COMMITTEE:	DATE:	CLASSIFICATION:	REPORT NO.	AGENDA NO.
Audit Committee **Council**	**28 June 2011** **13 July 2011**	**Unrestricted**		

REPORT OF: **Corporate Director of Resources** ORIGINATING OFFICER(S): **Oladapo Shonola, Chief Financial Strategy Officer**	TITLE: **2010-11 Treasury Management Outturn Report, Update to 31 May 2011** Ward(s) affected: N/A

Lead Member	**Cllr Alibor Choudhury – Resources**
Community Plan Theme	**All**
Strategic Priority	**One Tower Hamlets**

1. SUMMARY

1.1 This report advises the Audit Committee and Council of treasury management activity for the financial year ended 31 March 2011 as required by the Local Government Act 2003.

1.2 The report details the treasury management outturn position based on the credit criteria adopted by the Corporate Director of Resources, the investment strategy for the financial year as approved by Council and the investment returns.

1.3 The Council complied with its legislative and regulatory requirements. The key actual prudential and treasury management indicators detailing the impact of capital expenditure activities during the year, with comparators are also addressed in this report.

1.4 The Corporate Director, Resources confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

1.5 The Local Government Act 2003 also requires that a sub committee prior scrutiny of the investment strategy, mid year and outturn treasury management reports before they are reported to the full Council. As well as the above reports being reported to either Cabinet or the Audit Committee, updates on treasury management activities were also reported to the Audit Committee or 5 separate occasions.

2. DECISIONS REQUIRED

2.1 The Council is recommended to note the contents of this report.

3 REASONS FOR DECISIONS

3.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2010/11. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.2 During 2010/11 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (10 February 2010)
- a mid year (minimum) treasury update report (Council 8 December 2010)
- an annual report following the year describing the activity compared to the strategy (this report)
- in addition, the Audit Committee has received regulatory treasury management update reports on 29 June 2010, 13 July 2010, 21 September 2010, 14 December 2010 and 22 March 2011.

3.3 Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

3.4 The annual report of treasury management should assist in ensuring that Members are able to scrutinise officer decisions and check that investment strategy was implemented as approved by Full Council.

4 ALTERNATIVE OPTIONS

4.1 The Council is bound by legislation to have regard to the Treasury Management (TM) Code. The Code requires that the Council should receive an annual report on treasury management activities.

4.2 If the Council were to deviate from those requirements, there would need to be some good reason for doing so. It is not considered that there is any such reason, having regard to the need to ensure that Members are kept informed about treasury management activities and to ensure that these activities are in line with the investment strategy approved by the Council

5 BACKGROUND

5.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require local authorities to have regard to the Treasury Management Code. The Treasury Management code requires that the Council or a sub-committee of the Council should receive an annual report on treasury management activities.

5.2 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity;
- Investment activity; and
- Update on investment activity up to 31 May 2011.

6. CAPITAL EXPENDITURE AND FINANCING 2010-11

6.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

6.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed

£'000	**2009/10 Actual**	**2010/11 Estimate**	**2010/11 Actual**
Non-HRA capital expenditure	78,546	137,222	111,348
HRA capital expenditure	60,830	56,943	37,227
Total Capital Expenditure	139,376	194,165	148,575
Resources			
Capital Grants	67,769	127,404	97,437
Direct Revenue Financing	14,437	0	7,002
Major Repairs Allowance	13,836	15,500	7,641
Developers Contributions	9,013	890	5,011
Capital Receipts	11,387	29,550	5,792
Capital Expenditure (Financed from borrowing)	**(22,934)**	**(20,821)**	**(25,692)**

6.3 The difference between estimated capital expenditure to be funded from borrowing and the outturn is due to approved prior year brought forward projects to be funded from borrowing that were added to the programme in-year via officer delegated powers/Cabinet approval.

7 OVERALL BORROWING NEED

7.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2010/11 unfinanced capital expenditure as set out in the above table, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

7.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies such as the Public Works Loan Board (PWLB) or the money markets, or utilising temporary cash resources within the Council.

7.3 The Council's non-Housing Revenue Accounts (HRA) underlying borrowing need is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need (there is no statutory requirement to reduce the HRA CFR).

7.4 The Council's 2010/11 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2010/11 on 10 February 2010.

7.5 The Council's CFR for the year is shown below, and represents a key prudential indicator. This includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR (£m)	31-Mar-10 Actual	31-Mar-11 Original Indicator	31-Mar-11 Actual
Opening balance	421,698	437,730	437,730
Add unfinanced capital expenditure	22,934	20,678	25,692
Add PFI adjustment	38,978	41,205	41,205
Less MRP/	(6,902)	(7,201)	(7,003)
Less PFI Adjustment	(38,978)	(41,205)	(41,205)
Closing balance	**437,730**	**451,207**	**456,419**

7.6 **Net borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2010/11 plus the expected changes to the CFR over 2011/12 and 2012/13. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2010/11. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

£'000	31-Mar-10 Actual	31-Mar-11 Original	31-Mar-11 Actual
Net borrowing position	226,175	176,107	155,471
CFR	437,730	451,207	456,419

7.7 **The authorised limit** - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2010/11 the Council has maintained gross borrowing within its authorised limit.

7.8 **The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

7.9 **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

£'000	**2010/11**
Authorised limit	465,000
Maximum gross borrowing position	356,607
Operational boundary	445,000
Average gross borrowing position	333,969
Financing costs as a proportion of net revenue stream	2.41%

8 TREASURY POSITION as at 31 March 2011

8.1 The Council’s debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council’s Treasury Management Practices. At the beginning and the end of 2010/11 the Council‘s treasury position was as follows:

	31 March 2010 Principal	Rate/ Return	31 March 2011 Principal	Rate/ Return
Fixed Rate Funding:				
-PWLB	231,574	9.11%	275,974	7.71%
-Market	13,000	4.37%	13,000	4.37%
Total Fixed Rate Funding	244,574	8.86%	288,974	7.56%
Variable Rate Funding:				
-PWLB	0	0.00%	0	0.00%
-Market	64,500	0.89%	64,500	1.23%
Total Variable Rate Funding	64,500	0.89%	64,500	1.23%
Total debt	***309,074***	***7.20%***	***353,474***	***6.40%***
CFR	***437,730***		***456,419***	
Over/ (under) borrowing	***(128,656)***		***(102,945)***	
Investments:				
In house	83,100	1.23%	201,136	1.20%
External managers	0	0.00%	0	0.00%
Total investments	***83,100***	***1.23%***	***201,136***	***1.20%***

8.2 The maturity structure of the debt portfolio was as follows:

£'000	31 March 2010 Actual	2010/11 Original Limits	31 March 2011 Actual	31 March 2011 Actual in %
Under 12 months	6,179	10%	25,740	7.3%
12 months and within 24 months	25,983	25%	16,688	4.7%
24 months and within 5 years	44,589	25%	47,102	13.3%
5 years and within 10 years	119,355	90%	113,610	32.1%
10 years and above	112,968	100%	150,336	42.5%

8.3 The maturity structure for the investment portfolio was as follows:

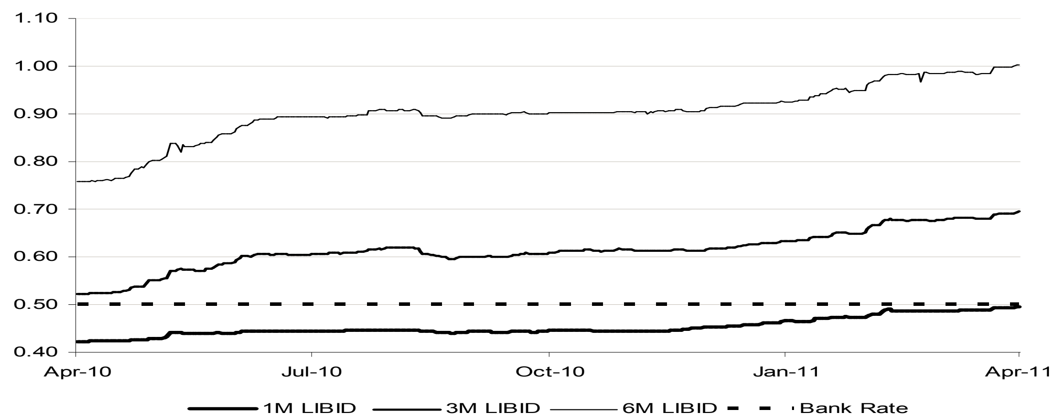
£'000	31 March 2010 Actual	2010/11 Original Limits	31 March 2011 Actual
Under 1 year	83,100	100%	201,136
More than 1 year	-	0%	-
Total	**83,100**	**100%**	**201,136**

9 THE INVESTMENT STRATEGY

9.1 The expectation for interest rates within the strategy for 2010/11 anticipated low but rising Bank Rate, starting in quarter 1 of 2010, with similar gradual rises in medium and longer term fixed interest rates over 2010/11. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

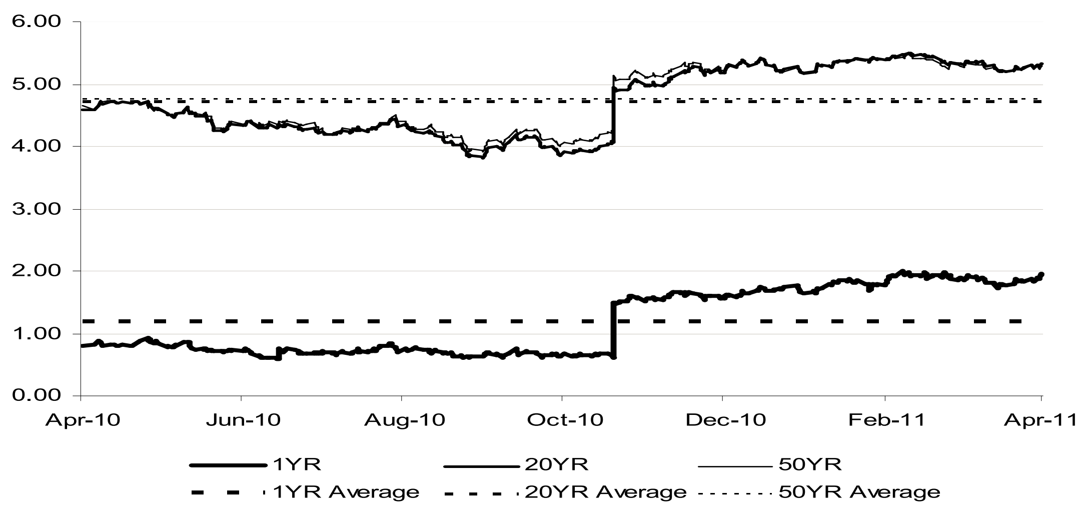
9.2 The Bank Rate actually remained unchanged throughout 2010-11 with the result that associated interest rates were lower than had been anticipated. The actual movement in rates is shown in the below chart.

Bank Rate v LIBID Investment Rate



9.3 2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75% – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

Average v New Borrowing Rates



9.4 Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government's debt reduction plans, especially in the light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected to cause the Monetary Policy Committee (MPC) to start raising Bank Rate earlier than previously expected.

9.5 Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at very low levels.

10 BORROWING OUTTURN

10.1 The Council borrowed £51m (£30m and £21m) from the PWLB on the 10th May 2010. This was done mainly to ensure benefits accruing from reform of housing finance can be maximised. The Council will also benefit from the decision to access funding in May 2010, which resulted in funding being secured at approximately 1% less than would have been the case had officers procrastinated.

10.2 Loans were drawn to fund the net unfinanced capital expenditure, naturally maturing debt and the effect of the housing finance reform proposals. The loans drawn were

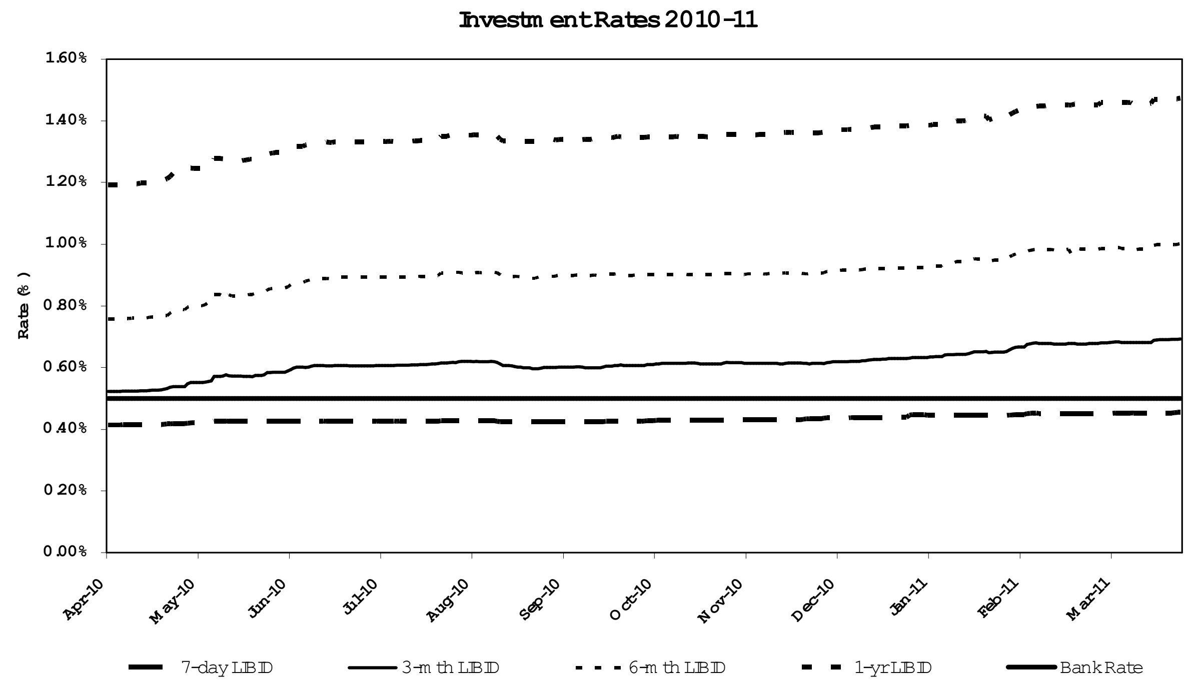
Lender	Principal	Type	Interest Rate	2010/11 Average
PWLB	£30m	Fixed Rate	4.24%	4.70%
PWLB	£21m	Fixed Rate	4.20%	4.70%

11 INVESTMENT RATES

11.1 The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 month and 12 month rates picking up.

11.2 Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This highlighted the ongoing need for caution in treasury investment activity. In line with the principles outlined in the Investment Strategy of 'security' first, the Council did not and does not have funds invested in any of the countries listed above.

11.3 The investment rates in 2010/11 are as detailed in the below chart.



12 INVESTMENT OUTTURN

12.1 The Council's investment policy is governed by CLG guidance, which was being implemented in line with the annual investment strategy approved by the Council on 10 Feb 2010. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies.

12.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

12.3 The Council maintained an average balance of £155.181m of internally managed funds. The internally managed funds earned an average rate of return of 1.22%. The comparable performance indicator is the average 7-day LIBID rate*,* which was 0.45%.

13 UPDATE ON INVESTMENT ACTIVITY UP TO 31 MAY 2011

13.1 Sector provides cash management services to the Council, but the Council retains control of the credit criteria and the investments, so that Sector's role is purely advisory.

13.2 In addition to providing cash management services, Sector also provides treasury consultancy/advisory service to the Council.

13.3 Sector's interest rate projections are that base rate will remain static at 0.5% until June 2011 after which there will be a steady rise up to 3.25% by December 2013. Against this perspective Sector has developed a strategy which delivers enhanced performance through maximising the investment term of the portfolio. This will enable the portfolio to obtain exposure to the higher rates associated with investment in the longer term.

13.4 Council cash balances are projected to average £140m in 2011-12, but daily balances will vary throughout the year.

13.5 The current balance of £201.136 million is higher than anticipated due to increased liquidity, additional funding that has been accessed by the Council to ensure it can take full advantage of the impact of housing finance reform and funds that are as yet unspent but have been earmarked to fund the capital programme. It is envisaged that the cash balance will reduce in the medium term.

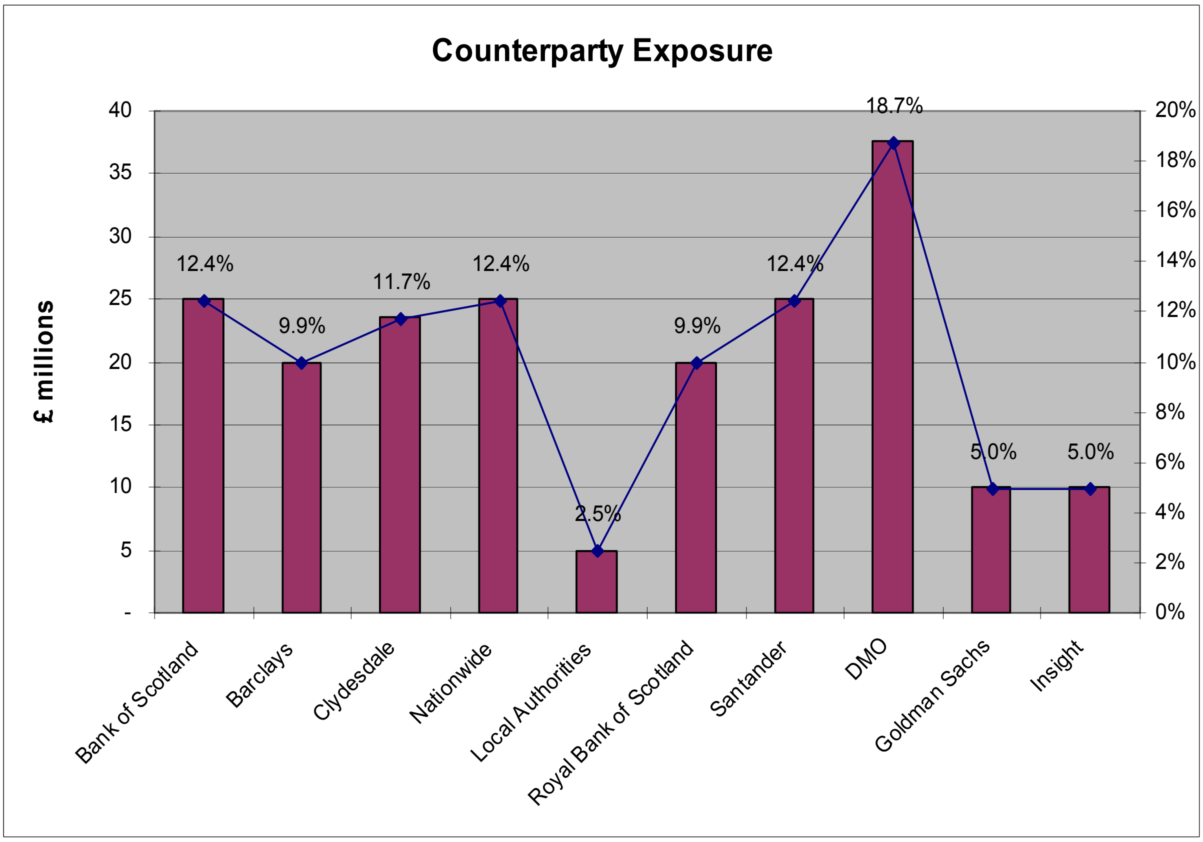
13.6 The Council's bankers, the Co-operative Bank plc, are used as depositors of last resort for investment of additional funds received after the treasury transactions have been completed and the money markets have closed.

13.7 The current investment strategy within the constraints of the Councils credit criteria and liquidity requirement is as set out below.

Investment Strategy

Projection			Actual Deal			
Term	**Amount £M**	**Rate %**	**Counterparty**	**Maturity/Type**	**Amount £M**	**Rate**
Overnight	30.000	0.80%	Santander UK	Call	5.000	0.80%
Overnight		0.75%	Clydesdale Bank	Call	23.536	0.75%
Overnight		0.75%	Bank of Scotland	Call	15.000	0.75%
Overnight		0.50%	Goldman Sachs	MMF	10.000	0.54%
Overnight		0.50%	Insight	MMF	10.000	0.64%
			SUB TOTAL		**63.536**	
1 Month	25.000	0.45%	Debt Management Office	01-Apr-11	37.600	0.25%
			Cater Allen (Santander)	11-Apr-11	5.000	2.20%
			Bank of Scotland	26-Apr-11	5.000	1.17%
3 Months	25.000	0.75%	Cater Allen (Santander)	13-May-11	3.000	1.50%
			Cater Allen (Santander)	13-May-11	2.000	2.10%
			Nationwide	03-Jun-11	5.000	1.35%
			Barclays	03-Jun-11	10.000	1.40%
			Royal Bank of Scotland	10-Jun-11	10.000	0.70%
6 Months	20.000	0.99%	Royal Bank of Scotland	11-Jul-11	10.000	0.81%
			Cater Allen (Santander)	18-Jul-11	5.000	2.50%
			Bank of Scotland	25-Jul-11	5.000	1.30%
			Barclays	10-Aug-11	5.000	1.05%
			Nationwide	10-Aug-11	10.000	0.95%
9 Months	20.000	1.30%	Nationwide	14-Oct-11	5.000	1.37%
			Barclays	10-Nov-11	5.000	1.30%
			Nationwide	17-Jan-12	5.000	1.43%
			Cater Allen (Santander)	17-Jan-12	5.000	2.50%
			North Tyneside Council	20-Jan-12	5.000	1.20%
12 Months	20.000	2.00%				
			SUB TOTAL		**137.600**	
	140.000		**TOTAL**		**201.136**	

13.8 The Council's exposure to any one counterparty/Group is represented by the below chart including exposure as a percentage of total assets invested as at 31 May 2011.



14.8 Investment returns since inception of the new arrangement with Sector has been consistently above the portfolio benchmark and the London Interbank Bid Rate (LIBID). Performance has dipped slightly from the last reporting date (22 March 2011) from 1.22% average return to 1.18%.

14.9 The portfolio is slightly underperforming benchmark set at 1.25%. Although, it is above the 7 Day LIBID rate of 0.46% and represents good performance given the issues around elevated cash balances arising from slippage on capital programme and other issues identified earlier in this report.

14.10 The 2011/12 investment strategy reviewed the credit criteria and investment threshold and Members approved a more flexible investment strategy in February 2011. This has made it possible to use alternative short term investment facilities other than the Government's Debt Management Office (DMO) and it is anticipated that this will positively impact on performance going forward.

15. COMMENTS OF THE CHIEF FINANCIAL OFFICER

15.1. The comments of the Corporate Director Resources have been incorporated into the report.

16. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

16.1. Treasury management activities cover the management of the Council's investments and cash flows, its banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks. The Local Government Act 2003 provides a framework for the capital finance of local authorities. It provides a power to borrow and imposes a duty on local authorities to determine an affordable borrowing limit. It provides a power to invest. Fundamental to the operation of the scheme is an understanding that authorities will have regard to proper accounting practices recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in carrying out capital finance functions.

16.2. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to have regard to the CIPFA publication "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" ("the Treasury Management Code") in carrying out capital finance functions under the Local Government Act 2003. If after having regard to the Treasury Management Code the Council wished not to follow it, there would need to be some good reason for such deviation.

16.3. The Treasury Management Code requires as a minimum that there be a practice of regular reporting on treasury management activities and risks to the responsible committee and that these should be scrutinised by that committee. Under the Council's Constitution, the audit committee has the functions of monitoring the Council's risk management arrangements and making arrangements for the proper administration of the Council's affairs.

17. ONE TOWER HAMLETS CONSIDERATIONS

17.1 Interest on the Council's cash flow has historically contributed significantly towards the budget. This Council's ability to deliver its various functions, to meet its Community Plan targets and to do so in accordance with its obligations under the Equality Act 2010 may thus be enhanced by sound treasury management.

18. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

18.1 There are no Sustainable Actions for A Greener Environment implications.

19. RISK MANAGEMENT IMPLICATIONS

19.1 Any form of investment inevitably involves a degree of risk. To minimise risk the investment strategy has restricted exposure of council cash balances to UK backed banks or institutions with the highest short term rating or strong long term rating.

20 CRIME AND DISORDER REDUCTION IMPLICATIONS

20.1 There are no crime and disorder reduction implications arising from this report.

21 EFFICIENCY STATEMENT

21.1 Monitoring and reporting of treasury management activities ensures the Council optimises the use of its monetary resources within the constraints placed on the Council by statute, appropriate management of risk and operational requirements.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D
LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"	Name and telephone number of holder And address where open to inspection

Appendix 1: Prudential and treasury indicators

Prudential indicators	2009/10	2010/11	2010/11
	Actual	Original	Actual
	£'000	£'000	£'000
Capital Expenditure			
Non – HRA	88,878	68,140	111,348
HRA	50,497	36,598	37,227
TOTAL	139,375	104,738	148,575
Ratio of financing costs to net revenue stream			
Non – HRA	2.98%	2.96%	2.62%
HRA	16.91%	18.82%	18.75%
Net borrowing requirement			
brought forward 1 April	322,198	354,250	354,250
carried forward 31 March	354,250	303,764	252,128
in year borrowing requirement	32,052	- 50,486	- 102,122
In year Capital Financing Requirement			
Non - HRA	1,352	5,821	9,298
HRA	15,500	15,000	16,588
TOTAL	16,852	20,821	25,886
Capital Financing Requirement as at 31 March			
Non - HRA	160,751	160,784	162,827
HRA	276,979	301,075	293,568
TOTAL	437,730	461,859	456,395
Incremental impact of capital investment decisions	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	8.46	4.27	4.27
Increase in average housing rent per week	0	0	0

Treasury management indicators	2009/10	2010/11	2010/11
	Actual	Original	Actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	483,050	565,000	565,000
other long term liabilities	-	-	-
TOTAL	483,050	565,000	565,000
Operational Boundary for external debt -			
borrowing	463,050	545,000	545,000
Other long term liabilities	-	-	-
TOTAL	463,050	545,000	545,000
Actual external debt			
Upper limit for fixed interest rate exposure			
expressed as either:-			
Net principal re fixed rate borrowing / investments	100%	100%	100%
Upper limit for variable rate exposure			
expressed as either:-			
Net principal re variable rate borrowing / investments	20%	20%	20%
Upper limit for total principal sums invested for over 364 days	£0.00	£0.00	£0.00
(per maturity date)			

TABLE 5: Maturity structure of borrowing during 2010/11	Upper Limit	Lower Limit
under 12 months	7%	0%
12 months and within 24 months*	5%	0%
24 months and within 5 years*	13%	0%
5 years and within 10 years	32%	0%
10 years and above	43%	0%

Appendix 2: Definition of Credit Ratings

Support Ratings

Rating	
1	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.
2	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.
3	A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.
4	A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.
5	A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

Short-term Ratings

Rating	
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.
F3	**Fair credit quality.** The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

Long-term Ratings

Rating	Current Definition (August 2003)
AAA	**Highest credit quality.** 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
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.
BBB	**Good credit quality.** 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category

Individual Ratings

Rating	
A	A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
B	A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects
C	An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
D	A bank, which has weaknesses of internal and/or external origin. There are concerns regarding its profitability, substance and resilience, balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
E	A bank with very serious problems, which either requires or is likely to require external support.