup>1</sup> TfL body means TfL, any subsidiary of TfL, a joint venture of TfL or an associated undertaking of TfL.

- (iv) rates or prices applicable to oil, electricity or any commodity which is used by any TfL body or by which a TfL body is affected or to which it is otherwise exposed under a relevant agreement;
  - (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; or
  - (vi) any index reflecting any of the matters referred to in paragraphs (i) to (v);
- (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 and section 127 of the Greater London Authority Act 1999.

#### **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 Committee is authorised to give consent on behalf of TfL to any derivative investment or a programme of derivative investments;
  - (c) the prior consent of the Finance Committee is required before a qualifying TfL subsidiary can enter into any derivative investment or a programme of derivative investments;
  - (d) the Finance Committee can issue any guidance or specific or general directions to any qualifying TfL subsidiary as to the manner in which it is to exercise its functions in relation to derivative investments;
  - (e) the Finance Committee will be provided with professional financial and legal advice, as required, in respect of their functions relating to the examination and approval of the exercise of the powers;

- (f) the approval of the statutory Chief Finance Officer<sup>2</sup> is required before any derivative investment or programme of derivative investments is entered into, in recognition of the statutory role under local authority finance legislation;
- (g) the approval of the managing Chief Finance Officer<sup>3</sup> is required before any derivative investment or programme of derivative investments is entered into;
- (h) in respect of the derivative investments, the statutory and managing Chief Finance Officers will approve the types of instruments used;
- (i) any one of the managing Chief Finance Officer, Director of Corporate Finance or Group Treasurer are authorised by the Finance Committee to give consent on behalf of TfL to approve derivative counterparties;
- (j) any use of derivative investments will be monitored on a regular basis by the statutory Chief Finance Officer;
- (k) any use of derivative investments will be reported in the TfL Group accounts in accordance with International Financial Reporting Standards (IFRS);
- (l) the reporting of all derivative investments in the TfL Group accounts will be subject to audit by the TfL Group's auditors; and
- (m) 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 COUNTERPARTY EXPOSURE LIMITS- DERIVATIVE INVESTMENTS**

5.1 TfL calculates its derivative investments counterparty exposures based on accepted market methodology. The current mark to market of each derivative investment is added to the potential future exposure (PFE). The PFE is calculated based on the maximum counterparty exposure assuming a 95 per cent confidence level of possible adverse future movements in interest rates or foreign exchange rates over the life of the instrument.

5.2 TfL expects to hold all derivative investment contracts to maturity. As such, exposures under derivative investment contracts are contingent exposures during the life of the contract. The contingent exposure is therefore the relevant risk factor rather than the notional value of the contract.

5.3 Derivative investments counterparty exposures have a limit based on long-term credit ratings, as these exposures will generally be for over one year. The notional limits shown in Table 1 are derived from notional limits used for Investments.

### **Table 1 – Derivative investments counterparty exposure limits**

<sup>2</sup> 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.

<sup>3</sup> References to managing Chief Finance Officer in this document mean the managing (non-statutory) Chief Finance Officer.

<u>Moody's</u>		<u>Standard &amp; Poor's</u>		<u>Fitch</u>		<u>Derivative limit per counterparty (£m)</u>
<u>ST</u>	<u>LT</u>	<u>ST</u>	<u>LT</u>	<u>ST</u>	<u>LT</u>	
P-1	Aaa	A-1+	AAA	F1+	AAA	180
	Aa1		AA+		AA+	172.5
	Aa2		AA		AA	165
	Aa3		AA-		AA-	157.5
	A1	-	-	A+	150	
	-	-	A+	A+	135	
	A2	A-1	A	F1	A	120
	A3	-	-	-	A-	105
P-2	A3	A-2	A-	F2	A-	90
	Baa1		BBB+		BBB+	0
	Baa2		-		BBB	0

5.4 Where a counterparty has a split rating, the limit for each rating is calculated as the average of the relevant limits for each rating available.

5.5 The proposed derivative investments counterparty exposure limits provide sufficient headroom for all proposed risk management activities in 2024/25. Derivative investments exposures are allocated over numerous approved counterparties to minimise concentration risk.

5.6 TfL benefits from the one-way credit support annexes (CSAs), calculated from long term credit ratings at the time that International Swaps and Derivatives Association (ISDA) documentation was (and may also in the future be) agreed. The one-way CSA obligates counterparties to post collateral in the event the mark to market exposure of the aggregated derivative investments exceeds the specified CSA threshold. The CSA thresholds for derivative counterparties is shown in Table 2.

**Table 2 – Derivative investments counterparty Credit Support Annex thresholds**

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

5.7 Tfl will apply the derivative investment limits as set out in this section for each counterparty unless circumstances outside its control prevent it from doing so. In this case the managing Chief Finance Officer or the Director of Corporate Finance or the Group Treasurer will implement appropriate replacement limits for that counterparty.

5.8 If any derivative investments limit, applicable to a counterparty, changes while Tfl has an outstanding derivative investment with that counterparty it will not be considered a breach of these limits. Tfl may seek to bring its exposure down to within the revised limits, or at the Director of Corporate Finance's or the Group Treasurer's discretion, may decide to allow a derivative investment to run its course for economic reasons.

## **6 RESPONSIBLE OFFICERS**

6.1 The Director of Corporate Finance and the Group Treasurer will be responsible for:

- (a) the proposal of all matters relating to the exercise of powers under section 49 of the Tfl Act;
- (b) reporting on a regular basis to the Finance Committee on the adequacy / suitability of the exercise of these powers, and on any specific issues as directed by the Finance Committee;
- (c) reporting, as a matter of urgency, to the statutory and managing Chief Finance Officers, the circumstances of any actual or likely difficulty in achieving Tfl's objectives in this respect; and
- (d) responding to any queries of the statutory or managing Chief Finance Officers following the statutory or managing Chief Finance Officers' review of the regular reports.

- 6.2 The approval of the statutory and managing Chief Finance Officers is required before:
- (a) any derivative investment or programme of derivative investments is proposed to the Finance Committee; or
  - (b) any changes to the Risk Management Strategy is proposed to the Finance Committee.
- 6.3 The Director of Corporate Finance and/or the Group Treasurer will propose exposure limits to counterparties with whom TfL may enter into derivative investments. These limits will be approved by the Finance Committee as part of the Treasury Management Strategy, prior to the start of the relevant financial year.
- 6.4 In order to ensure compliance with the legal controls set out in section 49, the statutory and managing Chief Finance Officer is required to state that all legal controls in section 49 will be met before a transaction can be executed. In giving this approval, the statutory and managing Chief Finance Officer must seek the advice of General Counsel and other professional advisers as may be required.
- 6.5 Once all the necessary approvals required under this policy have been obtained, the Director of Corporate Finance, Group Treasurer and 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.

## **7 REPORTING REQUIREMENTS, MONITORING AND MANAGEMENT INFORMATION ARRANGEMENTS**

- 7.1 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.
- 7.2 As a minimum, the following reports will be produced:
- (a) an annual report to the Finance Committee on the strategy to be pursued in the coming year;
  - (b) bi-annual reports to the Finance Committee on the performance of the treasury management function, including 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
  - (c) periodic reports to the statutory and managing Chief Finance Officers.
- 7.3 The statutory 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.

## **8 ACCOUNTING AND AUDIT ARRANGEMENTS**

- 8.1 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.
- 8.2 TfL will consult with external auditors as required regarding correct accounting treatment.
- 8.3 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.

## **9 POLICY CUSTODIAN AND OWNER**

- 9.1 The owner of this policy is the Director of Corporate Finance and the Group Treasurer but its content and any amendments to it must be approved by the Finance Committee.
- 9.2 This policy will be reviewed annually.

Deleted: Policy Custodian and Owner¶