Description of Investment Instruments

1. Certificates of Deposit (CDs)

Certificates of Deposit (CDs) are negotiable term deposits made with a bank or a building society and were introduced to solve the problem of rigidity in the interbank market, as term deposits cannot be traded on a secondary market once taken.
The minimum issue size for CDs is £100,000 and they have a maximum maturity of 5 years, however the majority are issued for periods of six months or less.

CDs are bearer instruments which can be issued at a discount and without a coupon (interest payment), however, more typically they pay either a fixed or a variable coupon; with variable rates of interest being fixed semi-annually against a reference rate such as LIBOR. The coupon is closely related to the current market deposit rate from the same counterparty for a corresponding maturity.

Large issues will typically be issued at par and are actively traded on a secondary market meaning that they can be acquired and sold on a daily basis.
CDs are a money market instrument and therefore the credit ratings will be the same as those for term deposits.

CDs offer the same credit quality as term deposits, but due to their liquidity there is an active secondary market and therefore the rate of interest paid is typically slightly lower than the rate earned on a term deposits of the same duration.

Some institutions such as HSBC and Standard Chartered Bank tend to conduct their wholesale sterling activities in the CD market as opposed to the fixed deposit market. Utilising CDs would, therefore, potentially unlock access to these banks as counterparties.

2. Gilts (bonds issued by the UK government)

Bonds issued by the UK government are guaranteed by the government and therefore are deemed to have the highest credit quality.

3. UK Treasury Bills (T-Bills)

Treasury Bills (T-Bills) are short term Government debt instruments and are a means to manage cash flow.

T-Bills are issued by the Debt Management Office and are an eligible sovereign instrument meaning that they have a AAA rating. Unlike Gilts, T-Bills are issued on a zero-coupon i.e. they are issued at a discount to their par nominal value whereupon maturity the par value redemption will be higher than the purchase price reflecting an income return alongside the return of the initial capital outlay.

T-Bills are issued at weekly tenders held by the DMO on the last business day of the week (Friday) for settlement on the next business day (Monday). They are typically issued for 1, 3 or 6 month periods although they can issue 12 month T-Bills as well but have not as yet done so.

T-Bills are actively traded on a secondary market meaning that they can be acquired and sold on a daily basis.

Minimum purchase is £0.5m.

T-Bills are *secure* with an implicit AAA rating; are *liquid* with an active secondary market and pay a *yield* that is currently around 0.5% that compares very favourably with the DMADF account rate of around 0.25%. Arlingclose believe that T-Bills provide an attractive alternative to the DMADF or, at the very least, a useful addition to client lending lists.

In order to be able to acquire T-Bills, there is a requirement to open custody accounts.

4. Bonds issued by multilateral development banks

A bond is a formal certificate of indebtedness issued in writing in return for loans. It bears interest and promises to pay a certain sum of money to the holder after a definite period.

A Multilateral Development Bank is an institution created by a group of countries, that provides financing and professional advising for the purpose of development. Two of the main Multilateral Development Banks are as follows:

<u>The European Investment Bank</u> - this is the world's largest multilateral development bank and was established in 1957. It is owned by the 27 Member States of the European Union (EU). The largest shareholders are Germany, France, UK and Italy with each of these countries holding 16% of the share capital. Spain holds almost 10% and the remaining 22 countries own the balance. Because the EU Member States are the European Investment Bank's shareholders, it carries the highest possible credit rating (AAA) on the money markets.

<u>The World Bank</u> – established together with the International Monetary Fund (IMF) in 1944 as part of the Bretton Woods system to rebuild the Western economies shattered by the second world War through financing of commercial and infrastructural projects. The bank is made up of two unique development institutions owned by 185 member countries - the International Bank of Reconstruction and Development and the International Development Association.

Its member countries must also be members of the IMF, and have voting power weighted according to their contribution to the Bank. For example, the US has about 20 percent of the voting power and always chooses the bank's president.

5. Money Market Funds

Money Market Funds (MMFs) are pooled funds which invest in a range of short term assets providing high credit quality and high liquidity. MMFs have as their primary objective the preservation of capital and the provision of liquidity. They provide the benefits of pooled investment, as investors can participate in a more diverse and high-quality portfolio than they otherwise could individually.

Shares in Stable NAV (Stable Net Asset Value) MMFs funds are issued with an unchanging face value (such as £1 per share) - this means for every £1 or principal invested, the fund will return £1 of principal on withdrawal by the investor, plus interest. Income in the fund is accrued daily and is paid out to the investor or used to purchase more shares in the fund at the end of the month.

6. Debt Management Account Deposit Facility

With the Debt Management Account Deposit Facility (DMADF), as the money is held by the Treasury, the scheme implicitly carries the Government's own sovereign AAA credit rating, thus providing the highest available security.

This facility has been developed jointly by the UK Debt Management Office (DMO) and the Public Works Loan Board (PWLB). The DMO is the Treasury

Executive Agency which manages Government debt and the Exchequer cash flows and the PWLB is responsible for making loans to local authorities.

By making a deposit in a DMADF, the Authority is entering into a contractual obligation to deposit sums in the DMADF for the agreed amount and for an agreed period. Deposits shall not be returnable until this agreed period expires. The DMO will quote market-related interest rates for any fixed term deposit which will be returned on the final maturity date.

In any period of significant stress in the markets, the default position is for investments to be made with the DMO or UK Treasury Bills (see below). The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Authority's capital is secure.