

CABINET – 16 JULY 2013

TREASURY MANAGEMENT OUTTURN 2012/13

Report by Assistant Chief Executive & Chief Finance Officer

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) 'Code of Practice on Treasury Management (Revised) 2009' requires that the Council (via Cabinet) and Audit & Governance Committee receives an updated report on Treasury Management activities at least twice per year. This report is the second report for the financial year 2012/13 and sets out the position as at 31 March 2013.
2. Treasury management is defined as: "The management of the local authority's 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."
3. The following annexes are attached
 - Annex 1 Debt Financing 2012/13
 - Annex 2 Public Works Loan Board (PWLB) Maturing Debt
 - Annex 3 Lending List Changes
 - Annex 4 Investment portfolio 31/03/2013
 - Annex 5 Prudential Indicators Outturn
 - Annex 6 Benchmarking

Strategy 2012/13

4. The Treasury Management Strategy for 2012/13 was based on an average base rate forecast of 0.50%. The budget for interest receivable assumed that an average interest rate of 1.00% would be achieved, 0.50% above base rate.
5. The Strategy for Long Term Borrowing was to continue to have the option to fund new or replacement borrowing up to the value of 25% of the portfolio through internal borrowing to reduce the Council's exposure to credit risk and reduce the cost of carry (difference between borrowing costs and investment returns) whilst debt rates remained higher than investment interest rates.
6. The Strategy included the continued use of the services of external fund manager Investec.

Market Background

7. In March the Office for Budgetary Responsibility halved its forecast growth in 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The fall in debt as a percentage of GDP, which the government had targeted for 2015/16, was pushed two years beyond this horizon. In light of the UK debt dynamics the credit rating agency Moody's made the decision to downgrade the UK one notch from its top rating of triple-A. The UK was also placed on review for downgrade with the Fitch and Standard and Poor's credit rating agencies.
8. The UK Economy contracted in three of the four quarters during the year, but recorded 0.2% growth over the year as a whole due to strong third quarter growth of 0.9%. This was aided by the Summer Olympic Games being held in London.
9. Annual Consumer Price Inflation (CPI) fell to 2.2% in September 2012 after starting the year at 3.0% before edging back up to 2.8% by the end of the year. Inflation remained above the Bank of England's target rate of 2% throughout the year.
10. The lack of growth and fall in inflation led the Bank of England to increase the size of its Quantitative Easing programme by £50bn to £375bn. This was designed to boost the economy through increasing liquidity in the financial system. The base rate was maintained at 0.5% throughout the year as expected.
11. UK gilt yields continued on a downward trajectory with the 5-year yield ending the year at 0.70% and the 10-year yield at 1.77%, down nearly 0.5% from the start of the year. This was partly driven by the expansion of the Bank of England's quantitative easing programme.
12. The government's Funding for Lending (FLS) initiative commenced in August 2012, which gave banks access to cheaper funding on the basis that it would then result in them passing on this advantage to the wider economy. There was an increase in mortgage approvals, but lending to small and medium enterprises remained muted.
13. One direct consequence of the FLS was the sharp drop in local authority bank deposit rates. 3-month, 6-month and 12-month London Interbank Bid Rates (LIBID) which were 0.90%, 1.22% and 1.74% at the beginning of the financial year fell to 0.38%, 0.48% and 0.78% respectively by the end of the year.
14. The big four banks in the UK – Barclays, RBS, Lloyds and HSBC – and several other global institutions including JP Morgan Chase, Citibank, Rabobank, UBS, Credit Suisse and Deutsche came under investigation in the London Interbank Offer Rate rigging scandal which led to fines by, and settlements with, UK and US regulators.
15. The US Federal Reserve extended quantitative easing through 'Operation Twist', in which it buys longer-dated bonds with the proceeds of shorter-dated US Treasuries. The Federal Reserve shifted policy to focus on the jobless rate, with a pledge to keep rates low until unemployment falls below 6.5%.
16. Financial troubles continued in Europe with Spain and Italy both experiencing spikes in government bond yields. Yields on both countries' 10-year sovereign bonds both exceeded 7% on debt concerns before returning to more sustainable levels by the end of

the year. Fears of a Greek exit from the Eurozone peaked in the summer of 2012 before subsiding after securing a bailout from the Eurozone and International Monetary Fund. However, Greece is still deep in recession and faces a long road to recovery. The handling of the bailout of Cyprus was widely viewed to have been handled poorly and resulted in fears in the market about the will of the Eurozone to support member countries who get in to trouble in the future. The European Central Bank rate was maintained at 0.75% throughout the year.

17. Emerging markets and in particular China were viewed as key to the global recovery. Data releases from China were mixed but overall China showed robust growth. The impact of Chinese data releases on the global markets was increasingly important as the markets focused on drivers for global growth, with below consensus data negatively impacting the wider markets.

Treasury Management Activity

Debt Financing

18. The Council's debt financing position for 2012/13 is shown in Annex 1.
19. The option to fund new or replacement borrowing requirements from internal balances, up to the value of 25% of the investment portfolio was retained in the 2012/13 annual treasury management strategy. This was intended to reduce the cost of carry of borrowing which is the difference between borrowing rates and investment returns.
20. No new borrowing has been arranged during 2012/13 with either the Public Works Loan Board (PWLB) or through the money markets.
21. At 31 March 2013, the authority had 68 PWLB loans totalling £362.38 and 10 LOBO¹ loans totalling £50m. The average rate of interest paid on PWLB debt was 4.59% and the average cost of LOBO debt in 2012/13 was 3.94%. The combined weighted average for interest paid on long-term debt was 4.52%.
22. In the March 2012 budget it was announced that the Government would be introducing a Certainty Rate on PWLB loans offering a 0.20% discount on the Standard Rate (currently gilts plus 1.00%). To qualify Authorities were required to provide additional information on their long-term borrowing and associated capital spending plans. The Certainty Rate was introduced in November 2012 and Oxfordshire County Council successfully applied to qualify for this rate. Although no new external borrowing is planned in the short-term it was decided that the Council should apply for the reduced rate in case a need to borrow arises.

¹ LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

Maturing Debt

23. The Council repaid £8.346m of maturing PWLB loans during the year. The weighted average interest rate payable on the matured loans was 4.88%. The details are set out in Annex 2.

Debt Restructuring

24. No long term debt was restructured during 2012/13.

Investment Strategy

25. Security and liquidity of cash was prioritised above the requirement to maximise returns. The Council adopted a cautious approach to lending to financial institutions, and continuously monitored credit quality information regarding the institutions on the Council's approved Lending List.
26. During 2012/13 the Council limited the exposure to banks by lending to local authorities deemed to be of high credit quality. At 31 March 2013 the Council had £98.617m of long term fixed deposits (deposits over 364 days), of which £86m was placed with local authorities or police authorities. The aim was to maintain a high level of security and manage exposure to interest rate and counterparty risk.
27. The weighted average maturity of all deposits at 31 March 2013, including money deposited in short-term notice accounts, was 349 days (compared with 282 days during 2011/12). This comprised £285m fixed deposits with a weighted average maturity of 352 days and £15m held in short-term notice deposit accounts. In addition, £2m was invested in other short-term investments.
28. The Council used fixed and structured deposits, as well as call accounts, money market funds and short dated bond funds to deposit its in-house temporary cash surpluses during 2012/13.
29. In compliance with the latest Chartered Institute of Public Finance Accountants (CIPFA) guidance on deposits held with Icelandic banks, the 2012/13 final accounts include an impairment for the potential lost interest on amounts placed with Landsbanki. It is expected that priority creditors, which include UK local authorities should receive 100% of their claim, although the exact timings of future distributions are currently unknown.

The Council's Lending List

30. The Council's in-house cash balances are deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List is regularly updated during the year to reflect changes in bank and building society credit ratings. Changes are reported to the Cabinet each month. The approved lending list may also be further restricted by officers, in response to changing conditions and perceived risk. Annex 3 shows the amendments incorporated into the Lending List during 2012/13, in accordance with the approved credit rating criteria and additional temporary restrictions.

Investment Outturn

31. The average daily balance of temporary surplus cash invested in-house was £309m in 2012/13. The Council achieved an average in-house return for the year of 1.01%, producing gross interest receivable of £3.136m (excluding interest accrued on Landsbanki deposits). Temporary surplus cash balances include: developer contributions; council reserves and balances; trust fund balances; and various other funds to which the Council pays interest at each financial year end, based on the average rate earned on all deposits.
32. During 2012/13 the average three month inter-bank sterling rate was 0.56%. The Council's average in-house return of 1.02% exceeded this benchmark by 0.46%.
33. The average in-house return was 0.01% higher than the budgeted rate of interest of 1.00%.
34. The Council operates a number of instant access call accounts and money market funds to deposit short-term cash surpluses. During 2012/13 the average balance held on instant access was £63.7m.
35. At 31 March 2013, the Council's investment portfolio of £329.62m comprised £284.62m of fixed term deposits, £17.37m at short term notice in money market funds and call accounts, £15.22m in short dated bond funds and £12.41m managed by external fund managers. Annex 4 shows the analysis of the investment portfolio at 31 March 2013.
36. The council's Treasury Management Strategy Team regularly monitors the risk profile of the Council's investment portfolio. An analysis of the credit and maturity position of the portfolio at 31/3/2013 is shown in Annex 4.

External Fund Managers

37. During the year, the Council continued to use the services of one external fund manager: Investec Asset Management Limited. External funds are used by the Council to help manage investment risks by diversification of the portfolio in terms of access to a range of different counterparties and through the use of different financial instruments such as corporate bonds.
38. The performances of the external fund is reported to and monitored by the Treasury Management Strategy Team on a monthly basis.
39. The Investec mandate was changed in December 2010 to a 'Dynamic Model' fund where proportions of the portfolio are invested in three different types of investment fund as set out in the table below:

Fund Name	Weighting	Investment Objectives
Liquidity Fund	5%	To achieve a superior return to that of cash deposits while maintaining capital and preserving liquidity.
Short Dated Bond Fund	65%	To provide capital stability and income through investment in short term fixed income and variable rate securities listed or traded in one or more Recognised Exchanges.
Target Return Fund	30%	To produce a positive return over the longer term regardless of market conditions by investing primarily in interest bearing assets and related derivatives.

40. The month on month performance of the Dynamic Fund has been volatile during 2012/13. Investec's overall return for the year (net of management charges) was 1.10%, compared with a benchmark of 1.62%. This reflects the nature of the fund and the need to view the performance over the longer term.
41. Officers are continuing to monitor the performance of the fund on a monthly basis and have regular meetings with the fund manager.

Prudential Indicators for Treasury Management

42. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Report. The outturn for the Prudential Indicators is shown in Annex 6.

External Performance Indicators and Statistics

43. The County Council is a member of the CIPFA Treasury and Debt Management Benchmarking Club and completed returns for the financial year 2012/13. The results of this exercise are not yet available.
44. Arlingclose has also benchmarked Oxfordshire County Council's investment performance against its other clients. Since 31 March 2012 the Council has maintained the yield on its deposits whilst simultaneously maintaining low credit risk. When compared against other County Councils, Oxfordshire County Council's deposit portfolio sits above the average line for interest rate and in the lowest quartile for credit risk. The investment performance benchmarking is shown on Annex 6.

Financial and Legal Implications

45. The combined activities of debt and investment management contribute to the strategic measures element of the Council's budget. In the Medium Term Financial Plan, the budget for Interest Payable in 2012/13 was £18.756m compared with the outturn of £18.844m giving a net overspend of £0.088m.
46. The 2012/13 budget for interest receivable was £2.234m, compared with the outturn of £3.288m giving a net overachievement of £1.054m. In addition the 2012/13 accounts recognise an increase in the value of available for sale assets² of £0.302m. The increase in interest received is due to higher average cash balances due in part to slippage on the capital programme and receipt of government grants earlier in the year. The average interest rate achieved also made a small contribution to the overachievement on interest receivable.

RECOMMENDATION

47. **The Committee is RECOMMENDED to note the report, and to RECOMMEND Council to note the Council's Treasury Management Activity in 2012/13.**

SUE SCANE

Assistant Chief Executive and Chief Finance Officer

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June 2013

² Available for sale assets comprise the Investec fund and short dated bond funds.

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2012/13

Debt Profile

		£m
1. PWLB	88%	370.72
2. Money Market LOBO loans	12%	50.00
3. Sub-total External Debt		420.72
4. Internal Balances	0 %	<u>-0.27</u>
5. Actual Debt at 31 March 2012	100%	420.45

6. Government Supported Borrowing		0.00
7. Unsupported Borrowing		0.76
8. Borrowing in Advance		0.00
9. Minimum Revenue Provision		<u>-17.88</u>

10. Actual Debt at 31 March 2013 **403.33**

Maturing Debt

11. PWLB loans maturing during the year		8.35
12. PWLB loans repaid prematurely in the course of debt restructuring		<u>0.00</u>
13. Total Maturing Debt		8.35

New External Borrowing

14. PWLB Normal		0.00
15. PWLB loans raised in the course of debt restructuring		0.00
16. Money Market LOBO loans		<u>0.00</u>
17. Total New External Borrowing		0.00

Debt Profile Year End

18. PWLB	88%	362.37
19. Money Market LOBO loans	12%	50.00
20. Sub-total External Debt		412.37
21. Internal Balances	0 %	<u>-9.04</u>
22. Actual Debt at 31 March 2013	100%	403.33

Line

- 1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2012). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.
- 6 'Government Supported Borrowing' is the amount that the Council can borrow in any one year to finance the capital programme. This is determined by Central Government, and in theory supported through the Revenue Support Grant (RSG) system.
- 7 'Unsupported Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.
- 8 'Borrowing in Advance' is the amount the Council borrowed in advance during 2012/13 to fund future capital finance costs.
- 9 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.
- 10 The Council's total debt by the end of the financial year at 31 March 2013, after taking into account new borrowing, debt repayment and movement in funding by internal balances.
- 11 The Council's normal maturing PWLB debt.
- 12 PWLB debt repaid early during the year.
- 13 Total debt repaid during the year.
- 14 The normal PWLB borrowing undertaken by the Council during 2012/13.
- 15 New PWLB loans to replace debt repaid early.
- 16 The Money Market borrowing undertaken by the Council during 2012/13.
- 17 The total external borrowing undertaken.
- 18-22 The Council's debt profile at the end of the year.

Long-term debt Maturing 2012/13**Public Works Loan Board: Loans Maturing in 2012/13**

Date	Amount £m	Rate %	Repayment Type
01/04/2012	2.000	9.000	Maturity
13/07/2012	0.500	2.350	EIP
31/07/2012	0.500	2.350	EIP
31/08/2012	0.346	1.120	Annuity
13/01/2013	0.500	2.350	EIP
31/01/2013	0.500	2.350	EIP
01/03/2013	4.000	4.400	Maturity
Total	8.346		

Repayment Types

Maturity – Full amount of principal is repaid at the final maturity date

EIP – Equal Instalments of Principal are repaid every 6 months until the final maturity date

Annuity – A reducing balance of principal is repaid every 6 months until the final maturity date

Annex 3
Lending List Changes during 2012/13

Counterparties added during 2012/13

Morgan and Stanley MMF

Svenska Handelsbanken

Development Bank of Singapore

United Overseas Bank

Overseas-Chinese Banking Corporation

Close Brothers

Credit Suisse

Lending limits & maturity limits increased from 1 April 2012

	Lending Limit as at 31 March 2013	Maximum Maturity as at 31 March 2013
Royal Bank of Scotland	£10,000,000	6 months
Lloyds TSB Bank plc	£25,000,000	12 months
Bank of Montreal	£25,000,000	12 months
Bank of Nova Scotia	£25,000,000	12 months
Barclays Bank	£15,000,000	6 months
Canadian Imperial Bank of Commerce	£25,000,000	12 months
Commonwealth Bank of Australia	£25,000,000	12 months
English, Welsh & Scottish Local Authorities	£30,000,000	3 years
HSBC Bank	£25,000,000	12 months
JP Morgan Chase Bank	£15,000,000	9 months
National Australia Bank	£25,000,000	12 months
Nationwide Building Society	£15,000,000	9 months
Standard Chartered Bank	£25,000,000	12 months

Annex 4**OXFORDSHIRE COUNTY COUNCIL INVESTMENT PORTFOLIO 31/03/2013****Fixed term deposits held at 31/03/2013**

Counterparty Date	Principal Deposited (£)	Maturity
The Mayor's Office for Policing and Crime	10,000,000	03-Apr-13
The Mayor's Office for Policing and Crime	5,000,000	03-Apr-13
Lloyds TSB Bank Plc	5,000,000	30-Apr-13
Salford City Council	2,000,000	29-May-13
Nationwide Building Society	5,000,000	17-Jun-13
Shepway District Council	2,000,000	28-Jun-13
Fife Council	5,000,000	28-Jun-13
Barclays Bank Plc (Direct)	5,000,000	28-Jun-13
Barclays Bank Plc (Direct)	5,000,000	18-Jul-13
North Tyneside Council	5,000,000	29-Jul-13
Barclays Bank Plc (Direct)	5,000,000	31-Jul-13
Nationwide Building Society	10,000,000	31-Jul-13
United Overseas Bank	5,000,000	27-Aug-13
Birmingham City Council	10,000,000	30-Aug-13
United Overseas Bank	5,000,000	30-Aug-13
Barnsley Metropolitan Borough Council	2,000,000	30-Aug-13
Northumberland County Council	5,000,000	16-Sep-13
Lloyds TSB Bank Plc	10,000,000	18-Sep-13
Development Bank of Singapore	5,000,000	23-Sep-13
United Overseas Bank	5,000,000	30-Sep-13
North Tyneside Council	5,000,000	30-Sep-13
Exeter City Council	5,000,000	30-Sep-13
Lancashire County Council	10,000,000	23-Oct-13
East Lothian Council	5,000,000	24-Oct-13
Kingston Upon Hull City Council	1,000,000	31-Oct-13
Fife Council	4,000,000	31-Oct-13
Birmingham City Council	5,000,000	31-Oct-13
Lloyds TSB Bank Plc	9,000,000	15-Nov-13
Fife Council	9,000,000	20-Dec-13
Exeter City Council	5,000,000	14-Jan-14
Birmingham City Council	5,000,000	15-Jan-14
Birmingham City Council	5,000,000	03-Feb-14
Tayside Fire & Rescue Authority	2,000,000	04-Feb-14
Isle of Wight Council	5,000,000	27-Feb-14
Doncaster Metropolitan Borough Council	5,000,000	25-Apr-14
Kingston Upon Hull City Council	6,000,000	15-May-14
Nottinghamshire County Council	5,000,000	22-Jul-14
Newcastle City Council	3,000,000	31-Jul-14
Fife Council	5,000,000	15-Aug-14

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Kingston Upon Hull City Council	2,000,000	05-Sep-14
Derby City Council	3,000,000	12-Sep-14
Rugby Borough Council	5,000,000	09-Jan-15
The Mayors Office for Policing and Crime	10,000,000	13-Mar-15
Newcastle City Council	5,000,000	03-Jul-15
Doncaster Metropolitan Borough Council	5,000,000	03-Jul-15
Lancashire County Council	10,000,000	31-Jul-15
Newcastle City Council	5,000,000	07-Aug-15
Fife Council	2,000,000	04-Sep-15
Newcastle City Council	10,000,000	09-Oct-15
Lancashire County Council	5,000,000	09-Oct-15
Landsbanki Islands HF	1,045,600	31-Mar-18
Landsbanki Islands HF	1,571,410	31-Mar-18
Total	274,617,010	

Structured deposits held at 31/3/2013

Counterparty Date	Principal Deposited (£)	Maturity
HSBC Bank plc	10,000,000	27-May-14
Total	10,000,000	

Short-term notice call accounts and Money Market Funds

Counterparty period	Balance at 31/03/13 (£)	Notice
Royal Bank of Scotland Call Account	10,030,754	Same day
Santander UK Call Account	4,999,975	Same day
Prime Rate Sterling Liquidity Fund	2,345,000	Same day
Total	17,375,729	

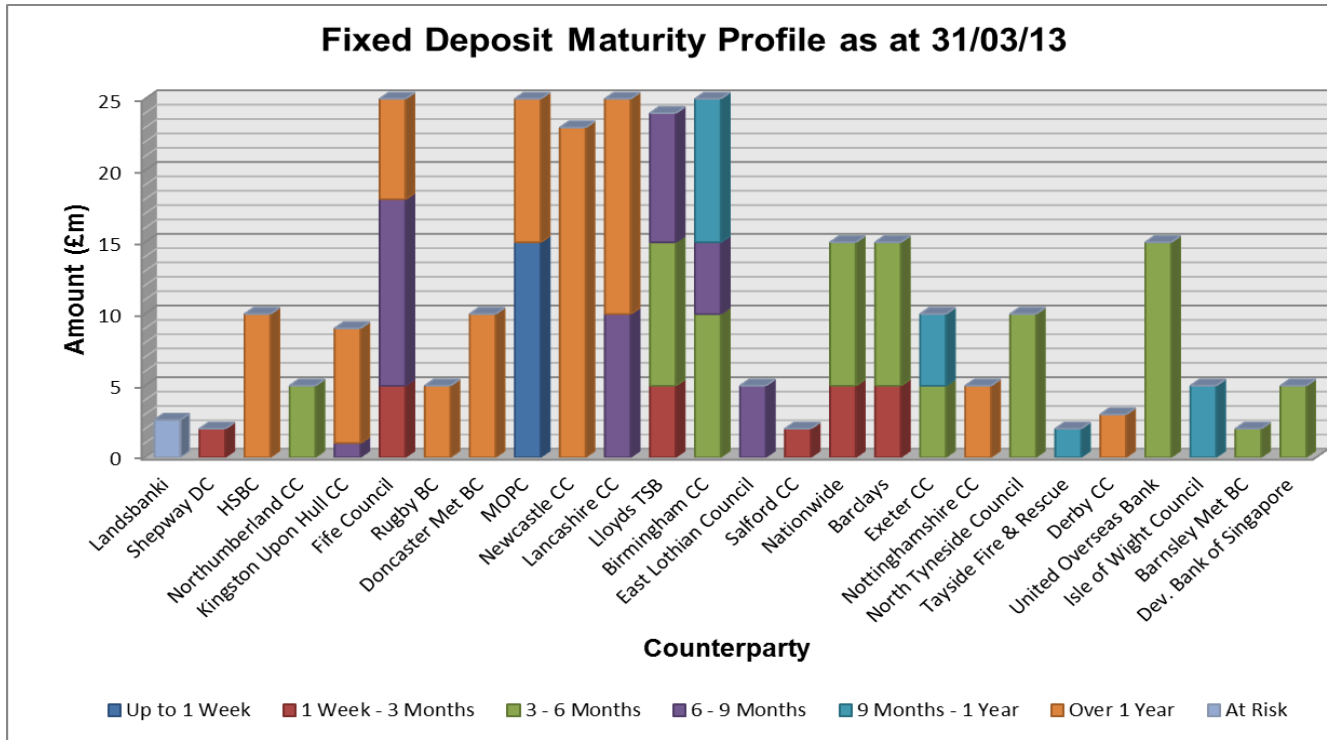
Short Dated Bond Funds

Counterparty period	Balance at 31/03/13 (£)	Notice
SWIP	12,152,010	2 days
Prime Rate Cash Plus Fund	50,945	2 days
Payden & Rygel Sterling Reserve Fund	3,017,099	2 days
Total	15,220,054	

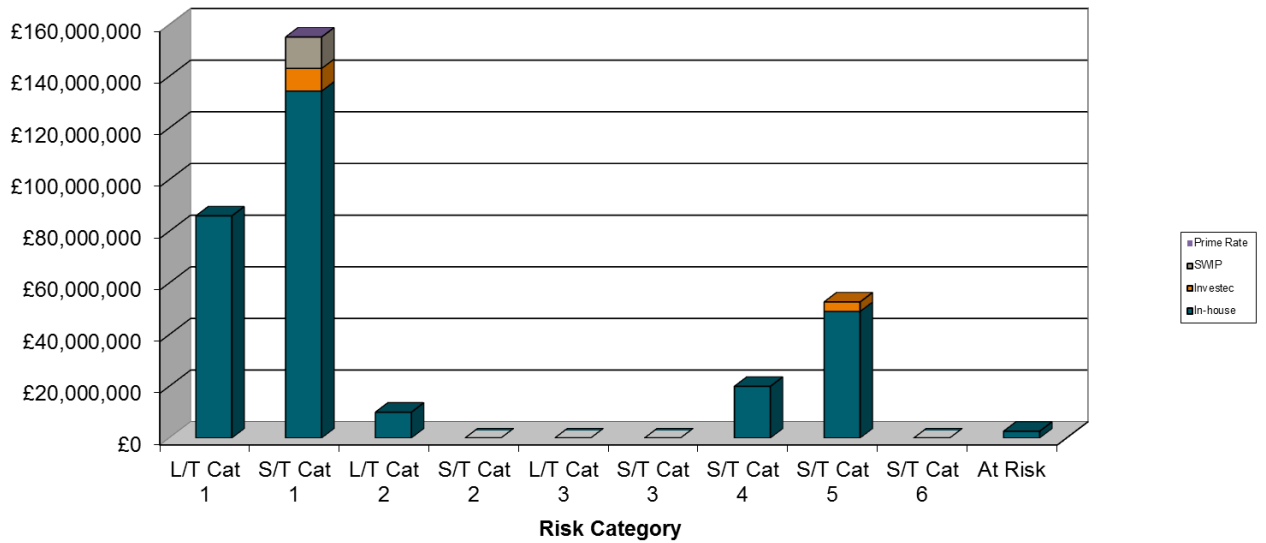
Externally Managed Funds

Fund Manager	Value of Fund at 31/03/13 (£)
Investec	12,410,687
Total	12,410,687

Risk profile of investment portfolio at 31/3/13



Risk Profile - Total Combined Portfolio as at 31.03.13

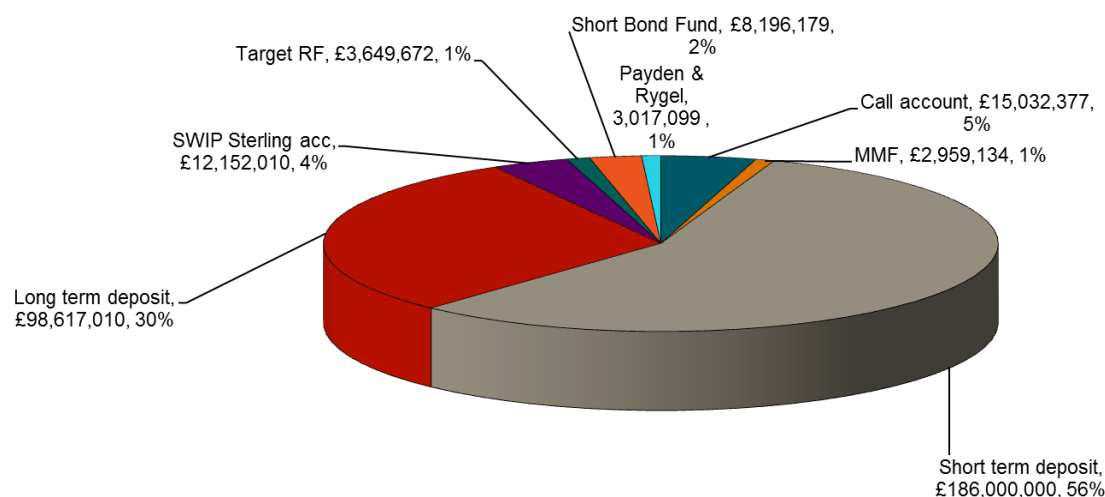


Risk Category	L/T	S/T	Individual	Viability
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	rating	rating	rating	rating
1 (Including Local Authorities)	AA+, AA	F1+	1, 2	aaa, aa
2	AA-	F1+	1, 2	aa, a
3	AA-	F1+	1	bbb
4	AA-	F1+	1	bbb
5	A+, A	F1	1, 2, 3	a, bbb,bb
6	A	F1	2, 3, lower	b or lower

Total Combined Portfolio as at 31.03.13



Annex 5

Prudential Indicators Outturn 31 March 2013

Authorised and Operational Limit for External Debt

Authorised Limit for External Debt
 £476,000,000
 Operational Limit for External Debt
 £466,000,000
 Actual External Debt at 31 March 2013
 £418,409,618

Fixed Interest Rate Exposure

Fixed Interest Net Borrowing limit 150.00%
 Actual at 31 March 2013 98.85%

Variable Interest Rate Exposure

Variable Interest Net Borrowing limit 25.00%
 Actual at 31 March 2013 1.15%

Sums Invested over 364 days

Total sums invested for more than 364 days maximum limit

£100,000,000

Actual sums invested for more than 364 days at 31 March 2013

£ 98,617,010

Maturity Structure of Borrowing at 31/03/13

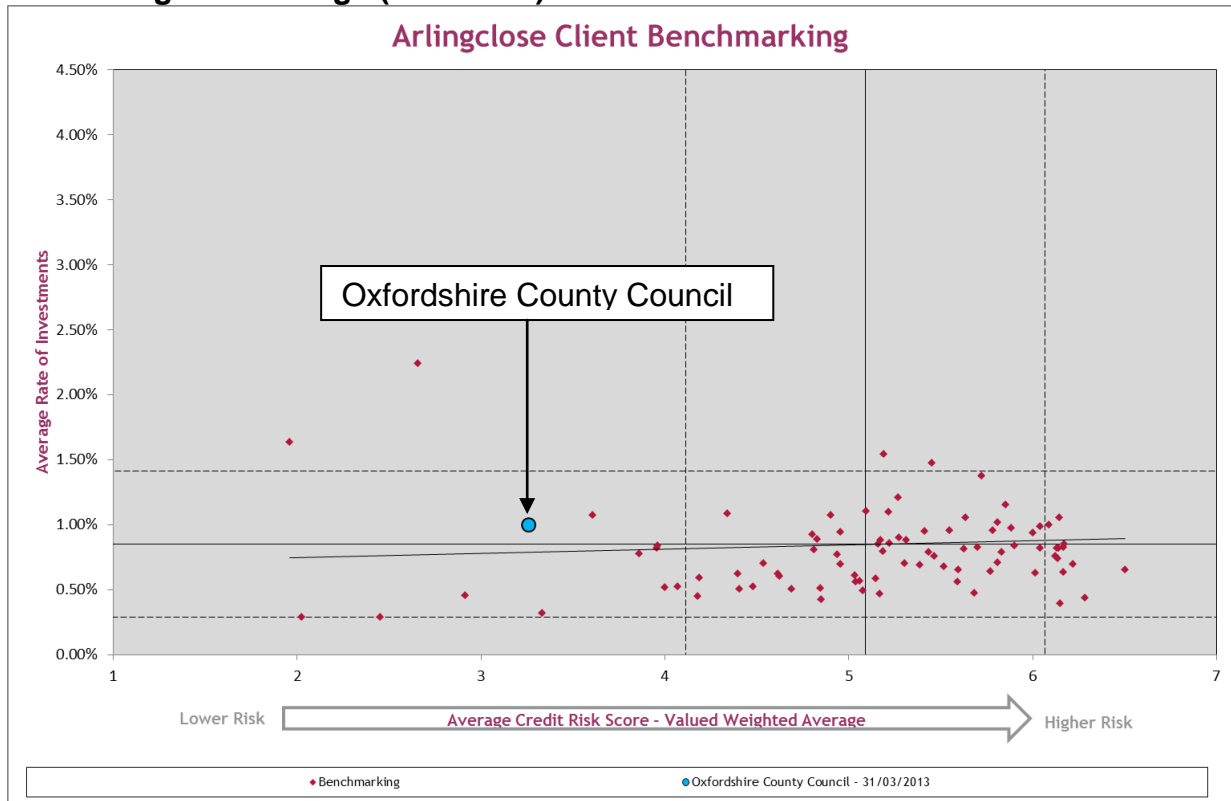
	Limit %	Actual %
From 01/04/12		
Under 12 months	0 - 20	0
12 – 24 months	0 - 25	8.73
24 months – 5 years	0 - 35	8.73
5 years – 10 years	5 - 40	18.67
10 years +	50 - 95	63.87

The Prudential Indictors for maturity structure are set with reference to the start of the financial year. The actual % shown above relates to the maturity period remaining at 01/04/12 on loans still outstanding at 31/03/13.

Actual Maturity Structure of Borrowing at 01/04/13

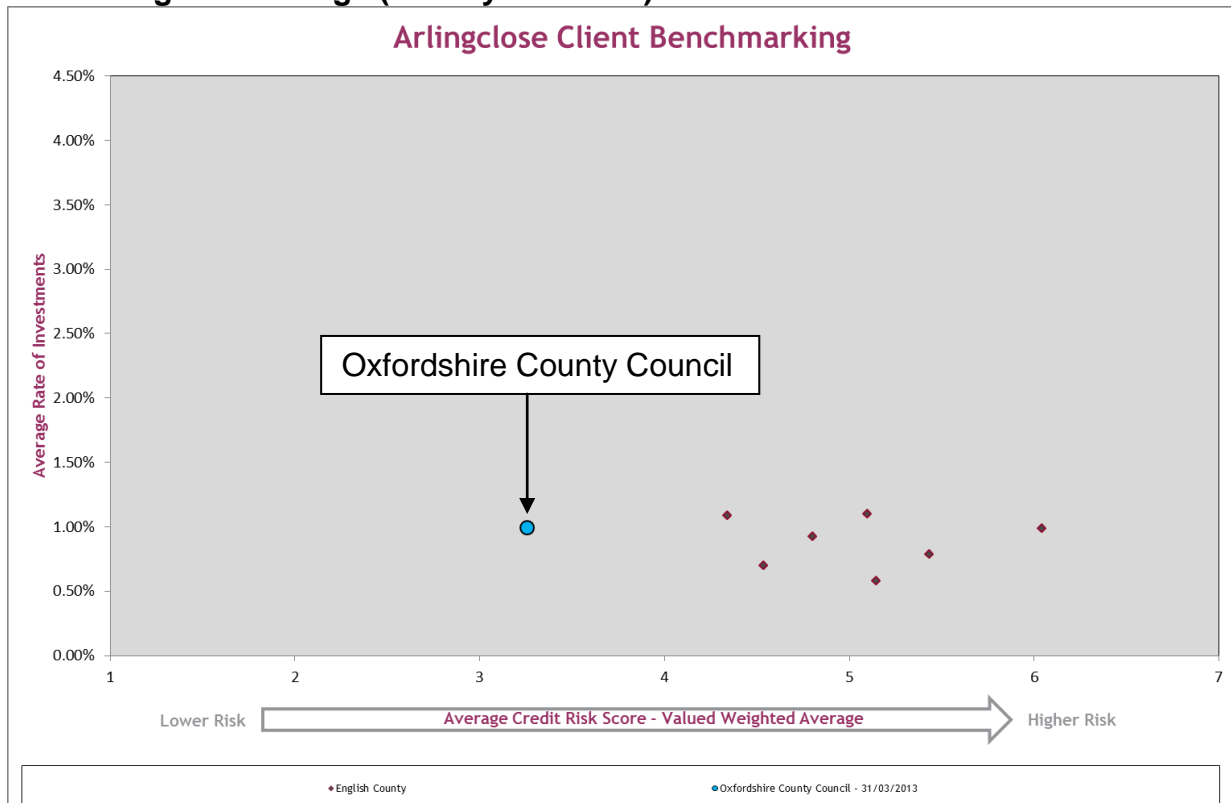
	Limit %	Actual %
From 01/04/13		
Under 12 months	0 - 20	6.30
12 – 24 months	0 - 25	1.70
24 months – 5 years	0 - 35	13.82
5 years to 10 years	5 – 40	16.00
10 years +	50 – 95	62.18

Value weighted average (all clients)



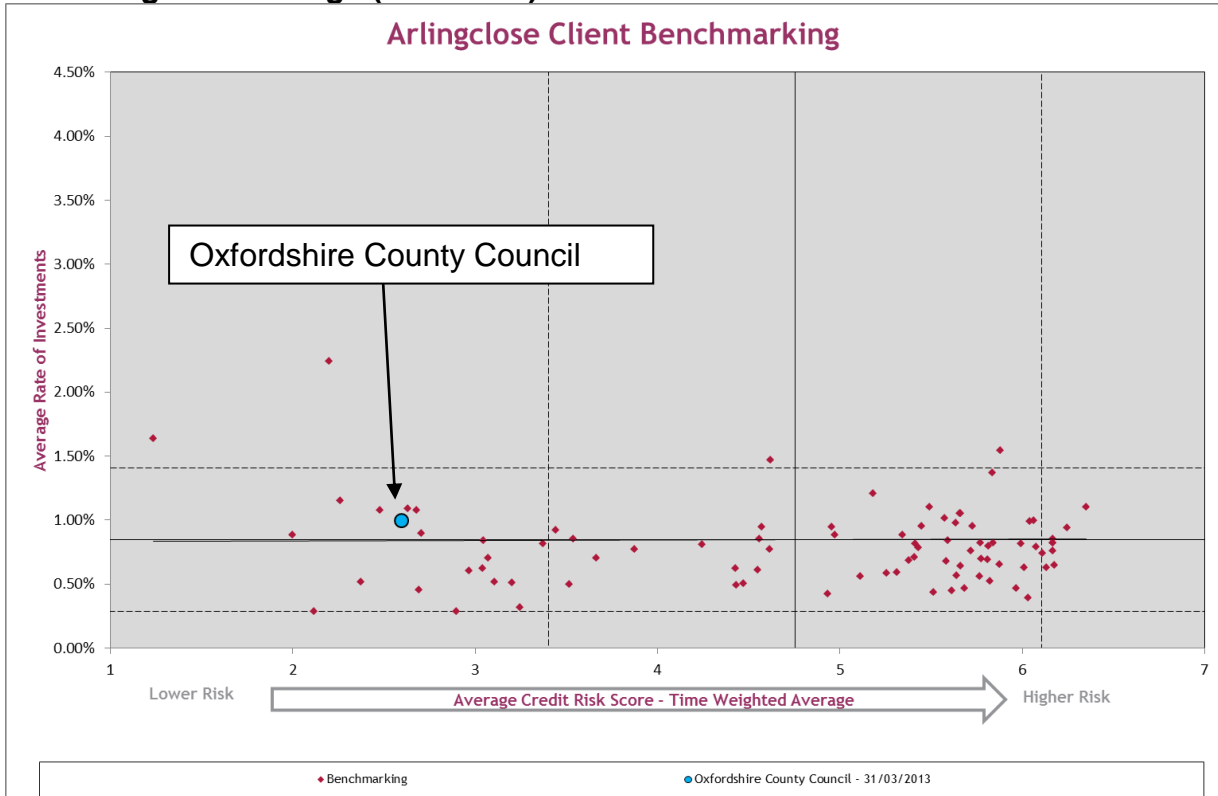
The above graph shows that Oxfordshire County Council achieved an above average interest rate when considering the credit risk of investments against all Arlingclose clients as at 31/03/2013.

Value weighted average (County Councils)



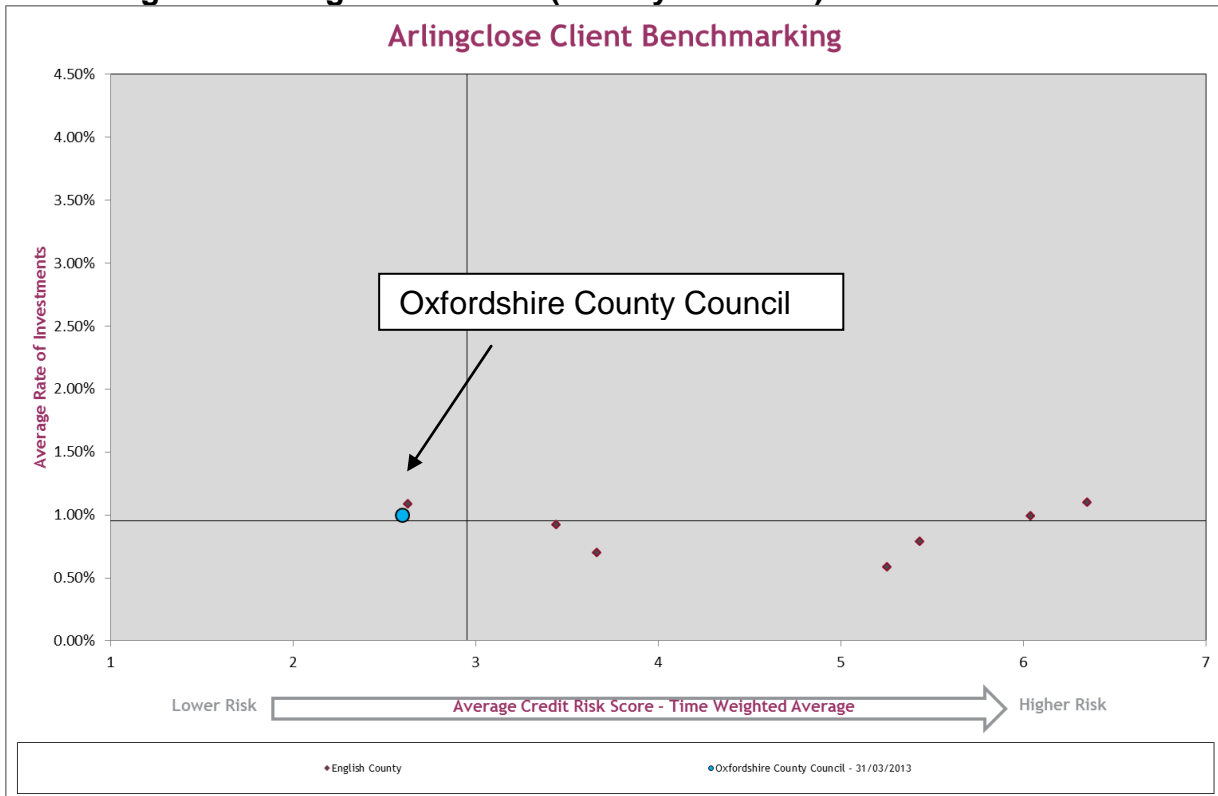
The above graph shows that Oxfordshire County Council achieved a similar interest rate for less credit risk compared to seven other County Councils as at 31/03/2013.

Time weighted Average (all clients)



The above graph shows that Oxfordshire County Council achieved an above average interest rate on deposits whilst maintaining a relatively low credit risk at 31/03/2013.

Time weighted Average Credit Risk (County Councils)



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The above graph shows that Oxfordshire County Council achieved a similar interest rate to the other County Councils in the sample, whilst it maintained a significantly lower time weighted credit risk as at 31/03/2013.