

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2013-14

CREDIT CRITERIA

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 If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, it will be withdrawn immediately.

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.

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Support Ratings

Support/Legal Ratings do not assess the quality of a bank. Rather, they are Fitch's assessment of whether it would receive support in the event of difficulties. Fitch emphasises that these ratings constitute their opinions alone - although they may discuss the principles underlying them with the supervisory authorities, the ratings given to banks are Fitch's own and are not submitted to the authorities for their comment or endorsement.

- 1 A bank for which there is a clear legal guarantee on the part of the state OR a bank of such importance both internationally and domestically that, in Fitch's opinion, support from the state would be forthcoming, if necessary. The state in question must clearly be prepared and able to support its principal banks.
- 2 A bank for which, in Fitch's opinion, state support would be forthcoming, even in the absence of a legal guarantee. This could be, for example, because of the bank's importance to the economy or its historic relationship with the authorities.
- 3 A bank or bank holding company which has institutional owners of sufficient reputation and possessing such resources that, in Fitch's opinion, shareholder support would be forthcoming, if necessary.

It must be emphasised that in the Support rating Fitch is not analysing how "good" or "bad" a bank is, but merely whether in Fitch's opinion it would receive support if it ran into difficulties.

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.

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| Aa | <i>Obligations are judged to be of high quality by all standards.</i>
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 |
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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:

- 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.

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- 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.

Bank Financial Strength Ratings Definitions

Moody's Bank Financial Strength Ratings (FSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's traditional debt and deposit ratings. FSRs do not address the probability of timely payment. Instead, FSRs can be understood as a measure of the likelihood that a bank will require assistance from third parties such as its owners, its industry group or official institutions. FSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification, as well as some risk factors in a bank's operating environment like the quality of banking regulation and supervision, the strength and prospective performance of the economy and the structure and relative fragility of the financial system.

The definitions for Moody's FSRs are as follows:

- A Banks rated A possess **superior** intrinsic financial strength. Typically, they will be institutions with highly valuable and defensible business franchises, strong financial fundamentals, and a very predictable and stable operating environment.
- B Banks rated B possess **strong** intrinsic financial strength. Typically, they will be institutions with valuable and defensible business franchises, good financial fundamentals, and a predictable and stable operating environment.
- C Banks rated C possess **adequate** intrinsic financial strength. Typically, they will be institutions with more limited but still valuable business franchises. These banks will display either acceptable financial fundamentals within a predictable and stable operating

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environment, or good financial fundamentals within a less predictable and stable operating environment.

- D Banks rated D display **modest** intrinsic financial strength, potentially requiring some outside support at times. Such institutions may be limited by one or more of the following factors: a weak business franchise; financial fundamentals that are deficient in one or more respects; or an unpredictable and unstable operating environment.

Intermediate Categories

Where appropriate, a “+” or a “-“ may be appended to ratings to distinguish those banks that fall into intermediate categories.