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LONDON BOROUGH

AUDIT COMMITTEE	**28 NOVEMBER 2017**
Subject Heading:	**TREASURY MANAGEMENT MID YEAR UPDATE 2017/18**
SLT Lead:	**Debbie Middleton** **Interim Chief Financial Officer**
Report Author and contact details:	**Reena Patel / Stephen Wild** **Treasury Manager / Head of Pensions and Treasury** **01708432485** **Reena.Patel@onesource.co.uk**
Policy context:	**The Code of Practice on Treasury Management 2009 requires that Council be provided with a mid-year report on treasury activities.**
Financial summary:	**There are no direct financial implications from the report.**

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Places making Havering	[x]
Connections making Havering	[x]

SUMMARY

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function to Full Council at least twice per year (mid-year and at year end).

The Authority’s treasury management strategy for 2017/18 was approved at a meeting of the Authority in February 2017.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

The key highlights of the Mid-Year report are as follows:

- Investment portfolio return was 0.69% outperforming its Benchmark by 0.39%, the Budgeted rate of return by 0.09% despite 3 month LIBOR falling steadily over the quarter.
- The Arlingclose 13 London Borough average was 0.48% in Q2 on comparable internally managed investments.
- No breach of the Authority’s prudential indicators and treasury indicators.

RECOMMENDATIONS

- To note the treasury management activities for the half year detailed in the report
- To note the regulatory update on “Ring Fencing” set out in **section 1.2** of this report.
- To note the regulatory updates on published FCA rules in relation to the second Markets in Financial Instrument Directive (MIFID II) included in **section 1.3** of this report and the recent consultation by CIPFA on the Prudential and Treasury Management codes.
- To note the changes brought about by *IFRS 9 Financial Instruments,* the new accounting standard for investments, borrowing, receivables and payables, which will apply to local authorities from the 2018/19 financial year onwards as detailed in **Appendix D**.
- To note the upcoming launch of a consultation exercise by DCLG to update the statutory guidance on Minimum Revenue Provision and Local Authority Investment Activity as detailed at the end of **section 1.2**

REPORT DETAIL

1. External Context

1.1. Economic Backdrop

UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 EU referendum result continued to feed through into higher import prices. The new inflation measure CPIH (Consumer Prices Index including owner occupiers' housing costs) was at 2.7%.

Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

The Bank of England's (BoE) Monetary Policy Committee (MPC) made no change to monetary policy at its meetings in the first half of the financial year. The (MPC) sets monetary policy to meet the 2% inflation target, to help sustain growth and employment. At its meeting ending on 1 November 2017, the MPC voted by a majority of 7-2 to increase Bank Rate by 0.25 percentage points, to 0.5% the first upward move in 10 years. The BoE predict that the bank rate will start drifting up gradually going forward.

In the UK, some borrowers have started to pass through the rise in UK official interest rates into modestly upward revised rates for investors. This could present a modest increase in the investment income earned for the current financial year but not enough to warrant an increase in budgeted investment income.

Credit Background

There were a few credit rating changes during the quarter. The significant change was the downgrade by Moody's to the UK sovereign rating in September from **Aa1 to Aa2** which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

The ratings agency also:

- affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1,
- placed Lloyds Bank's A1 rating on review for upgrade,
- revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable,
- downgraded the long-term rating of Leeds BS from A2 to A3. The Authority had no exposure to Leeds BS at the end of Q2.
- downgraded long-term ratings of the major Canadian banks on the expectation of a more challenging operating environment. The Authority's treasury advisers, Arlingclose remain comfortable with lending to these banks for a maximum period of six months.

  The Authority had no exposure to Canadian banks at the end of Q2, and as per Arlingclose's advice the duration of lending to these banks has been reduced to a maximum of six months on the Authority's lending list.
- downgraded the ratings of the large Australian banks to Aa3 from Aa2 on its view of the rising risks from their exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

  The Authority had £10m exposure with an Australian bank (Australia and New Zealand Banking Group) at the end of Q2, with a rating of Aa3. The maturity profile is as below:

Date	Amount
18/12/2017	£5m
11/01/2018	£5m

Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented by the end of 2019.

In May, following Arlingclose's advice, the Authority reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

1.2. Regulatory Updates

MiFID II: Local authorities are currently treated by regulated financial services firms as professional clients who can “opt down” to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can “opt up” to be professional clients, providing that they meet certain criteria.

In order to “opt up” to professional, the Authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the Authority must have at least one year’s relevant professional experience. In addition, the firms must make an assessment that the person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

A decision to maintain “Retail” status is expected to limit the investment options available, compared to “Professional” status. It is also important to note that the option to “opt-up” is not a one off exercise. It will need to be undertaken with each and every counterparty / fund manager that a client may wish to transact. Without “Professional” status, the Authority will be unable to deliver its Treasury Management Strategy and as a consequence investment income assumed in the budget strategy.

The Authority meets the conditions to “opt up” to professional status and intends to do so in order to maintain their current MiFID status.

The Authority intends to carry out the opting up process through a portal provided by CIPFA: the CIPFA/PS Link MiFID II portal which is more efficient than writing separately to each counterparty.

CIPFA Consultation on Prudential and Treasury Management Codes:

Following consultation on the relevance, adoption and practical application of the Treasury Management and Prudential Codes, CIPFA has proposed changes to the Prudential Code.

The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to Council which will cover the basis of the capital programme and treasury management.

The prudential indicators for capital expenditure and the authorised borrowing limit would be required to be included in this report but other indicators may be delegated to another committee if desired by Council. Other proposed changes include applying the principles of the Code to local authority subsidiaries.

Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of “investments” as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council.

CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England and a consultation is due to be published imminently.

Further, it is expected that the Chancellor’s budget on 22 November will introduce new restrictions upon the ability of local authorities to borrow to fund commercial investment. An assessment of the potential impact upon the Council’s regeneration and housing company investments will be undertaken in light of these announcements and consultations as they become clear.

2. Treasury Management Summary

The treasury management position as at 30th September 2017 and the change over the period is shown in table 1 below.

Table 1: Treasury Management Summary as at 30th September 2017

	31.3.17 Balance £m	Movement £m	30.9.17 Balance £m	30.9.17 Rate %
Long-term borrowing	210.234		210.234	3.60
Short-term borrowing	2.512	2.638	5.150	0.21
Total borrowing	**212.746**	**2.638**	**215.384**	**3.52**
Long-term investments	40.000	5.000	45.000	1.11
Short-term investments	130.808	8.996	139.804	0.56
Cash and cash equivalents	30.096	-9.051	21.045	0.50
Total investments	**200.904**	**4.945**	**205.849**	**0.69**
Net borrowing	**11.842**	**-2.307**	**9.535**	**2.83**

3. Borrowing Strategy During Half Year

3.1 The 30th September 2017 borrowing position is show in table 2 below.

Table 2: Borrowing Position

	Balance at 01/04/17 £m	Raised £m	Repaid £m	Balance at 30/09/17 £m	Weighted Average Rate %
Loans					
PWLB	203.234	-	-	203.234	**3.60**
Banks (LOBO)	7.000	-	-	7.000	**3.60**
Local Authorities and Other (Short Term Borrowing)	2.512	25.250	22.612	5.150	**0.21**
Total Loans	**212.746**	**25.25**	**22.612**	**215.384**	**3.52**

4. Investment Activity

4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position during the half year is shown in Table 3 below.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

Table 3: Investment Activity

	Balance at 01/04/17 £m	Raised £m	Repaid £m	Balance at 30/09/17 £m	Weighted Average Rate %
Investments					
Fixed Deposits	162.000	104.500	90.500	176.000	0.70
Money Market Funds	6.920	239.050	244.130	1.840	0.24
Call Accounts	23.176	17.192	21.163	19.205	0.52
Covered Bonds	8.808	0.000	0.004	8.804	0.95
Total investments	**200.904**	**360.742**	**355.797**	**205.849**	**0.69**

4.2 At 30 September 2017, investments were spread amongst 13 counterparties in comparison with an average of 15 counterparties in the Arlingclose universe of 13 London Boroughs. **Appendix A** shows the breakdown of counterparties and investments for the authority.

Appendix B provides a summary of Arlingclose's quarterly benchmarking report.

5. Budgeted Income and Return

5.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below:

Table 4: 2017/18 Treasury Investment Performance to 30/9/17

	Benchmark Return 3 month LIBOR (Average Quarterly Rate) %	Budgeted Rate of Return %	Budgeted Interest (Full Year) £m	Actual Rate of Return %	Actual Interest to end of Quarter £m
Quarter 1	0.31	0.60	1.350	0.68	0.372
Quarter 2	0.30	0.60	1.350	0.69	0.367
Total			1.350		0.739

5.2 The Authority outperformed its benchmark during the half year by 0.39%. This was achieved by locking into longer term deposits to mitigate the impact of falling 3 month LIBOR.

5.3 The Authority's 2017/18 budgeted rate of return was set at 0.60% and at the end of quarter 2; the authority outperformed its budgeted rate of return by 0.09%. The investment returns in the Arlingclose universe of 13 London Borough's was 0.48% as reported in the quarterly benchmarking.

6. Current Investment Opportunities

6.1 The Authority is made aware of long term investment opportunities by other oneSource Authorities, brokers or investment advisers.

6.2 Cabinet on the 13th September approved changes to the Treasury Management Strategy Statement (TMSS) which will now facilitate investment in a wider range of products.

6.3 In 2016/17, oneSource authorities (Newham and Bexley) and Warrington Council have invested in 5 year solar bonds. Subsequent to Cabinet's approval of the recommended changes to the TMSS, this authority now has the option of investing £3m in Solar bonds and the S151 Officer in consultation with the lead member for financial management will decide whether to take up this option.

7. New borrowing

7.1 Affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

7.2 As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the authority determined it was more cost effective in the short-term to use internal resources instead, referred to as internal borrowing.

7.3 As a result no long term borrowing was undertaken during the half year but this will be kept under continuous review as capital investment plans are developed and spending is monitored.

7.4 Market opportunities that may provide borrowing rates at less than equivalent PWLB will be considered, where such borrowing opportunities become available. The S151 Officer will consider the cost of carry before making a decision to borrow in advance of need or forward fixing borrowing rates. Such opportunities could be used by the Authority after careful consideration to potentially pay for the Authority's prefunding of the LGPS past service cost and deliver General Fund savings. However the S151 Officer will ensure that full cost of the capital programme over the same period and its affordability is adequately addressed before making a decision whether to use cash balances to prefund pension fund annual past service cost pension contributions for the next 3 years.

8. Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2017/18 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the Treasury Management Strategy Statement (TMSS) in February 2017. The changes to the 2017/18 TMSS presented to this Committee in June 2017 were approved by Full Council on the 13th September 2017 meeting. These changes as reported will enable the Authority to invest in secured bonds in unrated companies. Officers are currently reviewing those opportunities in consultation with the adviser after taking careful regard of risk.

8.2 During the half year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority Treasury Management Strategy Statement and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in **Appendix C** of this report.

IMPLICATIONS AND RISKS

Financial implications and risks:

There are no direct financial implications arising from this report.

Legal implications and risks:

There are no apparent legal implications or risks from noting this report.

Human Resources implications and risks:

There are no HR implications from this report

Equalities implications and risks:

There are no Equalities implications arising from this report

BACKGROUND PAPERS

1. 2017/18 Treasury Management Strategy
2. 2016/17 Treasury Management Annual report and Proposed Changes to 2017/18 Treasury Management Strategy
3. Arlingclose Investment Benchmarking Q2 2017

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Appendix A

Table 1 breakdown of Deposits at 30th September 2017

Institution Type	30th September 2017 Actual £m	31 March 2017 Actual £m
UK Banks		
Goldman Sachs INT"L Bank	23.100	18.000
Lloyds Bank PLC	15.000	24.000
Close Brothers Ltd	5.000	-
Royal Bank of Scotland	0.100	-
Santander UK PLC	0.005	20.176
Santander UK PLC (Covered Bond)	3.804	3.808
UK Building Societies		
Coventry Building Society	-	5.000
Nationwide Building Society	5.000	13.000
Yorkshire Building Society (Covered Bond)	5.000	5.000
Local Authorities & Other Public Sector		
Birmingham City Council	15.000	-
BlackBurn with Darwen Borough Council	5.000	-
Cheshire East Council	5.000	-
Eastleigh Borough Council	5.000	5.000
Falkirk Council	5.000	
Highland Council Inverness	5.000	12.000
Lancashire County Council	15.000	15.000
London Borough of Islington	5.000	5.000
Mid Suffolk District Council	5.000	
Newcastle Upon Tyne City Council	10.000	5.000
North Lanarkshire Council	5.000	5.000
Northumberland County Council	15.000	15.000
Stockport Borough Council	5.000	-
Non UK Banks		
Australia		
Australia & New Zealand Banking Group	10.000	3.000
Commonwealth Bank of Australia	5.000	10.000
Canada		
Bank of Montreal	-	4.000
Netherlands		
Cooperative Rabobank	10.000	15.000
Singapore		
Development Bank Singapore	7.000	2.000
United Overseas Bank	15.000	9.000
Money Market Funds		
HSBC Global Liquidity Fund Class G MMF	-	6.920
BNP Paribas Insticash Sterling MMF	1.840	-
TOTAL INVESTMENTS	**205.849**	**200.904**

Appendix B

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Investment Benchmarking

30 September 2017

	Havering	13 London & Met Boroughs Average	135 LAs Average
Internal Investments	£205.8m	£102.9m	£63.5m
External Funds	£0.0m	£4.4m	£10.3m
TOTAL INVESTMENTS	**£205.8m**	**£108.9m**	**£73.7m**
Security			
Average Credit Score	4.05	4.45	4.44
Average Credit Rating	AA-	AA-	AA-
Average Credit Score (time-weighted)	3.72	4.63	4.32
Average Credit Rating (time-weighted)	AA-	A+	AA-
Number of Counterparties / Funds	13	15	16
Proportion Exposed to Bail-in	32%	63%	64%
Liquidity			
Proportion Available within 7 days	1%	50%	44%
Proportion Available within 100 days	40%	72%	67%
Average Days to Maturity	271	137	40
Market Risks			
Average Days to Next Rate Reset	266	153	66
External Fund Volatility	0.0%	0.3%	1.8%
Yield			
Internal Investment Return	0.69%	0.48%	0.48%
External Funds - Income Return		1.53%	3.48%
External Funds - Capital Gains/Losses		0.73%	1.17%
External Funds - Total Return		2.26%	4.65%
Total Investments - Income Return	0.69%	0.56%	0.89%
Total Investments - Total Return	**0.69%**	**0.62%**	**1.12%**

Notes

- Unless otherwise stated, all measures relate to internally managed investments only, i.e. excluding external pooled funds.
- Averages within a portfolio are weighted by size of investment, but averages across authorities are not weighted.
- Credit scores are calculated as AAA = 1, AA+ = 2, etc.
- Volatility is the standard deviation of weekly total returns, annualised.

Appendix C

Compliance Report

All treasury management activities undertaken during the half year complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

1.1 Interest Rate Exposures

1.1.1 This indicator is set to control the Authority's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed will be:

Table1: Interest rate exposure activity

	2017/18 Limit %	2017/18 Q2 Actual %	2018/19 Limit %	2019/20 Limit %
Upper limit on fixed interest rate exposure	100	94.36	100	100
Upper limit on variable interest rate exposure	25	5.64	30	35

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

1.1.2 Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

1.2 Maturity Structure of Borrowing

1.2.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 2: Loan maturity structure

	Upper %	Lower %	Actual %
Under 12 months	40	0	5.57
12 months and within 24 months	40	0	0.00
24 months and within 5 years	60	0	0.52
5 years and within 10 years	75	0	9.54
10 years and above	100	0	84.37

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.3 Principal Sums Invested for Periods Longer than 364 days

1.3.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

1.3.2 The limits set in the 2017/18 treasury management strategy in comparison to the quarter one is set below. It is the authority's policy to classify available for sale investments with maturities exceeding one year as short term investments.

Table 3: Investments for periods longer than 364 days

	2017/18 Limit £m	2017/18 Actual £m	2018/19 Limit £m
Limit on principal invested beyond year end	75	45	75

1.4 Liquidity Treasury Indicator

1.4.1 The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments overnight and within a rolling three month period without additional borrowing.

Table 4: Liquidity activity as 30/09/2017

	Target £m	Actual £m
Total cash available by the next working day	5.000	1.940
Total cash available within 3 months	30.000	52.000

1.5 Gross Debt and the Capital Financing Requirement (CFR)

1.5.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 5: Gross debt and the CFR

	31.03.17 Actual £m	31.03.18 Estimate £m	31.03.19 Estimate £m	31.03.20 Estimate £m
Long Term External Debt	210.234	210.234	210.234	256.234
CFR	250.578	280.794	325.527	371.890
Internal Borrowing	40.344	70.560	115.293	115.656

1.5.2 Total debt is expected to remain below the CFR during the year. The actual debt levels are monitored against the Operational Boundary and authorised Limit for External Debt, below.

1.6 Operational Boundary for External Debt

1.6.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Table 6: Operational Boundary

Operational Boundary	**2017/18 £m**	**2018/19 £m**	**2019/20 £m**
Borrowing	276.300	310.600	341.400
Other long-term liabilities	2.000	2.000	2.000
Total	**278.300**	**312.600**	**343.400**

1.7 Authorised Limit for External Debt

1.7.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Table 7: Authorised limit for external debt

Authorised Limit	**2017/18 £m**	**2018/19 £m**	**2019/20 £m**
Borrowing	303.900	341.700	375.500
Other long-term liabilities	2.000	2.000	2.000
Total Debt	**305.900**	**343.700**	**377.500**
Long Term Debt	210.200	210.200	210.200
Headroom	**95.700**	**133.500**	**133.500**

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Appendix D

IFRS 9 Financial Instruments

Introduction

IFRS 9 Financial Instruments is the new accounting standard for investments, borrowing, receivables and payables, which will apply to local authorities from the 2018/19 financial year onwards.

Although the first set of accounts under the new standard won't be prepared until April 2019, two of the changes may impact upon the revenue account balance on transition, and therefore need considering when setting the 2018/19 budget in the coming months.

The first change relates to the impairment of financial assets, where potential losses on investments must be charged to revenue in case actual losses are incurred in future. The largest impact will arise on loans and receivables to high risk debtors where a provision is not already in place.

The second impact arises from changes in the treatment of unrealised gains and losses on certain investments, where movements in market value must now be charged to revenue.
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Impairment of Financial Assets

The new impairment rules require a loss provision to be created for most financial assets, including investments and service loans. The loss provision is created by a debit to the CI&ES, which in the absence of mitigating regulations will result in a charge to the General Fund.

The size of the provision, and hence the charge to revenue, depends on the type of asset, the risk of default and the likely loss given default.

Classification and Measurement of Financial Assets

Local authorities currently classify the vast majority of their financial assets as either "loans or receivables" or "available for sale". In either case, changes in fair value due to market fluctuations do not impact upon revenue. But the change to IFRS 9 means that more financial assets will be classified as "fair value though profit and loss" (FVPL) where changes in fair value DO impact upon revenue.

IFRS 9 requires financial assets to be accounted for at FVPL unless the following conditions are met:

- the authority does NOT hold the asset principally in order to sell it to another party,
  AND EITHER
- the contractual cash flows are solely payments of principal and interest,
  OR

- the asset is an equity instrument and the authority has designated it at “fair value through other comprehensive income”.

Pooled funds and equity investments

An equity investment is an instrument that evidences ownership of a share of an entity’s net assets after all of its liabilities have been deducted. This includes ordinary shares in companies and units in collective investment schemes. IFRS 9 requires equity investments to be accounted for at FVPL (where movements in the share/unit price affect revenue) unless the investor makes an irrevocable election to designate the investment as held at “fair value through other comprehensive income” (FVOCI). FVOCI accounting is very similar to the current “available for sale” accounting where dividend income is taken to revenue but changes in fair value are taken to a revaluation reserve.

The Authority has three financial assets which are currently classified as “available for sale”, and as the Authority does not hold the asset principally to sell to another party there would be no change to the accounting treatment of these financial assets as a result of IFRS 9.

The Authority also has a 100% shareholding in its subsidiary, Mercury Land Holdings. The equity investments in MLH are currently being accounted for in line with IFRS 3, Business Combinations and as such IFRS 9 is not applicable to this element.

The Authority also provides long-term finance in the form of a loan to MLH. The loan is due to be repaid on an annuity basis over forty years. The authority intends to hold the loan over this period. The loan to MLH would be classified as a financial asset in the Authority’s singly entity accounts and as such would be accounted for under IFRS 9.

IFRS 9 requires that a provision is made in the Income and Expenditure Statement to recognise the expected loss on this loan, in case actual losses are incurred in the future.
In the absence of mitigating adjustments, the loss provision created above will result to a charge in the General Fund.

Glossary of Terms **Appendix E**

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail**-in is the opposite of a **bail**-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.

Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.