

## **Annexe E – Glossary of Treasury Management Terms**

### **Bank Rate**

1. The rate of interest set by the Bank of England as a benchmark rate for British banks.

### **Bonds**

2. A long-term debt security issued by a company, a financial institution, a local authority, national government or its affiliated agencies. It represents an undertaking to repay the holder the fixed amount of the principal on the maturity date plus a specified rate of interest payable either on a regular basis during the bond's life (coupon) or at maturity.

### **Borrowing**

3. Loans taken out by the authority to pay for capital expenditure or for the prudent management of the Council's financial affairs, which are repayable with interest.

### **Capital Expenditure**

4. Capital expenditure pays for improvements to existing and new assets used in the delivery of Council services as well as other items determined by Regulation. Capital resources are scarce, costly and also have long term revenue implications over many years and even generations where capital expenditure is funded by borrowing. Hence the requirement of the Prudential Code to ensure what is charged as Capital Expenditure is Prudent, Sustainable and Affordable.
5. The statutory definition of capital expenditure is given in the Local Government Act 2003, the Local Authorities (Capital Finance) Regulations 2003 and 2004 as amended. Statute relies on the accounting measurement of cost in International Accounting Standard (IAS) 16 to determine whether expenditure is eligible to be capitalised or whether it should be treated as revenue expenditure. Key to what is eligible as capital spend are the following words in IAS 16 - 'Costs directly attributable to bringing the specific asset into working condition for its intended use'.

### **Capital Financing Requirement (CFR)**

6. An authority's underlying need to borrow for a capital purpose. It measures capital expenditure incurred but not yet financed by the receipt of grants, contributions and charges to the revenue account.

### **Capital Market**

7. A market for securities (debt or equity), where companies and governments can raise long-term funds (periods greater than one year). The raising of short-term funds takes place on other markets (e.g. the money market).

### **Capital Programme**

8. The Capital Programme sets out the Council's capital expenditure plans for the forthcoming financial year as well as for the medium term. It is approved annually at Council and identifies the estimated cost of those schemes, their projected phasing over financial years as well as the method of funding such expenditure.

### **Certificates of Deposits (CDs)**

9. A certificate issued for deposits made at a deposit-taking institution (generally a bank). The bank agrees to pay a fixed interest rate for the specified period of time and repays the principal at maturity. CDs can be purchased directly from the banking institution or through a securities broker. An active interbank secondary market exists to buy and sell CDs.

### **Chartered Institute of Public Finance & Accountancy (CIPFA)**

10. CIPFA is the professional body for accountants in public finance. As a specialised public services body, it provides information, guidance, and determines accounting standards and reporting standards to be followed by Local Government.

### **Collective Investment Scheme Structures**

11. Schemes whereby monies from a number of investors are pooled and invested as one portfolio in accordance with pre-determined objectives.

### **Corporate Bonds**

12. Bonds that are issued by a company or other non-government issuers. They represent a form of corporate debt finance and are an alternative means of raising new capital other than equity finance or bank lending.

### **Counterparty**

13. One of the parties involved in a financial transaction with whom the Council may place investments.

### **Counterparty / Credit Risk**

14. Risk that a counterparty fails to meet its contractual obligations to the Council to repay sums invested.

### **Credit Criteria**

15. The parameters used as a starting point in considering with whom the Council may place investments, aimed at ensuring the security of the sums invested.

### **Credit Default Swaps**

16. A financial transaction which the buyer transfers the credit risk related to a debt security to the seller, who receives a series of fees for assuming this risk. The levels of fees reflect the perceived level of risk.

### **Credit Rating**

17. A credit rating assesses the credit worthiness of an individual, corporation, or even a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. Ratings usually consist of a long-term, short term, viability and support indicators. The Fitch credit rating of F1 used by the Council is designated as "Highest Credit Quality" and indicates the strongest capacity for timely payment of financial commitments.

### **Debt Management Account Deposit Facility (DMADF)**

18. The Debt Management Office provides this service as part of its cash management operations and of a wider series of measures designed to improve local and central government's investment framework and cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.

### **Debt Restructuring**

19. Debt restructuring is a process that allows an organisation to reduce, renegotiate and undertake replacement debt.

### **Diversification of Investments**

20. The process of creating a portfolio of different types of financial instruments with regard to type, price, risk issuer, location, maturity, etc. in order to reduce the overall risk of the portfolio as a whole.

### **Duration (Maturity)**

21. The length of time between the issue of a security and the date on which it becomes payable.

### **External Borrowing**

22. Money borrowed from outside of the Council.

### **Financial Instrument**

23. Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another. Typical financial liabilities are borrowing and financial guarantees. Typical financial assets include bank deposits, amounts owed by customers, loans receivable and investments.

### **Fitch Credit Ratings**

24. A commercial organisation providing an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The opinion is usually provided in the form of a credit rating.

### **Fixed Rate**

25. An interest rate that does not change over the life of a loan or other form of credit.

### **Floating Rate Notes**

26. A money market security paying a floating or variable interest rate, which may incorporate a minimum or floor.

### **Fraud / Error Risk**

27. Risk of losses being incurred because of fraud, error or corruption in treasury management and failure to institute adequate systems, procedures and other arrangements to prevent irregularities.

### **Housing Revenue Account (HRA)**

28. The HRA is an account of expenditure and income that every local authority housing department must keep in accordance with the Local Government & Housing Act 1989. The account is kept separate or ring fenced from other Council activities. Income is primarily generated by the rents and service charges paid by tenants, while expenditure is on the management and maintenance of the housing stock, and capital financing charges on the HRA's outstanding loan debt.

### **Interest Rate Risk**

29. Risk that fluctuations in interest rates could impose extra costs against which the Council has failed to protect itself adequately.

### **Internal Borrowing**

30. Money borrowed from within the Council, sourced from temporary internal cash balances.

### **Investments**

31. The purchase of financial assets to receive income and/or make capital gain at a future time, however with the prime concern being security of the initial sum invested.

### **Lender Option Borrower Option Loans (LOBOs)**

32. Loans to the Council where the lender can request a change in the rate of interest payable by the Council at pre-defined dates and intervals. The council at this point has the option to repay the loan.

### **Liquidity**

33. The ability of the Council to meet its financial obligations as they fall due.

### **Market Loans**

34. Borrowing that is sourced from the market i.e. organisations other than the Public Works Loan Board or a Public Body.

### **Medium Term Financial Plan**

35. Plan outlining the financial strategies and actions that are envisaged by the Council in the medium term regarding the budget.

### **Markets in Financial Instruments Directive (MiFID)**

36. EU legislation that regulates firms who provide financial instrument services. MiFID was applied in the UK from November 2007 but was revised with changes taking effect from 3 January 2018 (MiFID II).
37. The aim is to ensure financial institutions undertake more extensive checks on their client's suitability for investment products. Organisations undertaking investments will be either classified as 'retail' or 'professional'.
38. MiFID II requires all Local Authorities to be initially treated as "retail clients" unless they "opt up" to a "professional client". The assumption being that retail clients require a greater level of due diligence and support for investment decision making. Financial

institutions will owe a greater duty of care to retail clients, however, they will have no greater financial protection than professional clients.

### **Minimum Revenue Provision (MRP)**

39. This is the amount which must be charged to the authority's revenue account each year and set aside as provision for repaying external loans and meeting other credit liabilities. The prudent amount is determined having regard to guidance issued by WG. This has the effect of reducing the Capital Financing Requirement (CFR).

### **Money Market**

40. The market for short-term securities or investments, such as certificates of deposit, commercial paper or treasury bills, with maturities of up to one year.

### **Money Market Funds**

41. An investment fund which pools the investments of numerous depositors, spreading those investments over a number of different financial instruments and counterparties. Funds with a Constant Net Asset Value (CNAV) are those where the sum invested is the same on maturity, Low Volatility Net Asset Value (LVNAV) are those where any sum invested is likely to be the same on maturity. Funds with a Variable Net Asset Value (VNAV) are those where the sum on maturity could be higher or lower due to movements in the value of the underlying investments.

### **Net Asset Value (NAV)**

42. The market value of an investment fund's portfolio of securities as measured by the price at which an investor will sell a fund's shares or units.

### **Pooling**

43. The process whereby investments or loans are held corporately rather than for specific projects or parts of the Council, with recharges to those areas for their share of the relevant income and expenditure using an agreed methodology, where such a recharge is required to be made.

### **Prudential Code for Capital Finance**

44. The system introduced on 1 April 2004 by Part 1 of the Local Government Act 2003 which allows local authorities to borrow without Government consent, if they can afford to service the debt from their own resources and that any such borrowing is prudent and sustainable. This requires the preparation and approval of various indicators.

### **Public Works Loans Board (PWLB)**

45. The Public Works Loans Board is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

### **Refinancing Risk**

46. Risk that maturing borrowing or other financing of capital projects cannot be renewed on terms that reflect existing assumptions and that the Council will suffer extra costs as a result.

### **Regulatory Risk**

47. Risk that actions by the Council or by any person outside of it are in breach of legal powers or regulatory requirements resulting in losses to the Council, or the imposition of extra costs.

### **Ring Fencing**

48. The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
49. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

### **Security**

50. Protecting investments from the risk of significant loss, either from a fall in value or from default of a counterparty.

### **Sovereign Credit Ratings**

51. The credit rating of a country. It indicates the risk level of the investing environment of a country, considering political risk and other factors.

### **Sterling**

52. The monetary unit of the United Kingdom (the British pound).

### **Term Deposits**

53. A term deposit is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time.

### **Treasury Management**

54. The management of the organisation’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

### **Treasury Bills**

55. Debt securities issued by a government with a short-term maturity of up to 6 months.

### **UK Government Gilts**

56. Fixed-interest debt securities issued or secured by the British Government. Gilts are always denominated in sterling though the Government occasionally also issues instruments in other currencies in the Eurobond market or elsewhere.

**Variable Rate**

57. An interest rate that changes in line with market rates.

**Yield**

58. The annual rate of return paid out on an investment, expressed as a percentage of the current market price of the relevant investment.