Bath & North East Somerset Council	
MEETING:	**Corporate Audit Committee**
MEETING DATE:	**28th September 2015**
TITLE:	**Treasury Management Outturn Report 2014/15**
WARD:	All
AN OPEN PUBLIC ITEM	

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 31st March 2015
Appendix 3 – Average monthly rate of return for 2014/15
Appendix 4 – The Council's External Borrowing Position at 31st March 2015
Appendix 5 – Counterparty Update
Appendix 6 – Arlingclose's Economic & Market Review of 2014/15
Appendix 7 – Interest & Capital Financing Budget Monitoring 2014/15
Appendix 8 – Summary Guide to Credit Ratings

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan for 2014/15.

2 RECOMMENDATION

The Corporate Audit Committee agrees that:

2.1 the 2014/15 Treasury Management Report to 31st March 2015, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 the 2014/15 Treasury Management Indicators are noted.

3 RESOURCE IMPLICATIONS

3.1 The financial implications are contained within the body of the report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 This report is for information only.

5 THE REPORT

Summary

5.1 The average rate of investment return for the 2014/15 financial year is 0.42%, which is 0.02% above the benchmark rate.

5.2 Performance against the Treasury Management & Prudential Indicators agreed as part of the annual Treasury Management Strategy is provided in Appendix 1. The outturn position and all treasury activity undertaken during the financial year is within the limits agreed by Council in February 2014 (as amended at its meeting on 13th November 2014), as shown in **Appendix 1**, as well as the CIPFA Code of Practice and the relevant legislative provisions.

Summary of Returns

5.3 The Council's investment position as at 31st March 2015 is given in **Appendix 2**. In line with the Annual Investment Strategy, investments were mainly temporary short term investments made with reference to the core balance and cash flow requirements.

5.4 The Council is the accountable body for the West of England Revolving Investment Fund (RIF) and received grant funding of £57 million at the end of the 2011/12 financial year. The Council acts as an agent and holds these funds on behalf of the West of England Local Enterprise Partnership until they are allocated in the form of repayable grants to the constituent Local Authorities to meet approved infrastructure costs. Since these funds are invested separately from the Council's cash balances and have been placed short term with the Debt Management Office and other Local Authorities, they are excluded from all figures given in this report. The value of the fund at the end of 2014/15 was £41.9 million.

5.5 Gross interest earned on investments for 2014/15 totalled £132k. Net interest, after deduction of amounts due to Schools, the West of England Growth Points, CHC and other internal balances, is £23k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.42%, which was 0.02% above the benchmark rate of average 7 day LIBID +0.05% (0.40%).

Summary of Borrowings

5.6 The Council's external borrowing as at 31st March 2015 is detailed in **Appendix 4.** £38.3 million of borrowing was arranged in 2014/15, with the Public Works Loan Board (PWLB) (£10.3m for periods of between 19.5 and 50 years) and five different Local Authorities, (£28m for periods of between one and five years). The majority of the borrowing was undertaken to maintain appropriate working cash balances with part related to funding a specific commercial estate investment opportunity. The Council's total borrowing was £108.3 million as at 31st March 2015.

5.7 The Council's Capital Financing Requirement (CFR) as at 31st March 2015 was £177 million. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

5.8 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. In total £38.3m of new fixed rate loans with an average rate of 1.68% and an average life of ten years were raised. The PWLB was the Authority's preferred source of long term borrowing given the transparency and control that its facilities continue to provide. Short-dated loans borrowed from the markets, predominantly from other local authorities, have also remained affordable and attractive.

5.9 The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5.10 In January 2015 the Department of Communities and Local Government (DCLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the PWLB. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The authority intends to use the PWLB's replacement as a potential source of borrowing if required.

5.11 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2015 apportioned to Bath & North East Somerset Council is £13.95m. Since this borrowing is managed by Bristol City Council and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.6.

Strategic & Tactical Decisions

5.12 **Appendix 5** provides further information on issues impacting on investment counterparties, including the implementation of bail-in provisions as highlighted in the mid-year treasury management monitoring report.

5.13 To increase diversification, throughout 2014/15 the Council invested in AAA rated Money Market funds, UK Banks and very highly rated Foreign Bank counterparties (AA-).

5.14 The Council continues to not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Council's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

5.15 The Council's average investment return is running slightly above the budgeted level of 0.35%, although the impact is offset by the lower than budgeted investment balances held.

Future Strategic & Tactical Issues

5.16 Our treasury management advisors economic and market review for 2014/15 is included in **Appendix 6**.

5.17 The Bank of England base rate has remained constant at 0.50% since March 2009.

5.18 Following the February Inflation Report and latest economic data, the Council's treasury advisors, Arlingclose, moved their forecast of the possible path of the Bank Rate. Their central case is now for a rise in Bank Rate in Q2 2016, although the risks to this forecast remain weighted to the downside. They reiterate their view that the pace of interest rate rises will be gradual and the extent of rises limited, projecting gilt yields on a shallow upward path in the medium term.

5.19 The benefits of the Council's current policy of internal borrowing are monitored regularly against the likelihood that long term borrowing rates are forecast to rise in future years. The focus is now on the rate of increase and the medium-term peak and, in this respect, the current forecast is that rates will rise slowly and to a lower level than in the past.

5.20 The borrowing that has taken place in 2014/15 is therefore driven by a need to maintain an appropriate working cash balance rather than any immediate changes to interest rates.

Budget Implications

5.21 A breakdown of the revenue budget for interest and capital financing and the actual year end position based on the period April to December is included in **Appendix 7**. This shows an overall underspend of £138k in 2014/15, resulting from the debt charges relating to new borrowing being less than forecast, partly offset by lower investment interest received due to holding lower cash balances.

5.22 This position will be kept under review during the new financial year, taking into account the Council's cash-flow position and the timing of any new borrowing required.

Payment of LGF Grant

5.23 The Local Growth Fund (LGF) letter from Tom Walker (Director Cities & Local Growth Unit) DCLG in February 2015 stated that 'DCLG will release a LGF capital grant payment of £16.6m in a single instalment on 1st April 2015'.

5.24 The Council checked with the department on 1st April 2015 and payment was confirmed as being due to arrive that day. On this basis payments were released for corresponding investments on that date to the equivalent value of £16.6m.

5.25 However DCLG failed to make the payment as expected, and the actual payment was not received until 10th April 2015. The Council therefore had to meet the committed investments from its own cash-flow over this period.

5.26 This is brought to the attention of Council given the size of the transactions and the technical exposure that resulted to the Council, even though not directly falling within the timeframe of the report.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

7 OTHER OPTIONS CONSIDERED

7.1 None.

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Finance and Efficiency, Section 151 Finance Officer and Monitoring Officer.

8.2 This report was also presented to July 2015 Cabinet & Council.

9 RISK MANAGEMENT

9.1 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and borrowing advice is provided by our Treasury Management consultants Arlingclose.

9.2 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

9.3 In addition, the Council maintains a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

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Background papers	*2014/15 Treasury Management & Investment Strategy* *1st & 3rd Quarter Treasury Performance Reports (Cabinet)* *Half yearly Treasury Performance Report (Cabinet & Council)*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	£'000	£'000
Borrowing	215,000	108,300
Other long term liabilities	2,000	0
Cumulative Total	**217,000**	**108,300**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	£'000	£'000
Borrowing	177,000	108,300
Other long term liabilities	2,000	0
Cumulative Total	**179,000**	**108,300**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	£'000	£'000
Fixed interest rate exposure	**177,000**	**88,300**

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	£'000	£'000
Variable interest rate exposure	**127,000**	**20,000***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the rate increase).

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**2014/15 Actual as at 31st Mar. 2015**
	%	%	%
Under 12 months	50	Nil	28*
12 months and within 24 months	50	Nil	7
24 months and within 5 years	75	Nil	9
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	56

* The CIPFA Treasury management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date (which are at 6 monthly intervals for the £20m of LOBO's). However, the Council would only consider repaying these loans if the Lenders exercised their options to alter the interest rate.

7. Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**. The Council agreed a reduction to the minimum portfolio average credit rating from A to A- at its meeting on 13th November 2014 in order to be able to respond to any changes to UK banks credit ratings resulting from implementation of the bail-in provisions of the EU Bank Recovery and Resolution Directive.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**A-**

8. Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	2014/15 Prudential Indicator	**2014/15 Actual as at 31st Mar. 2015**
Total cash available within 3 months	**£15m**	**£16m**

APPENDIX 2

The Council's Investment position at 31st March 2015

The term of investments, from the original date of the deal, are as follows:

	Balance at 31st Mar. 2015
	£'000's
Notice (instant access funds)	16,000
Up to 1 month	0
1 month to 3 months	0
Over 3 months	0
Total	**16,000**

The investment figure of £16.0 million is made up as follows:

	Balance at 31st Mar. 2015
	£'000's
B&NES Council	1,320
B&NES CHC	7,347
West Of England Growth Points	688
Schools	6,645
Total	**16,000**

The Council had an average net positive balance of £31.8m (including Growth Points & B&NES CHC Funding) during the period April 2014 to March 2015.

No fixed term investments were undertaken during 2014/15 with a maturity date in the following financial year. The balance of £16.0m was held in call accounts as at 31st March 2015.

Chart 1: Council Investments (£16.0m) as at 31st Mar. 2015

Chart 2: Council Investments (£22.15m) as at 31st Dec. 2014

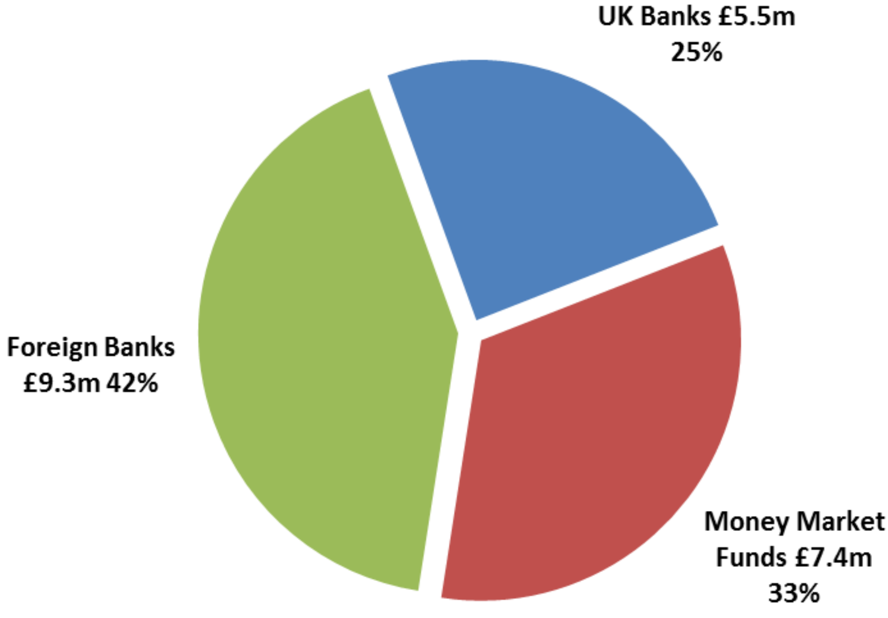
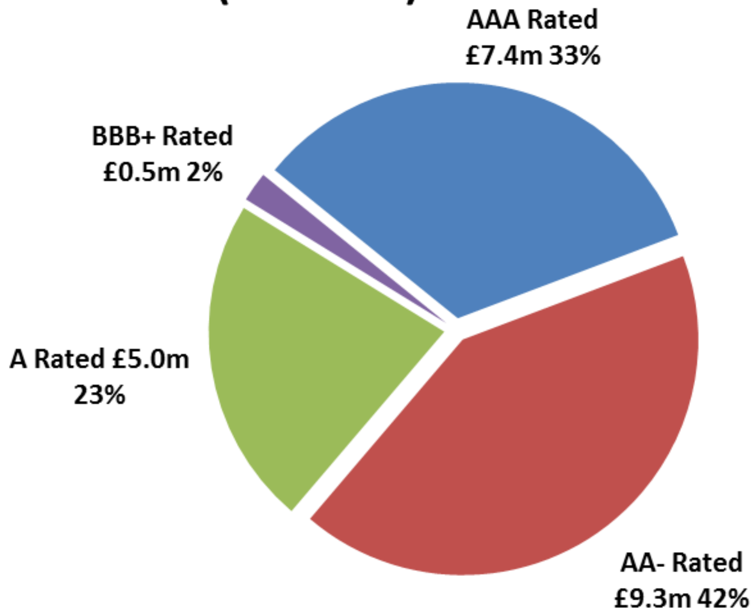


Chart 3: Council Investments per Lowest Equivalent Long-term Credit Ratings (£16.0m) 31st Mar. 2015

Chart 4: Council Investments per Lowest Equivalent Long-term Credit Ratings (£22.15m) 31st Dec 2014



APPENDIX 3

Average rate of return on investments for 2014/15

	April %	May %	June %	July %	Aug %	Sep %	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Average for Period
Average rate of interest earned	0.40	0.43	0.44	0.47	0.42	0.42	0.44	0.45	0.44	0.40	0.38	0.33	**0.42%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.39	0.39	0.40	0.39	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.40%**
Performance against Benchmark %	0.01	0.04	0.04	0.08	0.02	0.02	0.04	0.05	0.04	0.00	-0.02	-0.07	**0.02%**

APPENDIX 4

Councils External Borrowing at 31st March 2015

LONG TERM	Amount	Start Date	Maturity Date	Interest Rate
PWLB	10,000,000	15/10/04	15/10/35	4.75%
PWLB	5,000,000	12/05/10	15/08/35	4.55%
PWLB	5,000,000	12/05/10	15/08/60	4.53%
PWLB	5,000,000	05/08/11	15/02/31	4.86%
PWLB	10,000,000	05/08/11	15/08/29	4.80%
PWLB	15,000,000	05/08/11	15/02/61	4.96%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
KBC Bank N.V*	5,000,000	08/10/04	08/10/54	4.50%
Eurohypo Bank*	10,000,000	27/04/05	27/04/55	4.50%
West Midland Police Authority	5,000,000	08/10/14	10/10/16	1.10%
Portsmouth City Council	3,000,000	15/10/14	17/10/16	1.08%
Wirral Metropolitan Borough Council	5,000,000	07/11/14	06/11/15	0.65%
Gloucestershire County Council	5,000,000	25/11/14	25/11/19	2.05%
Derbyshire County Council	5,000,000	28/11/14	27/11/15	0.65%
Gloucestershire County Council	5,000,000	19/12/14	19/12/19	2.05%
PWLB	5,300,000	29/01/15	15/08/29	2.62%
PWLB	5,000,000	29/01/15	15/02/61	2.92%
TOTAL	**108,300,000**			
TEMPORARY	**Nil**			
TOTAL	**108,300,000**			**3.64%**

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

APPENDIX 5

Counterparty Update

The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. Taking the view that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish, over 2014-15 Moody's revised the Outlook of several UK and EU banks from Stable to Negative (note, this is not the same as a rating review negative) and S&P placed the ratings of UK and German banks on Credit Watch with negative implications, following these countries' early adoption of the bail-in regime in the BRRD.

S&P also revised the Outlook for major Canadian banks to negative following the government's announcement of a potential bail-in policy framework.

The Bank of England published its approach to bank resolution which gave an indication of how the reduction of a failing bank's liabilities might work in practice. The Bank of England will act if, in its opinion, a bank is failing, or is likely to fail, and there is not likely to be a successful private sector solution such as a takeover or share issue; a bank does not need to be technically insolvent (with liabilities exceeding assets) before regulatory intervention such as a bail-in takes place.

The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.
In December the Bank's Prudential Regulation Authority (PRA) stress tested eight UK financial institutions to assess their resilience to a very severe housing market shock and to a sharp rise in interest rates and address the risks to the UK's financial stability. Institutions which 'passed' the tests but would be at risk in the event of a 'severe economic downturn' were Lloyds Banking Group and Royal Bank of Scotland. Lloyds Banking Group, is taking measures to augment capital and the PRA does not require the group to submit a revised capital plan. RBS has updated plans to issue additional Tier 1 capital. The Co-operative Bank failed the test.

The European Central Bank also published the results of the Asset Quality Review (AQR) and stress tests, based on December 2013 data. 25 European banks failed the test, falling short of the required threshold capital by approximately €25bn (£20bn) in total – none of the failed banks featured on the Authority's lending list.

APPENDIX 6

<u>**Annual Economic Review 2014/15 (provided by Arlingclose)**</u>

Growth and Inflation: The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.

Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to $44.35 a barrel a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

Labour Market: The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

UK Monetary Policy: The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.

Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, however this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament; English MPs in turn demanding separate laws for England) lingers on. The highly politicised March Budget heralded the start of a closely contested general election campaign and markets braced for yet another hung parliament.

On the continent, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was from -0.10% to -0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the central bank at its January meeting in an effort to steer the euro area away from deflation and invigorate its moribund economies. The size was at the high end of market expectations and it will involve buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing March 2015 through to September 2016. The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

The US economy rebounded strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with ‘tapering’, i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough to weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word “patient” from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

Market reaction: From July, gilt yields were driven lower by a combination of factors: geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the big slide in the price of oil and its transmission though into lower prices globally. 5-, 10- and 20-year gilt yields fell to their lows in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively.

APPENDIX 7

Interest & Capital Financing Costs – Budget Monitoring 2014/15 (Outturn)

April 2014 to March 2015	YEAR END POSITION Budgeted Spend or (Income) £'000	Actual Spend or (Income) £'000	Actual over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	3,862	3,685	(177)	FAV
- Internal Repayment of Loan Charges	(8,182)	(6,985)	1,197	ADV
- Ex Avon Debt Costs	1,388	1,340	(48)	FAV
- Minimum Revenue Provision (MRP)	6,120	4,923	(1,197)	FAV
- Interest on Balances	(110)	(23)	87	ADV
Sub Total - Capital Financing	**3,078**	**2,940**	**(138)**	**FAV**

APPENDIX 8

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.

RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.