TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2012/13

CREDIT CRITERIA

This Appendix summarises the key definitions used by our Treasury Management Officers

The Council uses Fitch ratings to derive its counterparty criteria. Where a counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. The Council is alerted to changes in Fitch ratings through its use of the Sector creditworthiness service. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, it will be withdrawn immediately. (Appendix L (vi) refers).

FITCH Ratings

Long-Term Credit Ratings

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

A **High credit quality**. 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

Short-Term Credit Ratings

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for United States (US) public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

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.

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2012/13

Moody's Investors Service

Long-Term Ratings

Moody's Aaa - C long term ratings are applied to bonds and other obligations with an original maturity in excess of one year.

Aaa **Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.**

Aa **Obligations are judged to be of high quality by all standards**. Together with the Aaa group, they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because the margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risk appear somewhat larger than the Aaa securities.

A **Obligations possess many favourable investment attributes and are to be considered as upper-medium-grade obligations.** Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future.

The numeric modifiers, 1, 2 and 3 in each generic classification from Aa through B are applied in its long-term rating system. Modifier 1 indicates that the security ranks in the higher end of its generic rating category, modifier 2 indicates a mid-range ranking and modifier 3 indicates the issue ranks in the lower end of its generic rating category.

Short Term Ratings

Moody's short-term debt ratings are opinions of the ability of issuers to repay punctually senior debt obligations, which have an original maturity not exceeding one year. Obligations relying upon support mechanisms, such as Letters of Credit and Bonds of Indemnity, are excluded.

Moody's employs three designations (Prime-1, Prime-2 and Prime-3) all judged to be investment grade, to indicate the relative repayment ability of rated issuers:

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2012/13

Prime-1 **Issuers (or supporting institutions) have a superior ability for repayment of senior short-term debt obligations.** Prime-1 repayment ability will often be evidenced by many of the following characteristics:

- leading market positions in well-established industries
- high rates of return on funds employed
- conservative capitalisation structure with moderate reliance on debt and ample asset protection
- broad margins in earnings coverage of fixed financial charges and high internal cash generation
- Well-established access to a range of financial markets and assured sources of alternate liquidity.

Prime-2 **Issuers (or supporting institutions) have a strong ability for repayment of senior short-term debt obligations**. This will normally be evidenced by many of the characteristics cited above but to a lesser degree. Earnings trends and coverage ratios, while sound, may be more subject to variation. Capitalisation characteristics, while still appropriate, may be more affected by external conditions. Ample alternative liquidity is maintained.