



HM Treasury

# Financial Transaction Control Framework

## **Managing government's financial investments**

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October 2024



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# Contents

<b>Chapter 1</b>	<b>Government's approach to financial transactions</b>	<b>5</b>
<b>Chapter 2</b>	<b>Delivery through expert institutions</b>	<b>10</b>
<b>Chapter 3</b>	<b>Transparency on risk and return</b>	<b>15</b>
<b>Chapter 4</b>	<b>Value for money principles</b>	<b>21</b>
<b>Annex A</b>	<b>List of designated public financial institutions</b>	<b>24</b>

# Chapter 1

## Government's approach to financial transactions

### Overview

1.1 At Autumn Budget 2024, the government announced a set of reforms to the fiscal framework. The fiscal rules include the investment rule – to reduce debt, defined as public sector net financial liabilities (PSNFL) or 'net financial debt', as a share of the economy. This is a broad and comprehensive metric that captures all financial assets and liabilities on the public sector balance sheet, as defined in line with international guidance.<sup>1</sup>

1.2 Economic growth is the government's central mission and well-directed public investment can catalyse private investment. A move to net financial debt recognises where equity investments or loans create financial assets corresponding to the liability incurred to finance them.

1.3 The government intends to use expert institutions such as the National Wealth Fund (NWF) and British Business Bank (BBB) to make financial investments on its behalf, supporting growth while generating a positive return for the Exchequer.

1.4 While this creates opportunities, the government must invest in a fiscally responsible way. The introduction of a net financial debt fiscal rule is accompanied by new controls on financial transactions (FTs), where the public sector acquires or sells financial assets such as equities or loans or takes on new liabilities, such as guarantees. This will ensure financial transactions represent good value for money and do not crowd-out private sector investment.

1.5 These controls build on existing spending controls for managing FTs set out in Managing Public Money (MPM) and Consolidated Budgeting Guidance (CBG), which remain in place in their entirety.<sup>2</sup> The new controls introduced from 30 October 2024 are:

1.6 Delivery of new, large-scale FTs through designated public financial institutions with suitable expertise and capability (Chapter 2).

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<sup>1</sup> Definitions follow the National Accounts, set out in the '[System of National Accounts, 2008](#)' and '[Eurostat](#)'.

<sup>2</sup> [Managing Public Money](#), HM Treasury, May 2023; [Consolidated budgeting guidance 2024 to 2025](#), HM Treasury, February 2024.

- 1.7 An annual report on government's financial investment portfolio to offer transparency on value, performance and risk (Chapter 3).
- 1.8 Requirements to ensure all new FTs either generate a return above their cost of capital or recognise costs transparently, with any FTs expected to make a loss having costs paid for upfront by the responsible department (Chapter 3).
- 1.9 Standardised controls to manage the downside risk of unexpected losses via an economic capital approach (Chapter 3).
- 1.10 New value for money criteria that public financial institutions and departments must meet to get FTs approved (Chapter 4).
- 1.11 The Treasury will only approve spending on financial investments where robust controls are in place in line with this framework, and it will review the processes of public financial institutions and departments to ensure this. The Treasury will consult with departments on the implementation of this framework and with Devolved Governments on the impact on their approach to FTs. The Treasury will publish an updated framework in the first quarter of 2025.

## **Pre-existing spending control of FTs**

- 1.12 The following controls on FTs currently exist in budgeting rules and MPM. These controls are retained in full – Treasury consent and budget cover is still needed for departments to issue any FTs.

### **Treasury consent**

- 1.13 Departments must have Treasury consent before undertaking spending on FTs or making commitments that could lead to spending on FTs. This falls within a department's capital budget. In line with other departmental spending, Treasury consent is provided by:

1.13.1 Delegated limits, below which consent for spending on FTs is delegated to the department, or,

1.13.2 Direct approval in advance, required for all FTs with an overall value above a department's delegated limit; or FTs which are novel, contentious or repercussive.

1.14 Parliament must also approve spending on central government FTs via the estimates process. Budget cover for FTs will continue to be reflected in Capital Delegated Expenditure Limit (CDEL) or Capital Annually Managed Expenditure (CAME) control totals of the estimate. In addition, FTs will continue to score against these budgets in line with rules set out in CBG.

1.15 As is currently the case, departments will need appropriate legislative powers (*vires*) to deliver FTs where they constitute a 'new service', as set out in MPM.

## Spending Review and Budget processes

1.16 As at present, budget cover for FTs managed through DEL will continue to be allocated through the regular Spending Review process and budget cover for FTs managed in AME will continue to be forecast and reviewed at Budgets. Funding arrangements for the Devolved Governments will continue to apply as set out in the Statement of Funding Policy.

1.17 FTs will continue as now to impact departments' capital budgets when FTs are first entered into (i.e., when undertaking net lending and the purchase of shares) and as they are settled (i.e., sale of shares).

1.18 FTs will also continue to impact departments' resource budgets in either Resource DEL (RDEL) or Resource AME (RAME) via the returns received on assets, for example interest received on loans. FTs also impact departments' resource budgets through changes in the value and recognition of losses, such as scoring allowances for expected credit losses.

1.19 Currently, FTs form a separate ringfence within CDEL and CAME budgets for departments with significant FT expenditure. As is currently the case, departments may not switch budget cover out of their FT ringfence without approval from the Treasury.

## Principles government will apply to guide future controls

1.20 The government has established the following new principles for a Financial Transaction Control Framework (this document). These principles are reflected in the provisional design of that framework, which is covered in Chapters 2 to 4. The Treasury will consult with departments and interested parties on the proposals ahead of publishing a full Financial Transaction Control Framework including technical annexes in the first quarter of 2025. This current version of the framework will apply provisionally until the full framework is published.

### Public financial institutions

1.21 **Major financial transactions should be delivered through expert public financial institutions.** New, large-scale FTs above a specific threshold must be delivered by designated public financial institutions absent Treasury agreement to do otherwise. This will only be agreed if there are exceptional reasons where delivery through the public financial institution would undermine the objectives of the policy. The Treasury will set out this threshold in the planned update.

### Risk and return

1.22 **FTs should by default target a risk-adjusted expected return above the government's cost of borrowing (the relevant gilt rate)**

**and any institutional overhead costs.** Some losses occur in any portfolio, so government will target this return at the level of a public financial institution or across a portfolio of FTs, not each investment. Government will in limited cases, if there is a clear policy need to address a market failure, undertake FTs that it expects to be loss-making. These costs must be clearly recognised in departmental budgets and the loss-making element will worsen net financial debt.

**1.23 The government will publish an annual report on central government's financial investments,** delivered by UK Government Investments (UKGI). This report will use asset valuations drawn from government accounts already audited by the National Audit Office (NAO) and the Treasury is working with the Comptroller and Auditor General to ensure that the report builds appropriately on the existing audits of asset valuations. The report will provide transparency to the public, Parliament and markets on the value, risk and performance of government's financial assets.

**1.24 New standardised risk-based controls for FTs and guarantees will be introduced.** This will be delivered via an economic capital approach as used in several public financial institutions. This is set out in further detail in Chapter 3.

## Approval processes

**1.25 Treasury will set out value for money principles to meet, and the standardised data that departments must provide, for Treasury approval of FTs.** These flow from the Green Book and Contingent Liability Approval Framework, adapted for financial investments.<sup>3</sup>

## Scope of this framework

### Organisations covered

**1.26** As with CBG, this framework will apply to all entities classified by the Office for National Statistics (ONS) to central government, including government departments and their arm's length bodies, except for the Devolved Governments which will continue to be covered by the Statement of Funding Policy.

**1.27** It will also apply to any entity designated as a public financial institution under Chapter 2, regardless of their classification.

### Financial assets and instruments covered

**1.28** The table below sets out the financial instruments covered by this framework, including both their acquisition and sale. Definitions

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<sup>3</sup> [The Green Book](#), HM Treasury, March 2022; [Contingent Liability Approval Framework](#), HM Treasury, April 2024.



follow the National Accounts (SNA 2008 and ESA 2010) statistical frameworks, rather than International Financial Reporting Standards (IFRS) based definitions.<sup>4</sup>

**Table 1.1 Financial assets and instruments**

Category	Definition based on the National Accounts
Loan assets	Non-negotiable financial instruments, which must be interest-bearing and have to be repaid at maturity.
Equity assets	Residual claims held by a public sector entity on the assets of private sector corporations through share holdings or ownership.
Derivative assets	Financial instruments linked to financial or non-financial assets or to an index where the value is derived from the underlying asset or index.
Debt securities assets	Financial instruments which pay interest and have fixed dates of issuance and maturity. Assets comprise corporate bonds and bills held by public sector bodies.

**1.29** Student loans are partitioned under National Accounts guidance into a loan component and a capital transfer component – they are included in this framework.

**1.30** Guarantees are in scope of this framework in respect of the requirement for large financial instruments to be delivered by public financial institutions and inclusion in economic capital limits set out in detail from 3.12.

**1.31** This framework does not cover assets treated as “liquid” in UK public finance statistics, such as cash and short-term deposits.

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<sup>4</sup> Definitions follow the National Accounts, set out in the [System of National Accounts](#) and [Eurostat](#).

# Chapter 2

## Delivery through expert institutions

### Overview

2.1 The most suitable institutions to deliver financial transactions and guarantees are public financial institutions set up as centres of expertise in the management of financial instruments, who have appropriate staff, institutional design, and risk management models.

2.2 The current list of designated public financial institutions is set out in **Annex A**. They bring in expertise from the financial sector and typically manage risk in an equivalent way to a private sector bank through use of an economic capital or similar model.

### Public financial institutions

2.3 To ensure value for money and minimise unnecessary risk, all new, large-scale FTs and guarantees shall be delivered by a public financial institution unless explicit Treasury agreement is given to do otherwise. **The Treasury will set out what the precise threshold is for FTs and guarantees that must be delivered through public financial institutions in the update to this guidance.**

2.4 Organisations shall be designated as public financial institutions based on criteria set out in this guidance, at the discretion of the Chief Secretary to the Treasury. This is an administrative designation for spending control purposes and does not relate to the statistical definition of public financial corporations.

2.5 Departments may only deliver an FT or guarantee programme above the threshold through a non-designated organisation with approval of the Chief Secretary to the Treasury. Departments must set out why a public financial institution cannot deliver the programme and this will usually only be accepted where for policy reasons it must remain the responsibility of a department, such as sovereign-to-sovereign loans like HM Treasury's loan to Ireland during the Eurozone crisis. Departments must set out how they intend to mirror the criteria below as closely as possible within their management arrangements.

2.6 **Annex A** sets out the current list of designated public financial institutions. This list will be added to either through reform of existing

bodies to align with these criteria or through creation of new entities. This status can be withdrawn by the Treasury as well as granted.

**2.7** The government shall publish at future fiscal events the total investment capacity, annual spending limits (or annual forecast spending) and risk controls of each public financial institution for transparency, highlighting any decisions to change these limits.

## Public financial institutions criteria

**2.8** The Treasury does not expect all financial institutions to be designed in an identical way, as different organisational models can achieve the same outcomes. The Treasury does expect that entities seeking to become public financial institutions meet the following criteria or set out how the policy intent can be achieved via other means. Where existing institutions are set up under different arrangements, the Treasury will consider how to bring them in line with these criteria on a case-by-case basis.

**2.9** These proposed criteria and the details of their implementation, set out in draft below, will be finalised in the update to this guidance.

**2.9.1 Primary activity:** the main activity of public financial institutions shall be making financial transactions or guarantees. While some expenditure, for example on administration, will not be FTs, most of their expenditure should take the form of financial activity. Non-FT costs (e.g. administration) should be covered by investment income when institutions are mature. Public financial institutions should not be vehicles for delivering grants.

**2.9.2 Operationally independent:** public financial institutions shall usually be authorised to make day-to-day investment decisions independently, based on strategic objectives and criteria set by ministers within specified risk and cash-based limits. Ministers or departments can only direct public financial institutions to make specific investments via a designated and transparent process. This is to ensure that public financial institutions can make investment decisions on a commercial basis at arm's length from ministers.

**2.9.3 Staffing:** public financial institutions shall employ staff with suitable expertise to manage complex financial instruments, drawing on private sector capability where possible.

**2.9.4 Balance sheet:** public financial institutions should be set up either as government-owned companies with their own balance sheet financed through Treasury or department provided equity and debt, or as departments mirroring this arrangement. Public financial institutions should borrow from the Treasury or government departments at the relevant gilt rate plus an administration fee, so that repayment of this borrowing offsets the government's financing costs.

If specifically agreed by the Treasury, institutions can also borrow directly from financial markets.

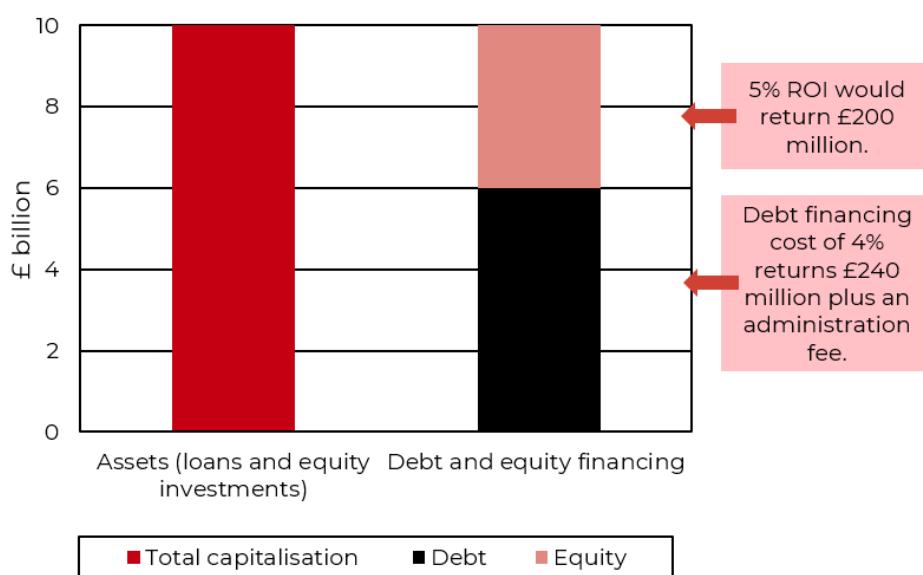
**2.9.5 Investment limits:** the investment limits of public financial institutions will be capped by the Treasury using existing spending controls. This will be operationalised by providing public financial institutions with debt and equity financing, both of which shall be limited by agreement with the Treasury, or another appropriate cash spending control. No public financial institution will be able either to borrow without limit or be provided with equity finance without limit.

### Box 2.A Balance sheet of a public financial institution

As set out in the illustrative example below, a public financial institution should be financed by a mix of equity and debt financing on their balance sheet (in some cases this will just be equity).

The sum of their equity and debt finance is equal to the total capacity of the organisation to make loans and investments.

**Capital structure of an illustrative public financial institution**



For equity finance, returns are agreed between departments and the Treasury and can either be recycled or taken as a dividend payment. For debt, this must be repaid to the Treasury or the parent department at the relevant gilt rate plus an administration fee. The

institution's value at risk (the maximum risk of losses) will be lower than their total capitalisation, set by their economic capital model.

In this example, the £240 million from debt financing costs would be repaid and the £200 million made on equity returns would either be returned to the Treasury or recycled within the institution.

**2.9.6 Rate of return/financial objectives:** public financial institutions shall target a return on equity of at least the government's cost of borrowing (the relevant gilt rate - see paragraph 3.10 for further explanation) and the institution's overhead costs, or an equivalent arrangement agreed with the Treasury. This return will be at the level of an institution or portfolio not individual investment and will be targeted over time not year-on-year. The target rate of return will also have a ceiling as well as a floor, to ensure that public financial institutions are concentrating on addressing market failures rather than crowding out private sector capital.

**2.9.7 Recycling of returns:** the public financial institution's business plan and dividend policy will set the long-term scale of the public financial institution's balance sheet. Typically, institutions will recycle repayments on the principal of loans and sales of equity into new investments, subject to continuing to meet their return on equity target. This ensures they have a permanent capital base and can maintain their existing scale of activity. The profits generated will then either be reinvested by the institution, allowing them to grow, or returned to the Treasury or shareholder department as a dividend, as agreed by the shareholder and Treasury.

**2.9.8 'Mandated activity' or 'service arm':** It may be value for money to use a public financial institution's expertise in delivering FTs that are subsidised or fully funded by government to achieve a policy outcome. These activities should be transparently reported and the public financial institution should manage such activities via a 'mandated activity' or 'service arm' model (see 3.27-3.31), with any grant element clearly recognised in departmental budgets and paid for upfront.

**2.9.9 Financial reporting:** public financial institutions shall produce annual reports and accounts in line with IFRS or the Government Financial Reporting Manual (FReM). The spending, income and balance sheet of public financial institutions will be included in the Public Sector Finances.

**2.9.10 Risk management:** public financial institutions shall manage risk through an economic capital model. This means losses will expect to be limited to the value of the economic capital in a downside economic

scenario. In addition, they should have appropriate risk management processes in place in line with MPM.

**2.9.11 Oversight:** The Treasury is considering whether additional oversight is required to manage the economic capital of public financial institutions, for example subjecting them to quasi-regulatory arrangements (as already the case to a degree for some institutions).

## Potential flexibilities for public financial institutions

**2.10** Alongside meeting the criteria, designated public financial institutions may be granted certain flexibilities by the Treasury to support their ability to deliver good value for money investments and operate in a suitably commercial way, while managing risk properly.

**2.11** These flexibilities are at the discretion of the Chief Secretary to the Treasury and will require a strong business case and demonstration that robust institutional-level controls are in place, such as an economic capital model for managing risk. The flexibilities could include:

**2.11.1** For entities in central government – how annual budgets are set, including management of expenditure in AME.

**2.11.2** Applying controls on an institution level, not on a programme basis, including the ability to use cash and risk budgets across their range of programmes, to best meet strategic objectives.

**2.11.3** Institutions can be given the certainty of a permanent capital base to support their market credibility.

**2.11.4** A bespoke pay framework for senior and specialist roles, to allow institutions to recruit the external expertise needed to manage complex financial instruments.

# Chapter 3

## Transparency on risk and return

### Overview

3.1 Government principally undertakes financial investments to solve market failures and achieve a policy impact, like boosting infrastructure and delivering net zero, rather than being profit-seeking. But the government must also invest in a fiscally responsible way.

3.2 To ensure this, the government has enshrined as a core principle that its financial assets should generate a return at a portfolio level that at least covers the government's cost of borrowing and any institutional overhead costs. Alternatively, where government makes investments that it expects to make losses from the outset, costs must be recognised upfront in departmental budgets.

3.3 If a financial asset sees unexpected losses, it worsens net financial debt, for example as loans are written-off or the value of equity holdings reduces. Therefore, the government will proactively manage downside risk using an economic capital-based approach.

### A government financial investment report

3.4 Government will be transparent about the investments it is making on behalf of taxpayers and ensuring all relevant information about those investments are accessible to the public, to Parliament and to markets.

3.5 Therefore, the government shall publish an annual *Government Financial Investment Report* setting out the financial assets owned by government, their latest valuations, their financial performance, and policy benefits achieved. This will be done at a portfolio or institution level where more appropriate. Over time, the report shall also assess risk in downside economic stress scenarios, in line with best practice principles applied in the banking sector.

3.6 The report will be delivered by UKGI, the government's centre of expertise for corporate finance and corporate governance. The government will ensure the information in this report is robust and independently verified, in particular the valuation of government's assets. This report will use asset valuations drawn from government accounts already audited by the National Audit Office (NAO) and the

Treasury is working with the Comptroller and Auditor General to ensure that the report builds appropriately on the existing audits of asset valuations.

3.7 The first iteration of the report will be produced by Autumn 2025 and published annually thereafter.

## Generating a return for the Exchequer

3.8 For the use of FTs to be consistent with fiscal sustainability, public financial institutions and departments should, by default, target risk-adjusted returns on FTs to cover at least the government's cost of borrowing and any institutional overheads. This cost of borrowing is the relevant gilt rate – the cost government must pay to service debt issued to finance FTs. If a return above the gilt rate is achieved, FTs will reduce government's overall net debt interest costs over time. Where there is credit or investment risk, this means pricing above the relevant gilt rate.

3.9 Some investment losses will occur in any portfolio. For public financial institutions returns should be targeted at an institution or portfolio level, and for departments at a programme level.

3.10 In practice, government's cost of financing its FTs is complex to capture as a single figure. FTs are issued at different times and feed into government's overall financing requirement. The Debt Management Office (DMO) borrows by issuing a mix of conventional and index-linked gilts with different maturities and Treasury bills. Gilt yields also vary over time according to various factors, like interest rates in the economy, gilt supply and demand, or market sentiment. The government also raises finance through National Savings and Investments.

3.11 **The Treasury will publish a technical annex to this framework, which will explain how organisations should set returns targets in line with the relevant gilt rate, noting the complexities set out above.**

## An economic capital approach to risk

### Introduction to economic capital

3.12 When the government undertakes financial investments, it is taking on the risk of unexpected losses. The established model in the financial sector to manage the downside risk of financial investments is economic capital. The Treasury proposes that public financial institutions and departments agree with the Treasury specific economic capital limits for FTs and guarantees to control risk.

3.13 Guarantees will be controlled in the same way as FTs for the purpose of economic capital limits, as they involve similar risk-taking and so managing them under a single framework aids consistency.

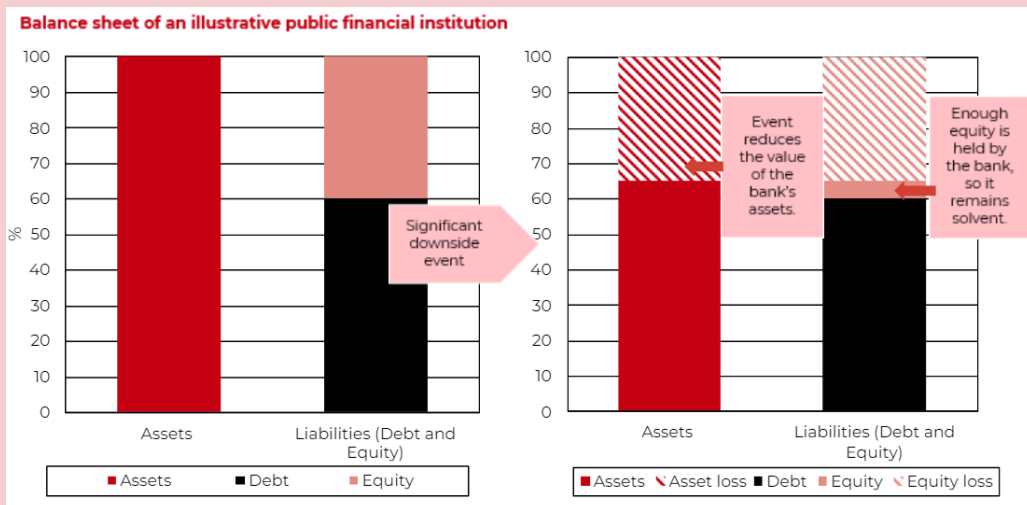


3.14 Under net financial debt, standardised guarantees (where a series of guarantees are offered on the same terms) have an upfront fiscal impact, equivalent to an estimate of the lifetime expected losses for the guarantees, net of fee income.

### Box 3.A Economic capital models

Economic capital reflects the expected riskiness of investments. An economic capital limit will place a constraint on the level of risk that an entity can undertake. It does this by setting a ceiling on the scale of asset value losses that an entity or programme should experience in a modelled low probability downside economic scenario.

For public financial institutions, this will usually be achieved through an economic capital model linked to their equity holdings, i.e., they can only take on risk such that potential asset losses can be met from their equity in all but the most remote downside scenario and they do not require an bailout from the Treasury on their debt. This is broadly equivalent to the approach taken by private sector banks under Prudential Regulation Authority (PRA) regulations.



Institutions undertaking FTs would be expected to model the potential losses their investments could make in a low probability downside scenario. To do this they should take into account the diversification of the financial assets within an FT programme, but also consider correlations in potential risk triggers across assets held.

### Virtual economic capital limits

3.15 As departments do not hold equity, the Treasury is proposing virtual economic capital (VEC) controls to define an equivalent risk

appetite to limit downside losses on FTs and guarantees from financial instruments not issued by a public financial institution.

**3.16** The purpose of VEC is to understand total risk-taking and agree suitable programme-level controls so that risk taken on is proportional to the policy objective. The Treasury will work with departments to ensure the application of this principle is proportionate to the scale of credit and investment risk undertaken.

**3.17** VEC limits will not form part of the budgeting framework – they do not represent expenditure – instead, they are a Treasury control on financial risk. Departments will agree VEC limits with the Treasury, either on a transaction or programme level and depending on the department’s delegation for FTs. This will manage the risk taken by that expenditure.

**3.18** For FTs or guarantees agreed before October 2024, the Treasury and departments will retrospectively agree a VEC limit so the downside risk of all financial assets can be understood. In many cases, this will involve restating existing risk-based controls. The Treasury will also explore if VEC should be applied to government-provided insurance.

**3.19** **The Treasury will work with departments to publish a technical annex on how to calculate and set VEC limits, learning from where this is already implemented effectively in the public sector.**

**3.20** The Treasury will use aggregate information on the risks across government's FT portfolio to consider an appropriate level of risk for government to hold. The annual *Government Financial Investment Report* will report on the level of risk taken and in time will assess economic stress scenarios.

## **Budgeting for loss-making FTs**

**3.21** Government does not just invest to generate a return – it invests to achieve policy objectives. In some cases, the best value for money way to achieve a given objective could be a loss-making FT – i.e., where public sector organisations issue a loan with a risk-adjusted rate of return below the relevant gilt rate and overhead costs, meaning the income to government is lower than the expenditure to fund the FT.

**3.22** Loss-making FTs should only be used in limited cases where they show value for money through correcting a market failure, delivering significant social or economic returns, and addressing a clear policy need. In these instances, the alternative option to a loss-making FT is likely a grant, which would represent worse value. This framework ensures that the cost of loss-making FTs is recognised in departmental budgets upfront and ensures that the loss-making element is treated as spending and prioritised against other decisions.

3.23 Departments will also need to have regard to the Subsidy Control Act 2022 in respect of such activities.<sup>5</sup>

## How losses already affect departmental budgets

3.24 The government already accounts for the risk and crystallisation of losses through its IFRS based budgeting system, which transparently reflects their cost within departmental resource budgets. For example:

3.24.1 Expected credit losses generally score to resource DEL. The estimate reflects a probability-weighted amount determined by evaluating a range of possible outcomes.

3.24.2 Other changes in the fair value of financial assets generally score to resource AME.

3.24.3 If government issues FTs below their fair value, the associated loss – i.e., difference between the transaction price and fair value – generally scores to resource DEL.<sup>6</sup>

3.24.4 Write-offs for FTs score in resource DEL.

3.25 Where the Chief Secretary to the Treasury has agreed that the spending of a specific public financial institution will be managed in AME, all the changes above will score in resource AME.

3.26 This established budgeting framework already ensures that the costs of loss-making FTs needs to be traded off with other forms of spending within departmental budgets.

## 'Mandated activity' and 'service arm' models

3.27 FTs should be delivered via public financial institutions wherever possible – even if policy-driven, loss-making FTs – as their expertise can ensure schemes are well-designed and minimise losses. Departments seeking to deliver a loss-making FT should engage with a public financial institution to support design and delivery.

3.28 There are specific mechanisms for setting up public financial institutions to deliver loss-making FTs. Examples are seen internationally in KfW in Germany and CDP in Italy or in the UK through the British Business Bank's COVID-19 programmes or UK Export Finance's export credit and insurance support for Ukraine. These typically involve bespoke accounting arrangements to manage the financial impacts of subsidised investments transparently.

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<sup>5</sup> [UK subsidy control regime: statutory guidance](#), Department for Business and Trade, December 2023

<sup>6</sup> In accordance with [Government Financial Reporting Manual: 2024-25](#), HM Treasury, December 2023, where future cash flows are discounted to measure fair value, entities should use the higher of the rate intrinsic to the financial instrument and the real financial instrument discount rate set by HM Treasury.

**3.29 ‘Mandated activity’ model:** investments sit on the public financial institution’s balance sheet and contribute to their return on equity target but are expected to be loss-making with a grant element. Such investments can be delivered via two funding arrangements, depending on how they impact an institution’s bottom line:

**3.29.1** To undertake mandated activities, sponsor departments should typically issue an annual grant to the institution to cover the costs of issuing loss-making FTs (effectively “topping-up” the institution to its returns target). This grant is for specific policy goals but can be flexibly deployed by the institution in meeting those goals. Departments have Accounting Officer (AO) responsibility for the value for money of the grant, while the public financial institution’s AO is responsible for pricing the risk of new mandated activities and investment decisions.

**3.29.2** By exception and with agreement of the Treasury, where a public financial institution generates realised profits above the “floor” of its return on equity target, this may be used to cross-subsidise “mandated” investments. The institution must still achieve its overall return on equity target, repay the costs of any debt issued to it, and ensure that costs of “mandated” investments are recognised clearly in its budgets in line with CBG. The public financial institution's AO will be responsible for regularity, propriety, value for money and feasibility of the delivery of subsidised activity that is funded in this way.

**3.30 ‘Service arm’ model:** investments sit on the department’s balance sheet and the public financial institution acts as an agent for a department, administering the investments through a ring-fenced financial account that sits outside their return on equity target. Departments provide all the funding, hold all financial risk, and have AO responsibility for a value for money decision on the investment, supported by expertise from within the public financial institution.

**3.31 The Treasury will consult with departments and publish a technical annex to this framework on how to design and implement the ‘mandated activity’ and ‘service arm’ models.**

# Chapter 4

## Value for money principles

### Principles for achieving value for money

- 4.1 This sets out draft principles that the Treasury expect public financial institutions, departments and ALBs to apply on issuing FTs. They won't always be appropriate but when a body does not apply them, the Treasury expects the rationale to be set out.
- 4.2 **Market failure:** where government undertakes a FT, there should be a clear articulation of the market failure necessitating intervention. Government financial investments should not crowd out private finance and there should be a clear explanation of why private capital markets have not been able to offer these financial products.
- 4.3 **Return on investment:** departments should ensure the risk-adjusted returns on FTs cover at least the government's cost of borrowing (i.e., the relevant gilt rate) and institutional overhead costs. If departments intend to undertake investments with lower expected returns, they should put forward a clear rationale and the loss-making element should be recognised as spending upfront in budgets.
- 4.4 **Concessionality:** to minimise market distortion, concessionality (where government invests on more favourable terms than if the market invested) should be limited only to where that is necessitated by policy goals and were compliant with subsidy control legislation.
- 4.5 **Additionality:** FTs should seek to maximise additionality – i.e., stimulating additional economic activity that wouldn't have occurred absent government intervention – and avoid crowding out private sector investment.
- 4.6 **Value for money against other options:** while FTs generate corresponding financial assets, they require debt issuance to finance initial investments. Proposals for spending on FTs need to be traded-off against other forms of spending, non-fiscal interventions like guarantees, or a do-nothing option.
- 4.7 **Use of public financial institutions:** all new, large-scale FTs and guarantees above a size materiality threshold must be delivered by a designated public financial institution unless Treasury consent to do otherwise has been given, which will only be granted in exceptional circumstances (see Chapter 2).

**4.8 Economic capital:** public financial institutions must have economic capital models in place and departments must agree a virtual economic capital (VEC) limit at a transaction or programme level with the Treasury to control risk taking (see Chapter 3).

### Other FT best practice to consider

**Subsidy control** – FTs have a lower market distortion than grants, but they will still need to comply with the Subsidy Control Act 2022.<sup>7</sup>

**Classification** – FTs, especially equity investments, may lead to reclassification of investees into the public sector if they result in public sector control over investees, which needs Treasury approval and which the department is responsible for managing.

#### For loans

**Creditworthiness** – when issuing loans, consideration should be given to the creditworthiness of the borrowers, to ensure an understanding of the risk of default that the loan exposes the government to.

**Interest and repayment** – the financial return will be dictated by the interest a lender charges the borrower as a share of the principal (i.e., the amount loaned) and the term date for repaying the principal.

**Tenor** – the term of the loan to maturity should be set out clearly in contract when the loan is agreed.

**Collateral** – it could represent value for money to require recipients of loans to post collateral to minimize the risk held by government or alternatively to allow government to take security over an asset, on insolvency of a borrower, to repay the loan.

**Seniority** – where government secures the status of a senior lender, i.e., that borrowers shall reimburse government before any other creditor, this should reduce the credit risk associated with a loan.

#### For equity investments

**Equity stake** – the size of the stake should be limited to avoid inadvertent nationalisation, alongside consideration of other factors like control being taken. In some scenarios, taking a larger stake may be value for money and this principle would not apply.

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<sup>7</sup> [UK subsidy control regime: statutory guidance](#), Department for Business and Trade, December 2023

**Shareholder responsibility** – investments require actively exercising shareholder responsibilities via an expert function such as UKGI.

**Dividend** – government should consider what dividend it receives when assessing the value for money of an equity investment, as well as the status of stock (e.g., preferred stock gives a higher claim to dividends).

**Exit strategy** – there should be a clear exit strategy upfront for an equity investment (e.g., IPO, trade-sale) to maximise returns and ensure asset sales represent good value for money.

## Approval process for financial transactions

### Treasury consent

4.9 Treasury consent for FTs is required if departments wish to issue FTs that are novel, contentious or repercussive, or where FTs are above a department's delegated limits.

4.10 **The Treasury will work to create a standard approach to describe the risk and returns of new FTs to aid approval processes and support the Treasury in providing information to help the OBR's forecast. This will be published as a technical annex.**

# Annex A

## List of designated public financial institutions

**A.1** Organisations shall be designated as public financial institutions based on the criteria set out in Chapter 2, at the discretion of the Chief Secretary to the Treasury.

**A.2** The current list of designated public financial institutions that have been deemed to meet the criteria set out within this control framework includes:

- British Business Bank
- British International Investment
- National Wealth Fund (formerly the UK Infrastructure Bank)
- UK Export Finance (legally the Export Credits Guarantee Department)

**A.3** The Student Loans Company does not function like a typical banking institution, but they have also been designated as a public financial institution under this framework as they are the expert institution for delivery of a unique type of financial asset. Student loans are partitioned under National Accounts, with only the element expected to be repaid netted off net financial debt. The Treasury does not intend to apply the full criteria set out in Chapter 2 to the Student Loans Company, reflecting their unique status.

**A.4** This list will be updated when the Chief Secretary to the Treasury makes decisions to designate any additional bodies as public financial institutions or change the designation of existing bodies.



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